

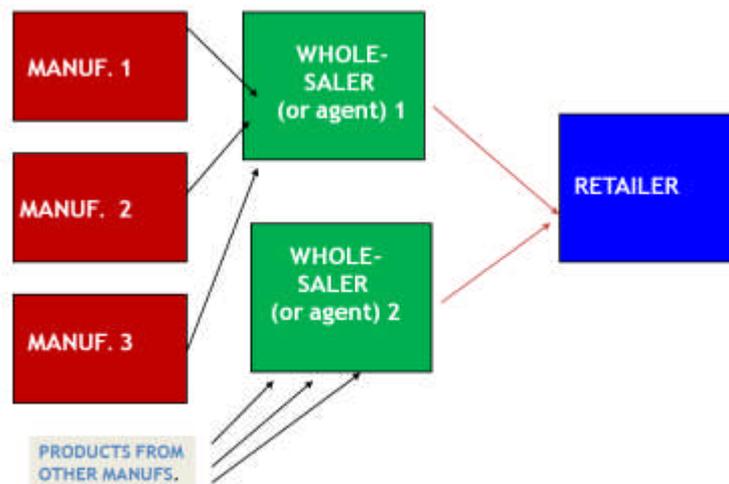
SUMMARY OF CLASSROOM MATERIAL

DISTRIBUTION

BACKGROUND

Distribution (also known as the *place* variable in the marketing mix, or the 4 Ps) involves getting the product from the manufacturer to the ultimate consumer. Distribution is often a much underestimated factor in marketing. Many marketers fall for the trap that if you make a better product, consumers will buy it. The problem is that retailers may not be willing to devote shelf-space to new products. Retailers would often rather use that shelf-space for existing products have that proven records of selling.

Although many firms advertise that they save the consumer money by selling direct and “eliminating the middleman,” this is a dubious claim. The truth is that intermediaries, such as retailers and wholesalers, tend to *add efficiency* because they can do specialized tasks better than the consumer or the manufacturer.



Because wholesalers and retailers exist, the consumer can buy one pen at a time in a store located conveniently rather than having to order it from a distant factory. Thus, distributors add efficiency by:

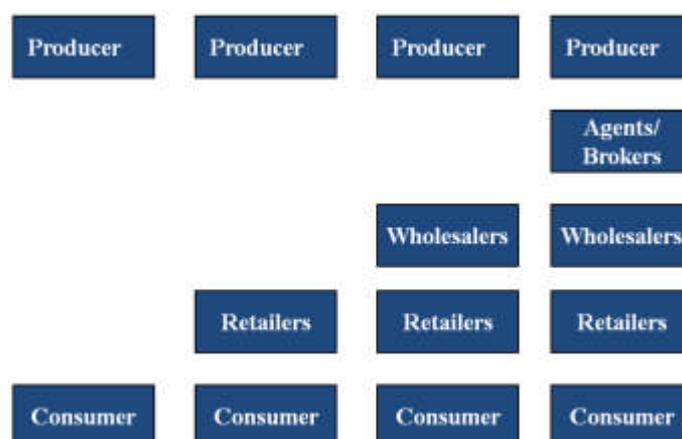
- **Breaking bulk**—the consumer can buy small quantities at a time. Small and modest scale retailers (e.g., the USC bookstore) can buy modest quantities. This service reduces *quantity discrepancy* in the supply-demand relationship between manufacturers and end customers.
- **Consolidation and Distribution.** It would be highly inconvenient for customers to have to buy each product at a different store. Most American consumers today also have limited patience with specialty stores in most categories. Rather than having to go to one store to buy produce, one store to buy meat, and other stores for other household products, there is considerable value in having everything available in a supermarket. The consumers can buy at a neighborhood store, which in turn can buy from a regional warehouse. It would also be very inconvenient for supermarkets and most other retailers to have to receive deliveries individually from each manufacturer. Wholesalers consolidate products from different manufacturers so that a large number of different products can be received in one

shipment. This reduces costs by increasing the efficiency with which products can be (1) delivered and (2) received. Consolidation and distribution services offered by wholesalers reduce the *assortment discrepancy* between manufacturers on the one hand and local retailers and consumers on the other. NOTE: Some very large retail chains such as Wal-Mart may be able to handle distribution more effectively than outside wholesalers. Wal-Mart often insists on sales directly to the chain from the manufacturer rather than sales through wholesalers. This is the exception to the rule since Wal-Mart is large enough to be able to handle distribution itself rather than going through retailers. It should be noted that Wal-Mart has made *very large investments* to make this possible, and these capabilities have taken a long time to develop. Wal-Mart had a very difficult time breaking into the grocery business—especially for perishable items—and took several years to perfect this capability.

- *Carrying inventory.* This service reduces the *temporal discrepancy* between
 - manufacturers who may need to schedule production at relatively constant levels and consumers who need certain products only at certain times (e.g., turkeys needed mostly at Thanksgiving and Christmas)
- *Financing.* Certain small manufacturers may have difficulty waiting for payment until goods are sold to the end-customer. Wholesalers and retailers may negotiate lower prices from the manufacturer in return for quick payment.

Many of the cost savings associated with having an efficient system of intermediaries result from specialization. Manufacturers specialize in what they do well—manufacturing products—while others specialize in handling various phases of the distribution path. Some specialize in retailing—usually selling a large assortment of goods in small quantities to a large number of end customers. Wholesalers, in turn, specialize in moving and goods from numerous manufacturers to a large number of retailers.

Channel structures vary somewhat by the nature of the product.



Commercial jet aircraft are custom made and shipped directly to the airline. Automobiles, because they are difficult to move, are shipped directly to a dealer. It is clearly too difficult for the customer to come to Detroit or Tokyo to buy the car. Therefore, the optimal channel length appears to involve one intermediary (although there is likely to be one or more central import facilities for imported cars). Other products are shipped through a wholesaler who can more efficiently handle, and combine, products from many different suppliers. Several layers of wholesalers may exist, depending on the product. Occasionally, agents may also be involved. Agents usually do not handle products, but instead take care of the business aspect of negotiating with distributors, which manufacturers may feel uncomfortable or ill prepared for doing themselves.

MANUFACTURER DISTRIBUTION PREFERENCES

Most manufacturers would prefer to have their products distributed *widely*—that is, for the products to be available in as many stores as possible. This is especially the case for convenience products where the customer has little motivation to go to a less convenient retail outlet to get his or her preferred brand. Soft drinks would be an extreme example here. The vast majority of people would settle for their less preferred brand in a vending machine rather than going elsewhere to get their top choice. This is one reason why being a small share brand in certain categories can become a vicious cycle that perpetuates itself.

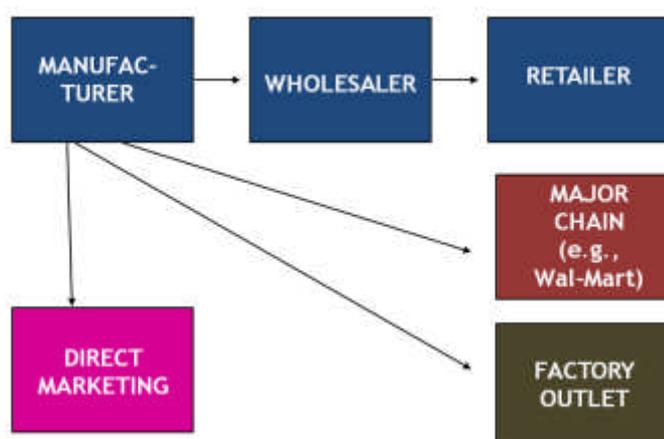
For most manufacturers, wide distribution is not realistically obtainable. In food product categories, for example, the larger supermarkets can carry a large number of brands. Smaller convenience stores and warehouse stores, however, are likely to carefully pick a few brands. After all, if convenience stores were to carry as many products as supermarkets, the purpose of having a neighborhood store with easy entry and exit would be defeated.

In a very small number of cases, some manufacturers prefer to have their products *selectively*, or even *exclusively*, distributed. This is usually the case for high prestige brands (e.g., Estee Lauder) or premium quality image brands (e.g., high end electronic products) that require considerable before and after sales service.

DISTRIBUTION INTERESTS: RETAILERS VS. MANUFACTURERS

Manufacturers of different kinds of products have different interests with respect to the availability of their products. For convenience products such as soft drinks, it is essential that your product be available *widely*. Chances are that if a store does not have a consumer's preferred brand of soft drinks, the consumer will settle for another brand rather than taking the trouble to go to another store. Occasionally, however, manufacturers will prefer *selective* distribution since they prefer to have their products available only in upscale stores.

Parallel distribution structures refer to the fact that products may reach consumers in different ways. Most products flow through the traditional manufacturer -> retailer --> consumer channel. Certain large chains may, however, demand to buy directly from the manufacturer since they believe they can provide the distribution services at a lower cost themselves. In turn, of course, they want lower prices, which may anger the traditional retailers who feel that this represents unfair competition. Firms may also choose to utilize factory outlet stores. To allay concerns held by conventional stores, however, these factory outlet stores are usually located in areas where they are not easily accessible.



We must consider what is realistically available to each firm. A small manufacturer of

potato chips would like to be available in grocery stores nationally, but this may not be realistic. We need to consider, then, both who will be willing to carry our products and whom we would actually like to carry them. In general, for convenience products, intense distribution is desirable, but only brands that have a certain amount of power—e.g., an established brand name—can hope to gain national intense distribution. Note that for convenience goods, intense distribution is less likely to harm the brand image—it is not a problem, for example, for Haagen Dazs to be available in a convenience store along with bargain brands—it is expected that people will not travel much for these products, so they should be available anywhere the consumer demands them. However, in the category of shopping goods, having Rolex watches sold in discount stores would be undesirable—here, consumers do travel, and goods are evaluated by customers to some extent based on the surrounding merchandise.

In general, a brand can expect lesser distribution in its early stages—fewer retailers are motivated to carry it. Similarly, when a product category is new, it will be available in fewer stores—e.g., in the early days, computer disks were available only in specialty stores, but now they can be found in supermarkets and convenience stores as well. Certain products that are not well established may have to get their start on "infomercials," only slowly getting entry into other types of outlets. (Please see PowerPoint chart).

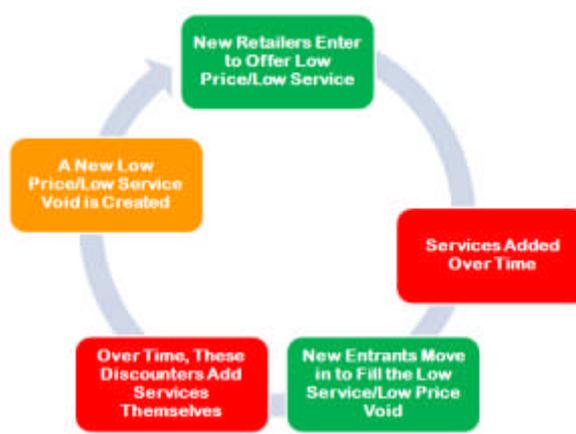
Different parties involved in the marketing of products tend to have different, and often conflicting, interests:

- Full service retailers tend to dislike intensive distribution.
- Low service channel members can "free ride" on full service sellers.
- Manufacturers may be tempted toward intensive distribution—appropriate only for some; may be profitable in the short run.
- Market balance suggests a need for diversity in product categories where intensive distribution is appropriate.
- Service requirements differ by product category.

Diversion occurs when merchandise intended for one market is bought up by a distributor that then ships it to a different market. Sometimes, a manufacturer will run a promotion in one region but not in another, and speculators will then buy extra quantity in the promoted area and ship it to another area. The speculator will then sell it to local retailers or distributors for a price slightly lower than what is being charged through the regular channel but at a price that still allows a nice profit. Certain products sell for different prices in different countries. As we discussed in the unit of international marketing, a gray market occurs when a product is bought in one country and exported to another where the price is generally higher. Both Louis Vuitton suitcases and golf clubs were imported to Japan, depressing prices there.

THE WHEEL OF RETAILING

The "Wheel of Retailing" is the phenomenon that new retail chains usually enter as low price, low service organizations. Over time, however, they tend to add more services which, in turn, add to the costs of doing business. This may, in fact, be the best way to serve most of the chain's current customers, but it creates a "void"—or unfulfilled demand for lower priced, lower service retailers:



Because an un-served demand for low service, low price retailing now exists, new retailers will tend to enter. Over time, however, these retailers will, themselves, tend to add more services, thus starting a new cycle.

RECENT RETAIL TRENDS

Over the past decade, there has been considerable growth in both extremes of the continuum from low price, low service to high price, high service retailers. There has been considerably growth both in the Wal-Mart *and* Nordstrom-type retailers than there has been in between.

For some time, during difficult economic times in the mid 2000s, discount stores like Wal-Mart actually tended to *increase* sales as consumers seemed to switch their purchases of the same products from higher priced to lower priced stores rather than reducing the quantity and quality bought in the product categories. It appears that consumers have done most of the switching that can be reasonably done this way already. More recently, Wal-Mart has felt more of an effect of weak economic times. Observations have been made that more and more customers seem to be running out of money at the end of the month.

During the last two decades, there has been strong growth in the “category killer” chains which specialize in a moderate assortment of goods. Chains like CompUSA, Best Buy, Staples, Circuit City, Office Depot, and Home Depot—which were rare before the 1990s—have expanded rapidly and have captured a very large share of the market in their respective areas of emphasis. These chains operate from two sources of strength:

- Although their total purchase volumes are usually smaller than those of the giants such as Wal-Mart and Target, these purchases are focused in more limited areas. Thus, the purchases of each “giant” account for a large proportion of the sales of many firms. Best Buy, for example, accounts for a large percentage of the sales of firms that make DVD players, TV sets, video games, and, to a lesser extent, computers and printers.
- The mega store chains will often negotiate very large contracts early in the purchasing cycle. Manufacturers are often willing to offer especially low prices to a buyer who will commit to taking large quantities well ahead of the time that these products are actually needed. This guarantees the manufacturers a certain volume—albeit at small margins—freeing the firm to commit to production and produce large quantities without having to worry about selling a large portion the production. Such deals often account for the very low sale prices that can be offered on select models in various product categories.