



# Marketing Channel Strategy and Analysis

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When you select a can of green beans from the supermarket shelf, you probably give little thought to the journey the can took to reach your grocery basket. The green beans began in a field somewhere in the world. They were picked and sorted, loaded into baskets and onto trucks. Depending on where the cannery is located, they may have been placed on a train or cargo ship. At the cannery, the green beans are cut, washed, and cooked in water with a little salt, before being sealed into a stainless steel can. Of course, when you buy a can of green beans, you buy the salt used to season them. The salt came from a salt mine, was ground up to granulate it, and sent on a train to the cannery. Your purchase of green beans includes the can. It came from a mine, then to a steel mill, then to a company that cuts rolled steel into cans. You also buy the label. It came from a timber farm, then to a paper mill. You also bought the ink on the label, which came from a chemical producer and went to a printing company, who printed the writing on the label. The finished can of green beans was put on a truck, sent to a couple of warehouses where it was combined with other products needed to stock the grocery store's shelves, and finally into your basket.

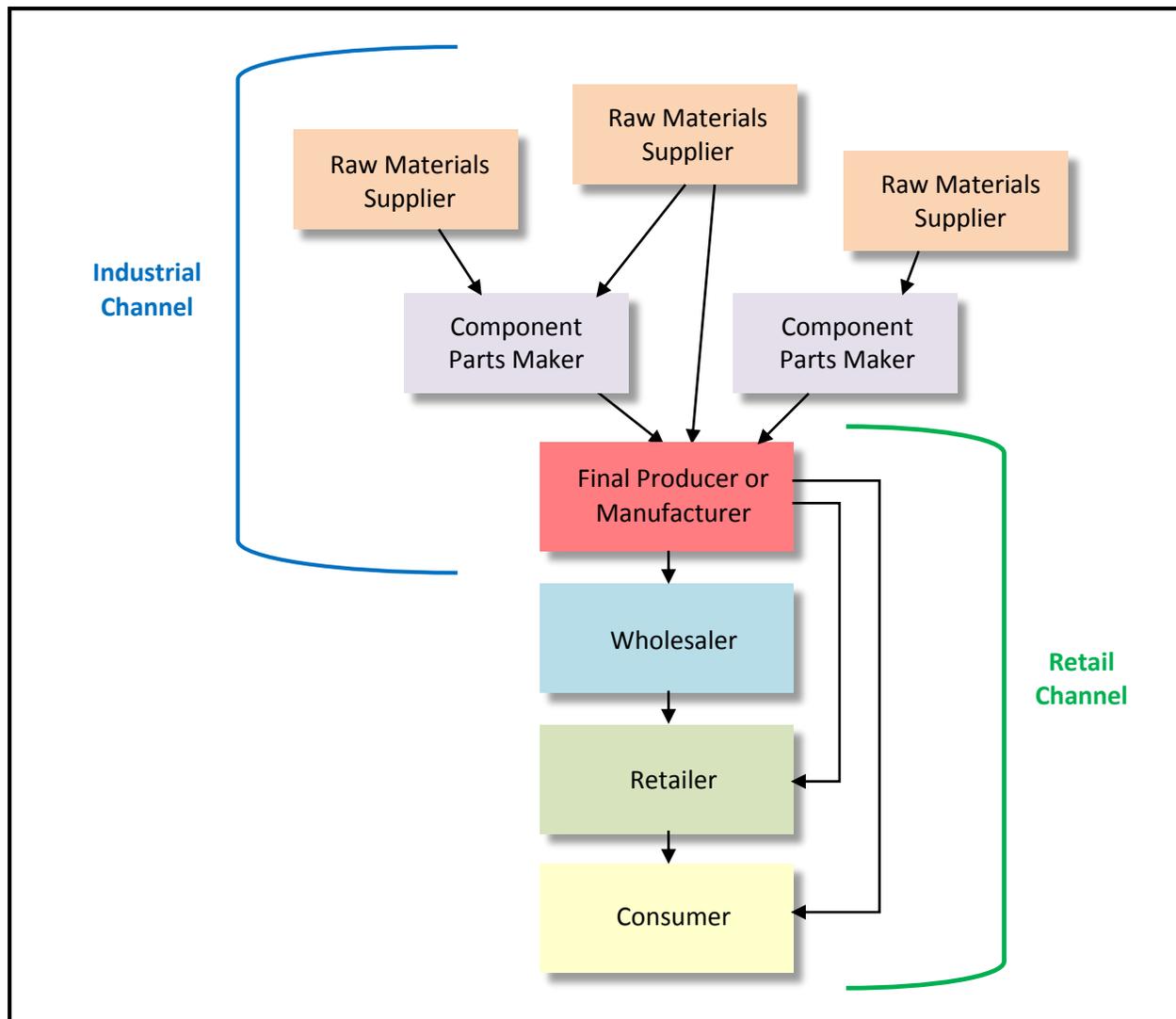
Now imagine how long this story would be if it were about a car.

## **MARKETING CHANNELS REFRESHER**

Bringing together the materials necessary to make even the simplest of products requires the combining of several series of exchanges that takes the raw materials necessary to make the product (and its packaging), and then ships the products to the location where it's made available for you to buy. These series of firms and exchanges are called *channels of distribution*. At each point in a channel where exchanges occur, marketing is involved to facilitate the exchanges.

### **Industrial and Retail Channels**

Exhibit 1 on the following page diagrams a very simple distribution channel. Note first the various types of firms that comprise a distribution channel. Raw materials suppliers, which may include such types of firms as farmers, timber companies, mines, and other businesses that extract or grow products from the earth, sell their raw materials to component part makers, who create finished or semi-finished goods for use in another product. Together, the raw materials suppliers and the component parts makers, sell their products to the final producer or manufacturer. The part of the distribution channel that begins



**Exhibit 1. Diagram of Distribution Channel**

with raw materials suppliers and ends with the final producer or manufacturer is called the *industrial channel*.

Once the final producer has finished creating the goods that will be sold to the consumer, the goods enter the retail channel. Notice that the final producer is in both the industrial and the retail channels. In the retail channel, the final producer may sell its goods to a wholesaler, who then sells to the retailer, who sells to the consumer. In many channels today, independent wholesalers are bypassed altogether. Large national retailers, for example, may create their own in-house systems of warehousing that eliminate the need for wholesalers. This possibility is shown as the arrow leading from the final producer to the retailer. In other instances, consumers can purchase directly from final producers with no need for wholesalers or retailers. Online ordering through the internet has fueled the growth of these direct to consumer retail channels.

Whatever their configurations, marketing channels perform many important functions. First, they make possible the legal transfer of ownership of products. As firms exchange with one another with the ultimate purpose of getting products into the hands of consumers, the very existence of these series of businesses provides an easily traced trail of ownership. This may seem like a relatively straightforward matter that we ordinarily take for granted. However, generally speaking, people like to own what they buy. Having a system that simplifies a potentially complicated legal issue is of critical importance to smoothly operating commerce. A second and related function is that channels provide an easy and efficient means by which payment moves up the channel. Ultimately, consumers pay for everything that occurs in channels all the way up to the raw materials suppliers. Channels help get the consumers' payment distributed to all of the parties involved in creating and distributing the product. Third, channels provide the logistical means by which products are physically transported to consumers in the assortments that consumers desire.

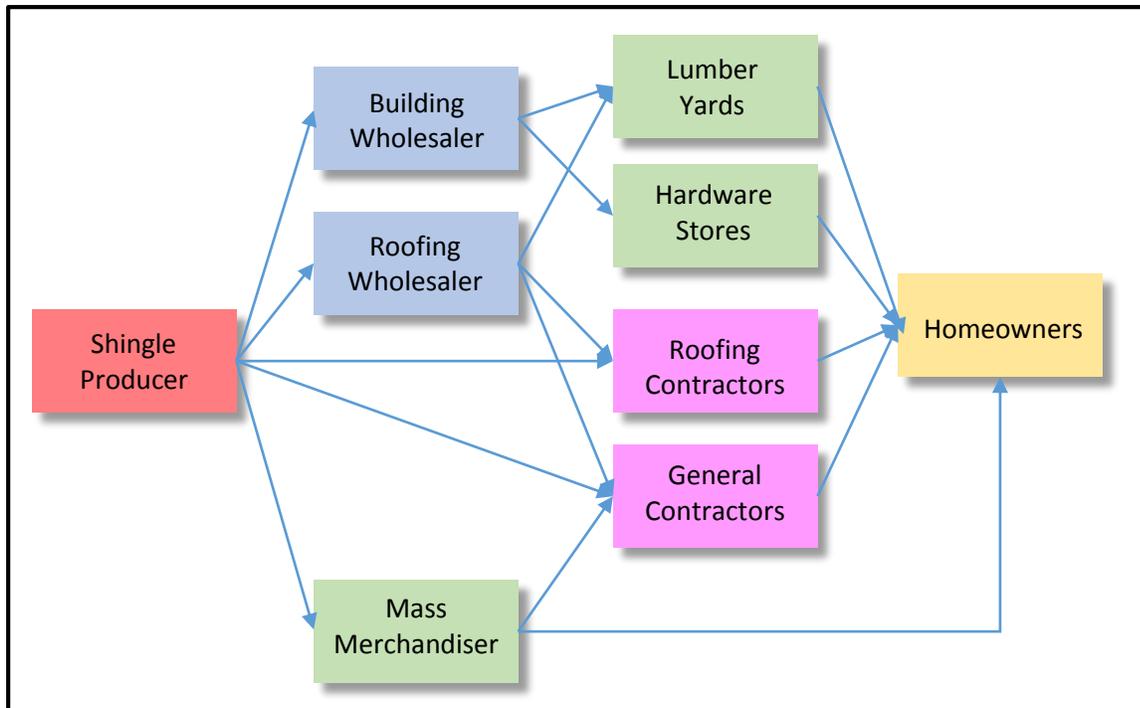
### **Channels Versus Supply Chains**

This third point in the previous paragraph provides an opportunity to distinguish, to the extent possible, between marketing channels and a highly related term, the supply chain. The two concepts share much in terms of meaning, however, some people make some distinctions. For example, to some, the supply chain centers on the logistical functions while channels represent the exchange relationships of channel members. To others, the supply chain focuses on firms and activities in the industrial part of the channel while marketing channels are limited to the retail part.

In my opinion, the distinction is unimportant. However, the interest among some in distinguishing supply chains from distribution channels has had a positive side effect. That is the emphasis that *supply chain management* places on orchestrating productive and efficient exchanges among all members of the channel, not just the channel members nearest any given firm. For example, even though Wal-Mart is a retailer, it exercises tight control over many of its suppliers and its suppliers' suppliers and its suppliers' suppliers' suppliers. Although Wal-Mart is famous for utilizing hardball tactics to extract concessions from its suppliers, it sometimes accomplishes this by extending its influence far up the channel (or supply chain) to extract concessions from these businesses. Other firms work more cooperatively and less coercively than Wal-Mart, but the basic idea is still the same. All points in the marketing channel (or supply chain) need to be aware of the actions and policies of all other members so that they can create exchanges that are maximally efficient and profitable over the long term.

### **Multiplicity of Distribution Channels**

Exhibit 2 on the following page illustrates an important point about marketing channels and channel members. In discussion about marketing channels, we tend to discuss channel membership as if it's exclusive in some way. In reality, businesses are typically members of many channels of distribution. In



**Exhibit 2. Example Showing Multiplicity of Channel Strategies**

fact, they may be members of as many channels as they have customers in the channel. Moreover, they may opt to get products to consumers using multiple channel strategies. This idea is shown in Exhibit 2, where a producer of shingles for houses employs multiple routes to get products to consumers. The paths through retail outlets, shown in green, probably serve consumers with small projects such as roof repairs, doghouses, or small storage sheds. The paths through roofing or general contractors represent large projects such as home roof replacement or new home construction. In all cases, the paths end with the shingles in the possession of consumer homeowners. Of course, businesses and other organizations own buildings with shingle roofs, so completely different distribution channels would exist for those customers. The point here is that, as we discuss channel strategies, bear in mind the complexity and multiplicity of channels and channel relationships.

## **EVALUATING CHANNEL PERFORMANCE**

### **Evaluating Channel Financial Performance**

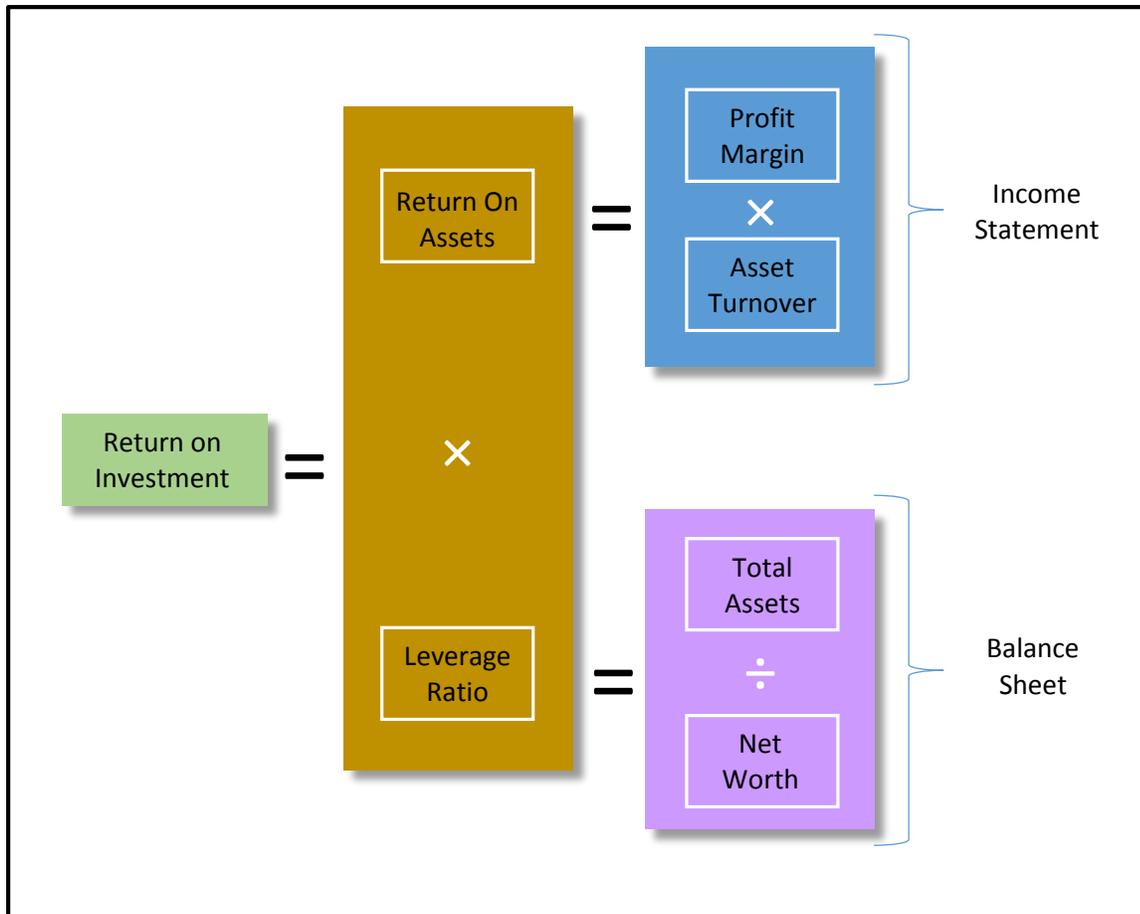
Why Channel Members Evaluate Each Other's Finances. As firms in channels of distribution become more complex and interdependent, and as new channels of distribution open up, evaluating the performance of channels and individual members becomes critical to assessing the need for altering channel strategy. Marketers utilize a variety of metrics to evaluate channel performance, with much of that effort going to evaluating the financial performance of other channel members. Generally speaking, more powerful channel members will examine the finances of weaker or smaller channel members. These days, large retailers such as Wal-Mart tend to be the most powerful firms in

distribution channels. However, large producers such as Procter and Gamble may look at the finances of smaller wholesalers or retailers to determine creditworthiness or their abilities to sustain long term channel relationships. In vertical marketing systems such as franchises, it is common for both parties to periodically look at each other's finances.

There are generally two reasons for this kind of scrutiny. First, when one channel member is selecting a new channel partner. For example, when Wal-Mart is considering carrying merchandise from a new vendor, before Wal-Mart commits to that relationship, they will want to know whether that vendor is financially sound and has the resources necessary to continuously stock Wal-Mart's shelves. The second reason is to determine whether channel members are wasting the resources of other members. Returning to Wal-Mart, this is a retailer famous for putting pressure on vendors to cut costs, reduce operating margins, and allow Wal-Mart to keep its own prices as low as possible. When Wal-Mart examines a vendor's finances, it wants to know where the vendor may be inefficient or wasteful. Indeed, Wal-Mart is so aggressive about this, it will even go to its vendor's suppliers to examine their finances.

The Strategic Profit Model. A relatively simple and unintrusive way to analyze the finances of a channel member is through the strategic profit model, which was developed by managerial accountants at the DuPont Company as an easy way to diagnose and isolate potential financial problems. The strategic profit model provides insights into several key metrics of financial performance. First is return on investment (ROI), which is a key absolute and relative measure of profitability. ROI gives an indication of whether the firm can be expected to operate into the future. Obviously, unprofitable firms tend to go out of business. Second is liquidity. Liquidity is simply the amount of cash or assets that can be quickly turned to cash that the firm possesses. Sound liquidity indicates that a business is able to pay its bills at least in the short term. Third is the firm's leverage ratio. This metric provides a clue into how reliant a firm is on borrowing to operate. Most companies borrow. The question is how much relative to the value of the company.

The strategic profit model uses various metrics to calculate the ROI for a particular channel member. In the case of publicly held companies, much of the information is openly available. Privately owned firms may be pushed to reveal financial information by larger more powerful channel members. The value of the strategic profit model is the series of calculations it uses to arrive at ROI can be diagnostic in identifying where potential problems may exist in a channel member's financial circumstances. Exhibit 3 diagrams the various calculations used in the strategic profit model. While the inputs to calculating each of the model's components can be broken or combined into even more metrics, Exhibit 3 shows how some easily obtained financial measures can be used to assess the viability of current or potential channel members. Equally if not more important, of course, the strategic profit model is also used to help managers inside a company evaluate the performance of their own companies.



**Exhibit 3. Diagram of the Strategic Profit Model**

### Evaluating the Distribution Performance of Marketing Channels

Obviously, the purpose of marketing channels of distributions is to distribute goods to consumers. In organizational markets, channels get required raw materials, component parts or finished goods to producers or to business customers outside of the distribution channel. The point here is that effective distribution sees to it that goods reach those who demand them. Our focus in this discussion will be on the retail part of the channel, where distribution strategy is more complex and more nuanced. There are several reasons why distribution strategy to consumers is more complicated. First, there are far more individual consumers than there are businesses. To reach consumers, distribution strategy must break goods into very small quantities that consumers can use, however, the small quantities must be offered in great abundance because there are so many individual consumers. Second, because there are so many consumers, and because they come from such a diverse array of backgrounds, effectively getting goods into their hands may require many very diverse distribution strategies. Third, consumers shop for many emotional and psychological reasons that are reflected in the types of stores they shop. Thus distribution strategies must be consistent with the image and emotional factors that drive purchases.

Marketing managers should bear in mind two perspectives through which channel performance should be evaluated. First is the actual performance of other channel members in meeting their obligations to move goods through the channel. Second, marketing managers should constantly evaluate the viability of their own channel strategies. In other words, are the distribution channels a particular company has selected appropriate to that company and other parts of their overall marketing mix strategy? Both perspectives can apply to the various metrics below.

Distribution Intensity Metrics. Distribution intensity pertains to the number of retail outlets that carry a particular brand. Distribution intensity attempts to strike a balance between making sure that sufficient numbers of retailers carry the brand on the one hand, while assuring that the availability of the product is consistent with the brand's image and that the intensity strategy justifies the distribution costs. Marketing managers typically classify distribution intensity into three categories. *Intensive distribution* attempts to place brands in as many retail outlets as possible. For example, staple grocery products such as milk are available in many types of stores, including supermarkets, wholesale clubs, drug stores, discount stores, and convenience stores. Selective distribution often applies to items that consumers are willing to shop around for, within limits, to find the best price or to meet particular tastes or preferences. Therefore, *selective distribution* places products in many but not all types of retail outlets. Certain brands of clothing, for example, may only be found at specialty stores and department stores. It is worth mentioning that many types of clothing, however, are pursuing more intensive distribution strategies. Think of all the types of stores where you can purchase t-shirts, for example. Finally, exclusive distribution places products in relative few retailers, which limits access to those brands. Consider Rolex watches as an example. They are available in some, but not all fine jewelry stores.

In terms of number of retailers, exactly what numerically constitutes an intensive versus selective versus exclusive strategy is a matter of interpretation and circumstance. Whatever the limits of these boundaries are, some marketing managers must still quantify them. The percent of relevant outlets is one metric that simply calculates the percentage of outlets that are appropriate for the brand that carry the brand. This proportion is calculated simply as the number of relevant outlets that carries a brand divided by the total number of appropriate outlets.

$$\text{Percent Relevant Outlets} = \frac{\text{Number of Relevant Outlets Carrying Brand}}{\text{Total Number of Relevant Outlets}}$$

Of course, the trick to using this metric is deciding what outlets are "relevant." That decision depends on many factors including the desired image of the brand and the congruity of the retail store image to the brand image and the geographic regions in question.

A slightly more sophisticated measure of distribution intensity is referred to as Product Category Volume, which is the percentage of all category sales of the stores carrying a particular brand. Product category volume gives a sense for how much of the total product market (represented by dollars) is shopping at the stores carrying a particular brand. All Commodity Volume is calculated:

$$\text{Product Category Volume}(\%) = \frac{\text{Category Sales of Relevant Outlets Carrying Brand}}{\text{Category Sales of All Relevant Outlets}}$$

Notice that product category volume does not figure sales of the brand in question into the calculation. The idea of this metric is to gauge the opportunity your brand has to be purchased within the relevant set of outlets carrying your brand and competitive brands. The focus on outlet category sales rather than number of outlets helps account for differences in outlet size. Having your brand carried in a retail store on Times Square should count for more than having it carried in a store located in the Jordan Creek Mall in West Des Moines, Iowa.

A third metric is the amount of “in-store real estate” your brand controls, which is measured in shelf facings. A shelf facing is simply the number of individual retail packages facing the consumer as he or she walks by. The more shelf facings, the more visible the product is relative to competitors, which provides greater opportunities to buy. The typical metric is the percent of category shelf facings, which is calculated as:

$$\text{Percent of Category Shelf Facings} = \frac{\text{Total Shelf Facings for Brand}}{\text{Total Shelf Facings for All Category Brands}}$$

The shelf facings metric is so important to many consumer products manufacturers that they have hired market research companies including Nielsen to have employees go into assigned stores and photograph and count the facings for hundreds of brands in dozens of categories. Of course, the value of shelf facings and shelf locations is not lost on retailers. Good real estate is valuable, so retailers charge for it. Large retailers routinely charge so-called *slotting allowances* to producers for shelf facings in prime store locations.

Logistics Performance Metrics. Perhaps the most important functions of marketing channels are their logistical functions, which simply pertain to the coordinated physical movements of goods to various locations. The degree to which channel members perform their logistical functions well is critical to all other members, because any failure could result in product not reaching the final consumer, which results in lost revenues for all channel members, not just retailers.

Logistical functions extend beyond simply putting goods on trains or trucks and sending them on their way. Think about the variety of goods in your local Kroger or Meijer stores. Now think about the content of the trucks that pull up to the loading docks behind these retail stores. If the channel’s logistical functions are operating properly, the trucks will be loaded with the right amounts of goods necessary to stock the store such that the right amounts of needed goods are provided and unneeded goods are not included. The process of breaking down large quantities of goods from producers and then mixing them with other goods from other producers to create assortments of goods that can be loaded on trucks and sent to individual retail stores is a critically important logistical function. Two metrics that can identify potential problems in these activities are commonly used by marketing managers.

The first metric is simply to measure the stockouts that occur in retailers at the end of a marketing channel. As the name implies, stockouts occur when a retailer has no inventory of a particular branded product, or SKU. SKU stands for stock keeping unit, which is a number that a retailer assigns to a specific product of a specific brand of a specific size, color, or other variety. In other words, each and every

unique product in a retail store has an individual and unique SKU. When specific SKUs are unavailable, many consumers will turn to the next best available alternative. However, if desired SKUs are chronically out of stock, consumers may look for other retail outlets, or may switch brands permanently. If so, the producer, the retailer, and other channel intermediaries may suffer the loss.

The most common measures of stockouts are the Stockout Rate and Stockout Days, which are shown below.

$$\text{Stockout Rate} = \frac{\text{Number of Outlets Where Listed SKU is Unavailable}}{\text{Total Number of Outlets Listing SKU}}$$

$$\text{Stockout Days} = \frac{\text{Number of Days in Period an SKU is Out of Stock at a Specific Outlet}}{\text{Number of Days in Period}}$$

These two metrics provide information to channel members about the nature and severity of potential problems in channel logistics. The stockout rate helps marketing managers know whether a stockout problem is widespread or isolated to one or only a few outlets. If the stockout rate is high, it is likely the case that a logistics problem exists higher in the channel than the individual retail store. If the channel utilizes a wholesaler, it may be a possible candidate for being source of the problem. If the channel does not utilize a wholesaler, then the problem may exist with whatever channel member or members perform wholesaling or warehousing functions, which could be either the producer or the wholesaler. Problems may also exist with ordering, order fulfillment, or with accurately forecasting demand.

Stockout days is a metric generally used for individual stores or retail chains. It simply gives the proportion of days a particular retail outlet is out of stock during a given period of time, perhaps a month or a quarter. Higher number of stockout days suggest a chronic nature to the stockout problem, indicating that earlier fixes did not work.

Finally, a long used metric called the stockturn rate measures the number of times a given amount of inventory for a particular SKU moves through a retail outlet during a fixed period of time. The calculation of stockturn rate is shown below.

$$\text{Stockturn Rate} = \frac{\text{Annual Revenues from SKU}}{\text{Average Inventory of SKU}}$$

High stockturn rates indicate that inventory is moving quickly through the store. While this seems like a good situation to be in, there are circumstances that could cause concern. For example, high stockturn rates may indicate that insufficient inventory is kept on hand or that the SKU has an insufficient number of shelf facings. High stockturn rates means that inventory must be replenished frequently, which raises costs. Moreover, if high stockturn rates are accompanied by occasional stockouts, then this a clear indication that inventories are too low and may tend to lag slightly behind demand. Poor inventory

control can be blamed on the retailer, whose ordering may be sporadic or inaccurate. The fault can lie with delivery or order fulfillment, who may not schedule an even flow of highly demanded product to affected locations. It could be the fault of the producer who may have uneven or insufficient production. The point is that metrics such as the ones above can help pinpoint problems in the channel and make certain that all channel parties operate efficiently to assure a steady but profitable flow of goods from producer to consumer.

### **Evaluating Channel Member Satisfaction**

The metrics described in the previous sections may be calculated from secondary data, often provided by the various members of the channel. In some instances, however, channel performance may be best evaluated by collecting primary data via questionnaire. It's important to keep in mind that channel members buy from and sell to one another. There are marketer-customer relationships involved. Therefore, as with many customer relationships, satisfaction surveys are often an excellent way to assess how one party feels about another.

In the no nonsense world of marketing channels, softer issues of channel member satisfaction may seem out of place. However, several studies of marketing channels (e.g., Morgan and Hunt 1994) conclude that channels where members are satisfied, trusting, and cooperative tend to be more efficient and more profitable. As we speak about such things business-to-business marketing and marketing channels of distributions, it is easy to forget that organizations are simply collections of people. As a rule, people tend to care about feelings such as satisfaction. In other words, satisfaction matters in marketing channels, so it should be evaluated periodically.

Periodic satisfaction surveys of channel members may be very useful for anticipating where performance problems may exist. Such surveys are more frequently conducted by producers, but need not be so. In fact, large retailers such as Wal-Mart assess the satisfaction not only of their own vendors, but also suppliers from up in the industrial part of the channel. Wal-Mart insists on efficient channel operation because of their constant pressure on prices.

Stern, El-Ansary and Coughlan (1996) recommend surveying channel members about satisfaction in several different performance areas. These include:

- Satisfaction with member sales performance including unit sales, market penetration, or market share.
- Satisfaction with financial performance including costs, profits, and resources needed to deal with channel members.
- Satisfaction with the skills and adaptability displayed by the channel members.

For example, a tire manufacturer could send the survey to dealers asking about their own performance or the performance of some other channel member or firm doing business in the channel such as a finance company or trucking company. The point here is that channel members all have an interest in the smooth, efficient and profitable operation of the channel, and all members play a role in that.

## REFERENCES

The importance of committed satisfied channel relationships comes from:

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Some of the metrics on channel logistics were adapted from

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Inclusion of the Strategic Profit Model and survey methods for assessing channel performance was suggested by:

Stern, Louis W., Adel I. El-Ansary, and Anne T. Coughlan (1996), *Marketing Channels* (5<sup>th</sup> ed.), Upper Saddle River, NJ: Prentice-Hall.