LECTURE NOTES

CHAPTER OPENING EXAMPLE

VINAMILK OFFERS OVER 220 DELICIOUS AND NUTRITIOUS PRODUCTS TO VIETNAMESE AND INTERNATIONAL CUSTOMERS THROUGH ITS EXTENSIVE MARKETING CHANNELS

- Vinamilk is the leading manufacturer of milk and dairy products in Vietnam.
- The company holds a 37 percent share of the Vietnamese market and has 220 distributors and 1.25 million outlets throughout the country.
- The company has an experienced team of 1,787 salespeople who visit the distributors and support them in the areas of supply and merchandising, training, marketing, and selling to the retailers.
- These salespeople also develop relationships with new distributors and retailers, and are entrusted with turnover and service goals. They are organized into three areas: traditional channels, modern channels, and key accounts.
- Vinamilk equips retailers with fridges and freezers, which act as a barrier to competitors as these appliances require a large investment. The company also seeks to communicate with these distributors and retailers through advertising and sales promotion activities.
- The company's distribution network consists of its headquarters in Ho Chi Minh City and three branches in Hanoi, Danang, and Can Tho. Beyond that, the company has distribution centers to sort goods and service orders from distributors and retail outlets in various regions. The company has ten factories all over Vietnam and a warehouse and transport center in Ho Chi Minh City.
- Vinamilk exports its products to Australia, Cambodia, Iraq, Kuwait, the Maldives, the Philippines, Suriname, the United Arab Emirates, and the United States. The largest foreign market for the company is Iraq.

I. NATURE AND IMPORTANCE OF MARKETING CHANNELS [LO1]

Reaching prospective buyers, either directly or indirectly, is a prerequisite for successful marketing.

A. What Is a Marketing Channel of Distribution?

- A **marketing channel** consists of individuals and firms involved in the process of making a product or service available for use or consumption by consumers or industrial users.
- Marketing channels make possible the flow of goods from a producer, through intermediaries, to a buyer.

  a. Some intermediaries purchase items from the seller, store them, and resell them to buyers.

  b. Others represent sellers but do not take title to products.

B. Value Is Created by Intermediaries

Producers recognize that intermediaries make selling goods and services more efficient because they minimize the number of sales contacts necessary to reach a target market.

1. Important Functions Performed by Intermediaries.

a. Intermediaries make possible the flow of products from producers to buyers by performing three basic functions:

- A *transactional function*. Involves buying, selling, and risk taking because they stock merchandise in anticipation of sales.
- A *logistical function*. Involves gathering, storing, and dispersing of products to buyers.
- A *facilitating function*. Assists producers in making the transactions of goods and services more attractive for buyers.

b. All three functions must be performed in a marketing channel, even though each channel member may not participate in all three.

c. Channel members often negotiate about which specific functions they will perform.

2. Consumers Also Benefit from Intermediaries.

Marketing channels help create value for consumers through: time, place, form, and possession utilities.

LEARNING REVIEW

1. **What is meant by a marketing channel?**

   Answer: A marketing channel consists of individuals and firms involved in the process of making a product or service available for use or consumption by consumers or industrial users.

2. **What are the three basic functions performed by intermediaries?**

   Answer: Intermediaries perform transactional, logistical, and facilitating functions.

II. CHANNEL STRUCTURE AND ORGANIZATION [LO2]

A product can take many routes from a producer to buyers and there are differences between marketing channels for consumer goods and those for industrial goods.

A. Marketing Channels for Consumer Goods and Services

- Figure 15-4 shows the four most common marketing channels for consumer goods and services and the number of levels in each channel based on the number of intermediaries between a producer and ultimate buyers.

- As the number of intermediaries between a producer and buyer increases, the length of the channel increases. For example, the producer→wholesaler→retailer→consumer channel is longer than the producer→consumer channel.

1. **Direct Channel**.

   a. A *direct channel* is a marketing channel where a producer and ultimate consumers deal directly with each other.

   b. Since there are no intermediaries, the producer must perform all channel functions. Channel A (producer→consumer).

2. **Indirect Channel**.

   a. *Indirect channels* are marketing channels where intermediaries are inserted between the producer and consumers and perform numerous channel functions.

   b. The producer→retailer→consumer channel (Channel B) is the most common if the retailer can buy large quantities from a producer or when the cost of inventory makes it too expensive to use a wholesaler. Why? Because:

- Many product variations may exist that it would be impossible for a wholesaler to stock all the models required to satisfy buyers.
- The cost of maintaining an inventory would be too high.
- However, large retailers buy in sufficient quantities to make it cost effective for a producer to deal with only a retail intermediary.

c. The producer→wholesaler→retailer→consumer channel (Channel C) is most common for low-cost, low-unit value items that consumers frequently purchase.

d. The producer→agent→wholesaler→retailer→consumer channel (Channel D) is used when there are many small manufacturers and many small retailers and an agent is used to help coordinate a large supply of the product.

B. Marketing Channels for Business Goods and Services

- Figure 15-5 shows the four most common marketing channels for business goods and services and the number of levels in each channel based on the number of intermediaries between a producer and ultimate buyers.
- Business channels are shorter and rely on one intermediary or none at all because business users are fewer in number, are more concentrated geographically, and buy in larger quantities.

1. Direct Channel.

a. Channel A is a direct channel where a producer and industrial user deal directly with each other (producer→industrial user).

b. Firms using this channel maintain their own sales force and perform all channel functions.

c. A direct channel is used when buyers are large and well defined, the sales effort requires extensive negotiations, and the products are of high unit value and require hands-on expertise in terms of installation or use.

2. Indirect Channel.

a. Channels B-D are indirect channels where one or more intermediaries are inserted between the producer and industrial users to perform numerous channel functions.

b. In Channel B (producer→industrial distributor→industrial user):

- An **industrial distributor** performs a variety of marketing channel functions, including selling, stocking, delivering a full product assortment, and financing.
- Industrial distributors are like wholesalers in consumer channels.

c. In Channel C (producer→agent→industrial user) introduces a second intermediary, an *agent*, who serves as the independent selling arm of producers and represents a producer.

d. Channel D (producer→agent→industrial distributor→industrial user) is the longest channel and includes both agents and distributors.

C. Electronic Marketing Channels

- Interactive electronic technology has made possible **electronic marketing channels**, which employ the Internet to make goods and services available for consumption or use by consumers or business buyers.
- Electronic marketing channels combine electronic and traditional intermediaries to create time, place, form, and possession utility for buyers.
- Electronic intermediaries perform transactional and facilitating functions effectively and at a lower cost than traditional intermediaries because of information technology.
- Electronic intermediaries are incapable of performing elements of the logistical function, which remains with traditional intermediaries or with the producer.
- Many services can be distributed through electronic marketing channels, but others still involve traditional intermediaries.

D. Direct and Multichannel Marketing

- **Direct marketing channels** allow consumers to buy products by interacting with various advertising media without a face-to-face meeting with a salesperson.

  a. Direct marketing channels include mail order selling, direct mail sales, catalog sales, telemarketing, interactive media, and televised home shopping.

  b. Some firms sell products almost entirely through direct marketing channels while others use both wholesalers and retailers as well as catalogs and telemarketing to reach more buyers.

- **Multichannel marketing** is the *blending* of different communication and delivery channels that are *mutually reinforcing* in attracting, retaining, and building relationships with consumers who shop and buy in traditional intermediaries and online.

  a. Multichannel marketing seeks to integrate a firm's electronic and delivery channels.

  b. Multichannel marketing also can leverage the value-adding capabilities of different channels.

  - Retail stores can leverage their physical presence by allowing customers to pick up their online orders at a nearby store or return or exchange nonstore purchases if they wish.
  - Catalogs can serve as shopping tools for online purchasing, as they do for store purchasing.
  - Websites can help consumers do their homework before visiting a store.

E. Dual Distribution and Strategic Channel Alliances

- **Dual distribution** is an arrangement whereby a firm reaches different buyers by employing two or more different types of channels for the same basic product.

  a. In some instances, firms pair multiple channels with a multibrand strategy to minimize cannibalization of the firm's family brand and differentiate the channels.

  b. In other instances, a firm will distribute modified products through different channels.

- **Strategic channel alliances** is a practice whereby one firm's marketing channel is used to sell another firm's products.

  a. Is a recent development in marketing channels.

  b. Are popular in global marketing, where the creation of marketing channel relationships is expensive and time consuming.

MARKETING MATTERS

Business Objects and IBM—Partners in Asia

Business Objects, a leading French enterprise software company, and IBM have expanded their strategic alliance to co-develop, sell, and implement information-on-demand solutions to customers in the Asia Pacific.

Together, the two companies intend to capture more market share in the growing market of more than 15 Asia-Pacific countries including Australia, New Zealand, China, India, Taiwan, Korea, Japan, Singapore, and Malaysia.

In the alliance, IBM provides increased sales and technical coverage for Business Object solutions; Business Objects trains IBM technical experts on the former's industry-specific solutions; and both companies jointly develop localized products for the region.

F. A Closer Look at Channel Intermediaries

Channel structures for consumer and business products assume various forms based on the number and type of intermediaries. Knowledge of the roles played by these intermediaries is important for understanding how channels operate.

1. Merchant Wholesalers.

a. **Merchant wholesalers** are independently owned firms that take title to the merchandise they handle.

b. Over 80 percent of the firms engaged in wholesaling activities are merchant wholesalers.

c. Merchant wholesalers are classified as either full-service or limited-service wholesalers, depending on the number of functions performed.

d. Two major types of full-service wholesalers exist:

- *General merchandise* (or *full-line*) *wholesalers* carry a broad assortment of merchandise and perform all channel functions but do not maintain much depth of assortment within specific product lines.
- *Specialty merchandise* (or *limited-line*) *wholesalers* offer a relatively narrow range of products but have an extensive assortment within the product lines carried.

c. Four major types of limited-service wholesalers exist:

- *Rack jobbers* furnish the racks or shelves that display merchandise in retail stores, perform all channel functions, and sell on consignment to retailers, which means they retain the title to the products displayed and bill retailers only for the merchandise sold.
- *Cash and carry wholesalers* take title to merchandise but sell only to buyers who call on them, pay cash for merchandise, furnish their own transportation for merchandise, and carry a limited product assortment

and do not make deliveries, extend credit, or supply market information.

- *Drop shippers*, or *desk jobbers*, are wholesalers that own the merchandise they sell but do not physically handle, stock, or deliver it. They simply solicit orders from retailers and other wholesalers and have the merchandise shipped directly from a producer to a buyer.
- *Truck jobbers* are small wholesalers that have a small warehouse from which they stock their trucks for distribution to retailers. They usually handle limited assortments of fast-moving or perishable items that are sold for cash directly from trucks in their original packages.

2. **Agents and Brokers**.

    a. Agents and brokers do not take title to merchandise and typically provide fewer channel functions. They make their profit from commissions or fees paid for their services.

    b. Producers use two types of agents:

    - **Manufacturer's agents**, or *manufacturer's representatives*, work for several producers and carry noncompetitive, complementary merchandise in an exclusive territory. They act as a producer's sales arm in a territory and are principally responsible for the transactional channel functions, primarily selling.
    - **Selling agents** represent a single producer and are responsible for the entire marketing function of that producer. They design promotional plans, set prices, determine distribution policies, and make product strategy recommendations.

    c. **Brokers** are independent firms or individuals whose principal function is to bring buyers and sellers together to make sales.

    - Brokers, unlike agents, usually have no continuous relationship with the buyer or seller but negotiate a contract between two parties and then move on.
    - A unique broker that acts in many ways like a manufacturer's agent is a food broker, representing buyers and sellers in the grocery industry. Food brokers act on behalf of producers on a permanent basis and receive a commission for their services.

3. **Manufacturer's Branches and Offices**.

    a. Manufacturer's branches and sales offices are wholly owned extensions of the producer that perform wholesaling activities when there are no intermediaries to perform these activities, are few geographically concentrated customers, or orders are large or require significant attention.

b. Two types exist:

- A *manufacturer's branch office* carries a producer's inventory and performs the functions of a full-service wholesaler.
- A *manufacturer's sales office* does not carry inventory, typically performs only a sales function, and serves as an alternative to agents and brokers.

G. Vertical Marketing Systems and Channel Partnerships

Vertical marketing systems are professionally managed and centrally coordinated marketing channels designed to achieve channel economies and maximum marketing impact.

1. Corporate Systems.

a. A *corporate vertical marketing system* is the combination of successive stages of production and distribution under a single ownership.

- *Forward integration* occurs when a producer owns an intermediary at the next level down in the channel.
- *Backward integration* occurs when a retailer owns a manufacturing operation.

b. Companies seeking to reduce distribution costs and gain greater control over supply sources or resale of their products pursue forward and backward integration.

- Both types of integration increase a company's capital investment and fixed costs.
- Many companies favor contractual vertical marketing systems to achieve channel efficiencies and marketing effectiveness.

2. Contractual Systems.

a. A *contractual vertical marketing system*:

- Consists of independent production and distribution firms that combine their efforts on a contractual basis to obtain greater functional economies and marketing impact than they could achieve alone.
- Is the most popular of the 3 types of vertical marketing systems.

b. Three variations of contractual systems exist:

- *Wholesaler-sponsored voluntary chains* involve a wholesaler that develops a contractual relationship with small, independent retailers to standardize and coordinate buying practices, merchandising programs, and inventory management efforts to compete with chain stores.
- *Retailer-sponsored cooperatives* exist when small, independent retailers form an organization that operates a wholesale facility cooperatively to concentrate their buying power through the wholesaler and plan collaborative promotional and pricing activities.
- **Franchising** is a contractual arrangement between a parent company (a franchisor) and an individual or firm (a franchisee) that allows the franchisee to operate a certain type of business under an established name and according to specific rules.

c. Four types of franchise arrangements are:

- *Manufacturer-sponsored retail franchise systems*, where a manufacturer licenses dealers to sell its products subject to various sales and service conditions (Ford).
- *Manufacturer-sponsored wholesale franchise systems*, where a manufacturer licenses wholesalers that purchase the product and then distributes to retailers (Pepsi-Cola).
- *Service-sponsored retail franchise systems*, where a firm has designed a unique approach for performing a service and wishes to profit by selling the franchise to others (McDonald's).
- *Service-sponsored franchise systems*, where a franchiser licenses individuals or firms to dispense a service under a trade name and guidelines (H&R Block).

3. Administered Systems. *Administered vertical market systems* achieve coordination at successive stages of production and distribution by the size and influence of one channel member rather than through ownership.

4. Channel Partnerships.

a. A **channel partnership** consists of agreements and procedures among channel members for ordering and physically distributing a producer's products through the channel to the ultimate consumer.
b. A central feature of channel partnerships is the collaborative use of information and communication technology to better serve customers and reduce the time and cost of performing channel functions.

LEARNING REVIEW

3. What is the difference between a direct and an indirect channel?

Answer: A direct channel is one in which a producer of consumer or business goods and services and ultimate consumers or industrial users deal directly with each other whereas an indirect channel has intermediaries that are inserted between the producer and consumers or industrial users and who perform numerous channel functions.

4. Why are channels for business products typically shorter than channels for consumer products?

Answer: Business channels are typically shorter because business users are fewer in number, tend to be more concentrated geographically, and buy in larger quantities.

5. What is the principal distinction between a corporate vertical marketing system and an administered vertical marketing system?

Answer: A corporate vertical marketing system combines successive stages of production and distribution under a single ownership. An administered vertical marketing system achieves coordination by the size and influence of one channel member rather than through ownership.

III. CHANNEL CHOICE AND MANAGEMENT [LO3]

Marketing channels not only link a producer to its buyers but also provide the means through which a firm executes its marketing strategy.

A. Factors Affecting Channel Choice and Management

The final choice of a marketing channel by a producer depends on a number of factors that often interact with each other.

1. Environmental Factors.

Changing family lifestyles, advances in distribution and Internet technology, and new or repealed regulations, both in the U.S. and globally, all influence marketing channels.

MARKETING MATTERS

Wrigley Markets a Controlled Substance in Singapore—Chewing Gum

Wrigley's chewing gum is now sold in Singapore after all chewing gum was banned from the country in 1992. Only Wrigley's Orbit brand chewing gum, which features a health benefit, can be marketed, but it is available only from a pharmacist or a dentist.

Wrigley officials say Singapore's restrictions are preferable to an outright ban. Wrigley obviously has little choice in its Singaporean marketing channel given regulatory restrictions placed on the marketing of chewing gum.

2. **Product Factors**.

    a. Highly sophisticated products, unstandardized products, and products of high unit value are distributed directly to buyers.

    b. Unsophisticated, standardized products with low unit value are typically distributed through indirect channels.

    c. A product's stage in the life cycle also affects marketing channels.

3. **Company Factors**.

    a. Firms unable to employ a salesforce use manufacturer's agents or selling agents to reach wholesalers or buyers.

    b. If a firm has multiple products for a particular target market, it might use a direct channel.

    c. Firms with a limited product line might use intermediaries to reach buyers.

B. Channel Choice Considerations

Marketing executives typically consider three questions when choosing a marketing channel and intermediaries:

- Which will provide the best coverage of the target market?
- Which will best satisfy the buying requirements of the target market?
- Which will be the most profitable?

1. **Target Market Coverage**.

    Achieving the best target market coverage requires attention to the density—the number of stores in a given geographical area—and type of intermediaries to be used at the retail level of distribution. Three degrees of distribution density exist:

a. **Intensive distribution** means that a firm tries to place its products and services in as many outlets as possible. It is usually chosen for convenience products or services.
b. **Exclusive distribution** is the extreme opposite of intensive distribution because only one retail outlet in a specific geographical area carries the firm's products. It is typically chosen for specialty products or services.

[*SLN 15-1: Turning Exclusive Distribution on Its Head*]

c. **Selective distribution** lies between these two extremes and means that a firm selects a few retail outlets in a specific geographical area to carry its products. It is usually used for shopping goods or services.

- Selective distribution weds some of the market coverage benefits of intensive distribution to the control over resale evident with exclusive distribution.
- For this reason, it is the most common form of distribution density.

2. **Satisfying Buyer Requirements**.

A second consideration in channel design is gaining access to channels and intermediaries that satisfy at least some of the interests buyers might want fulfilled when they purchase a firm's products or services. These interests fall into four categories:

a. *Information* is an important requirement when buyers have limited knowledge or desire specific data about a product or service. Properly chosen intermediaries communicate with buyers through in-store displays, demonstrations, and personal selling.

b. *Convenience* has multiple meanings for buyers, such as proximity or driving time to a retail outlet or hours of operation.

c. *Variety* reflects buyers' interest in having numerous competing and complementary items from which to choose and is evident in both the breadth and depth of products and brands carried by intermediaries.

d. *Pre- or post-sale services* provided by intermediaries are an important buying requirement for products that require delivery, installation, and credit.

Web Link

Visit an Apple Store to See What All the Excitement Is About

Interested in visiting an Apple Store to see what all the excitement is about? Is a store situated near you? If you answered yes to the first question and no to the second, then log on to www.ifoapplestore.com. Here you will find exterior and interior photographs and video tours of various Apple Stores. If you are interested in learning whether or not an Apple Store is planned for your area, visit this website to find announcements of grand openings.

3. **Profitability**.

   a. Is determined by the margins earned (revenue minus cost) for each channel member and for the channel as a whole.

   b. Channel costs include distribution, advertising, and selling expenses.

   c. The extent to which channel members share these costs determines the profitability of each member and of the channel as a whole.

USING MARKETING DASHBOARDS

Channel Sales and Profit at Charleburg Furniture

Channel Sales and Profit and Annual Percentage Change in Sales by Channel

Charlesburg Furniture sells its furniture through furniture store chains, independent furniture stores, and department store chains in the southern U.S. The company has traditionally allocated its marketing funds for cooperative advertising, in-store displays, and retail sales support on the basis of dollar sales by channel.

Your Challenge.

Review the company's sales and profit in its three channels and recommend a course of action. The question: Should Charlesburg Furniture continue to allocate its marketing funds on the basis of channel dollar sales or profit?

Your Findings.

Charlesburg Furniture tracks the sales and profit from each channel (and individual customer) and sales trends on its marketing dashboard. Several findings stand out:

- Furniture store chains and independent furniture stores account for 85.2 percent of Charlesburg Furniture sales and 93 percent of company profit.
- These two channels also evidence growth as measured by annual percentage change in sales.

- By comparison, department store chains annual percentage sales growth has declined and recorded negative growth in 2007. This channel accounts for 14.8 percent of company sales and 7 percent of company profit.

Your Actions.

- Charlesburg Furniture should consider abandoning the practice of allocating marketing funds solely on the basis of channel sales volume. The importance of independent furniture stores to Charlesburg's profitability warrants further spending, particularly given this channel's favorable sales trend.
- Doubling the percentage allocation for marketing funds for this channel may be too extreme, however. Rather, an objective-task promotional budgeting method should be adopted (see Chapter 18). Charlesburg Furniture might also consider the longer-term role of department store chains as a marketing channel.

C. Global Dimensions of Marketing Channels

- Marketing channels around the world reflect traditions, customs, geography, and the economic history of individual countries and societies.

- Intermediaries outside Western Europe and North America tend to be small, numerous, and often owner operated.

- Japanese marketing channels tend to include many intermediaries based on tradition and lack of storage space. As many as five intermediaries are involved in the distribution of soap in Japan compared with one or two in the U.S.

  a. In Japan, the distribution *keiretsu* ("alignments") bonds producers and intermediaries together through vertical integration and social and economic ties to ensure that each channel member benefits from the alignment.

  b. The dominant member of the *keiretsu*, typically a producer, has much influence over channel member behavior, such as which competing products other channel members sell.

D. Channel Relationships: Conflict, Cooperation, and Law [LO4]

Because channels consist of independent individuals and firms, there is always potential for disagreements concerning who performs channel functions, how profits are distributed, who will provide what products and services, and who makes critical channel-related decisions.

1. **Sources of Conflict in Marketing Channels**.

   a. **Channel conflict** arises when one channel member believes another channel member is engaged in behavior that prevents it from achieving its goals.

   b. *Vertical conflict* occurs between different levels in a marketing channel, such as a manufacturer and a retailer. Three sources of vertical conflict are:

      - **Disintermediation** is channel conflict that arises when a channel member bypasses another member and sells or buys products direct.
      - Conflict over how profits are distributed among channel members.
      - Conflict when manufacturers believe wholesalers or retailers are not giving their products adequate attention.

   c. *Horizontal conflict* occurs between intermediaries at the same level in a marketing channel, such as between two or more retailers or two or more wholesalers, who handle the same manufacturer's brands. Two sources are:

      - Conflict when a manufacturer increases its distribution coverage in a geographical area.
      - Dual distribution causes conflict when different types of retailers carry the same brands.

2. **Securing Cooperation in Marketing Channels**. Conflict can have destructive effects on the workings of a marketing channel so it is necessary to secure cooperation among channel member.

3. **Channel Captain**. Is a channel member (producer, wholesaler, or retailer) that coordinates, directs, and supports other channel members.

4. **Channel Influence**. A firm (a producer, wholesaler, or retailer) becomes a channel captain because it is the channel member with the ability to influence the behavior of other members. Influences can take four forms:

   a. *Economic*, which arises from the firm's ability to reward other members, given its strong financial position.

   b. *Expertise*, in the form of inventory management, order processing, etc.

   c. *Identification*, or the desire to be associated with a channel member gives that firm influence over others.

   d. The *legitimate right* of one channel member to direct the behavior of other members, such as under contractual vertical marketing systems where a franchisor can legitimately direct how a franchisee behaves.

e. Channel influence can be used to gain concessions from other channel members.

MAKING RESPONSIBLE DECISIONS

The Ethics of Slotting Allowances

Some large supermarkets demand slotting allowances from food manufacturers, paid in the form of money or free goods, to stock and display their products. These allowances can be as high $25,000 per item for a supermarket chain and cost food makers about $1 billion annually. Manufacturers consider these "extortional allowances" because they already pay supermarkets $25 billion a year in "trade dollars" to promote and discount their products. Supermarkets see allowances as a cost of doing business. Is the practice is unethical?

5. Legal Considerations.

a. Conflict in marketing channels is typically resolved through negotiation or the exercise of influence by channel members. Sometimes conflict produces legal action.

b. Suppliers can select whomever they want as channel intermediaries and may refuse to deal with whomever they choose.

c. The FTC and the Justice Department monitor channel practices that restrain competition, create monopolies, or otherwise represent unfair methods of competition under the *Sherman Act* (1890) and the *Clayton Act* (1914).

d. Six practices have received the most attention:

- *Dual distribution*, although not illegal, can be viewed as anticompetitive and violate both the *Sherman* and *Clayton Acts* when a manufacturer distributes through its own vertical channel in competition with independent wholesalers and retailers that also sell its products to lessen competition by eliminating these resellers.
- *Vertical integration* is viewed in a similar light. Although not illegal, this practice is sometimes subject to legal action under the *Clayton Act* if it has the potential to lessen competition or foster monopoly.
- *Exclusive dealing* exists when a supplier requires channel members to sell only its products or restricts distributors from selling directly competitive products. It is specifically prohibited under the *Clayton Act* when it lessens competition or creates monopolies.
- *Tying arrangements* occur when a supplier requires a distributor purchasing some products to buy others from the supplier. These arrangements arise in franchising.

- These are illegal under the *Clayton Act* if the tied products could be purchased at fair market values from other suppliers at desired quality standards of the franchiser.
- Full-line forcing is a special kind of tying arrangement, which involves a supplier requiring that a channel member carry its full line of products in order to sell a specific item in the supplier's line.

- A *refusal to deal* with existing channel members may be illegal under the *Clayton Act* even though a supplier has a legal right to choose intermediaries.
- *Resale restrictions* refer to a supplier's attempt to stipulate to whom distributors may resell the supplier's products and in what specific geographical areas or territories they may be sold. These practices have been prosecuted under the *Sherman Act*. Today, the courts apply the "rule of reason" in such cases and consider whether such restrictions have a "demonstrable economic effect."

LEARNING REVIEW

6. What are the three degrees of distribution density?

Answer: intensive; exclusive; selective.

7. What are the three questions marketing executives consider when choosing a marketing channel and intermediaries?

Answer: The three questions are: (1) Which will provide the best coverage of the target market? (2) Which will best satisfy the buying requirements of the target market? (3) Which will be the most profitable?

8. What is meant by *exclusive dealing*?

Answer: Exclusive dealing exists when a supplier requires channel members to sell only its products or restricts distributors from selling directly competitive products. It is specifically prohibited under the *Clayton Act* when it lessens competition or creates

APPLYING MARKETING KNOWLEDGE

1. A distributor for Celanese Chemical Company stores large quantities of chemicals, blends these chemicals to satisfy requests of customers, and delivers the blends to a customer's warehouse within 24 hours of receiving an order. What utilities does this distributor provide?

Answer: The distributor for Celanese Chemical Company provides time utility because it delivers blends to a customer's warehouse within 24 hours of receiving an order.

Each time a product is delivered to a customer's warehouse, the distributor provides possession utility. Finally, the distributor provides form utility each time it blends chemicals to meet a customer's specifications.

2. **Suppose the president of a carpet manufacturing firm has asked you to look into the possibility of bypassing the firm's wholesalers (who sell to carpet, department, and furniture stores) and selling directly to these stores. What caution would you voice on this matter, and what type of information would you gather before making this decision?**

   Answer: Before making a decision to bypass the firm's distributors, a firm should consider all the functions the distributors perform. Information on the costs incurred by distributors should be gathered and compared with a system where the distributor is bypassed. Also, functions performed by distributors, such as maintaining sensitive relationships with customers, are difficult to put a monetary value on. Therefore, qualitative factors must enter into the decision as well.

3. **What type of channel conflict is likely to be caused by dual distribution, and what type of conflict can be reduced by direct distribution? Why?**

   Answer: A dual distribution system is most likely to cause horizontal conflict between intermediaries. On the other hand, direct distribution is most likely to reduce vertical conflict.

4. **How does the channel captain idea differ among corporate, administered, and contractual vertical marketing systems with particular reference to the use of the different forms of influence available to firms?**

   Answer: Corporate, administered, and contractual systems achieve influence largely through size resulting from combining firms or stages. Channel captains, on the other hand, generate influence from their financial position, expertise in a given area, identification with a particular channel member, or from a legitimate right resulting from a contractual agreement.

5. **Comment on this statement: "The only distinction among merchant wholesalers and agents and brokers is that merchant wholesalers take title to the products they sell."**

   Answer: Agents and brokers provide a limited number of channel functions, whereas many full-line merchant wholesalers perform all channel functions. Additionally, agents and brokers make their profit from commissions or fees paid for their services, whereas merchant wholesalers make their profit from the sale of the merchandise they own.

6. **How do specialty, shopping, and convenience goods generally relate to intensive, selective, and exclusive distribution? Give a brand name that is an example of each goods-distribution match up.**

Answers:

DISTRIBUTION DENSITY	PRODUCT TYPE	BRAND
Exclusive distribution	Specialty goods	Rolls Royce
Selective distribution	Shopping goods	Panasonic HDTV
Intensive distribution	Convenience goods	Orbit chewing gum

BUILDING YOUR MARKETING PLAN

Does your marketing plan involve selecting channels and intermediaries? If the answer is no, read no further and do not include this element in your plan. If the answer is yes:

1. **Identify which channel and intermediaries will provide the best coverage of the target market for your product or service.**

2. **Specify which channel and intermediaries will best satisfy the important buying requirements of the target market.**

3. **Determine which channel and intermediaries will be the most profitable.**

4. **Select your channel(s) and intermediary(ies).**

   Answer: If a student's marketing plan involves a manufacturing operation, choosing effective channels of distribution and intermediaries are often vital to the firm's success. In this case, key considerations in channel decisions are consist of factors like effectiveness of reaching and serving the needs of customers in the target market segments and the margins needed for channel members that will still provide adequate profit for the manufacturer. But marketing plans for retail shops or college-related activities, these channel issues are largely irrelevant.

SLN 15-1: SUPPLEMENTAL LECTURE NOTE

Turning Exclusive Distribution on Its Head

The text describes exclusive distribution from a producer's perspective, as is the typical case. However, a growing practice is for retailers to request, and sometimes demand, exclusivity in the sale of a manufacturer's or supplier's products and brands. This practice has become more widespread in recent years, as large, powerful retailers have exercised their economic influence.

The most prominent example of retailers seeking exclusivity for products and brands exists in the $85.4 billion toy and game industry. General merchandise stores, including Wal-Mart and Target, and toy retail chains such as Toys "Я" Us, account for almost 76% of toy and game sales in the United States. Wal-Mart is the world's largest toy retailer. Each of these large toy retailers has negotiated exclusive arrangements with manufacturers, such as Mattel and Hasbro, to sell specific toys. Why? Exclusive arrangements provide toy retailers with a source of differentiation and fatter gross profit margins. According to industry sources, retailers earn between 40% and 50% gross margins on exclusive toys and games, compared with 20% to 35% gross margins on widely distributed toys and game.

Sources: "Toys and Games: Playing to Win," *Brandweek* (February 16, 2004), p. 20; "Retailers Won't Share Their Toys," *The Wall Street Journal* (December 4, 2001), pp. B1, B4 and *World Toy Facts and Figures—2004* (New York: International Council of Toy Industries, 2004).