

### Learning Objectives (PPT 12-2)

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- ❖ Describe the three major functions of a distribution channel.
- ❖ Explain how the internet is affecting distribution channel length.
- ❖ Discuss trends in supply chain management and power relationships among channel players.
- ❖ Outline the major models used by online channel members.
- ❖ Highlight how companies can use distribution channel metrics.

### Distribution Channel Overview

A **distribution channel** is a group of interdependent firms that work together to transfer product and information from the supplier to the consumer. The channel is composed of producers, intermediaries and buyers. These members transfer products from the point of origin to the point of consumption.

### Online Channel Intermediaries

A good way to classify online intermediaries is according to their business model, which are: content sponsorship, direct selling infomediary, or intermediary (three separate models).

#### *Content Sponsorship*

Firms create Web sites in hopes of attracting traffic and selling advertising. This model is often used in conjunction with other models to generate multiple revenue streams.

#### *Infomediary*

An infomediary is an online organization that aggregates and distributes information. This could be in the form of a market research firm or a variation on the content sponsorship model, using permission to buy space on a computer screen.

#### *Intermediary Models*

There are three main intermediary models on the Internet.

*Brokerage Models* – A broker creates a market in which buyers and sellers negotiate and complete transactions, then charge a transaction fee for their service. Examples may be online exchange or online auction services. Brokers do not represent either party in the transaction.

*Agent Models* – Unlike brokers, agents do represent either the buyer or the seller, depending on who pays the fee. Examples and classifications will be detailed in the outline section.

*Online Retailing* – Online retailing is one of the most visible e-business models. These online firms may sell digital products or tangible products.

### Distribution Channel Length and Function

The length of the distribution channel refers to the number of intermediaries between the supplier and the consumer. In **direct distribution**, the product goes directly from the manufacturer to the end user. An **indirect channel** includes one or more intermediaries. Originally experts believed the Internet would wipe out intermediaries, but instead new intermediaries are emerging, called **metamediaries**.

#### *Functions of a Distribution Channel*

Intermediaries perform a multitude of tasks and functions along the distribution channel including: holding inventory or performing the pick, pack, and ship functions.

*Transactional Functions* – making contact with buyers and using marketing communication strategies to make them aware of products. Activities may include: contact with buyers, marketing communications, negotiating prices, processing transactions, and matching products to buyer's needs.

*Logistical Functions* – include physical distribution activities and the function of aggregating product, sometimes outsourced to third-party logistics specialists. Activities may include: physical distribution, aggregating product, third-party logistics (outsourced logistics), and the last mile problems.

*Facilitating Functions* – these are performed by channel members including marketing research and financing.

### *Distribution System*

The distribution channel is actually a unified system of interdependent organizations working together to build value as products proceed through the channel to the consumer. There are three ways to define the scope of the channel as a system which will be covered in detail in the outline section.

## **Channel Management and Power**

Just as the Internet has increased the power of buyers by providing access to more information and to more suppliers, it has increased the power of suppliers, as well. Once a channel structure is established, its viability requires a certain measure of coordination, communication, and control to avoid conflict among its members. A channel member must emerge to assume leadership in these measures. A type of business-to-business commerce known as **electronic data interchange** (EDI) is effective in establishing structural relationships between businesses.

## **Distribution Channel Metrics**

Distribution channel metrics help e-marketers determine if e-commerce works. Firms must consider its effectiveness in terms of reaching target market segments efficiently and enticing them to purchase online.

### *B2C Market*

The Business to Consumer market accounted for \$114 billion in online sales in 2003. This figure represents a significant increase over the previous year and do not include offline purchases inspired by online research. In the B2C market, two strategies are particularly effective, which will be detailed in the outline section.

### *B2B Market*

Impressive as the B2C figures are, they are nothing compared to the B2B market. Estimates put the U.S. B2B e-commerce figures at \$624 billion, although it is impossible to garner a precise measurement. B2B metrics may look at: time from order to delivery, order fill levels, and other activities that reflect functions performed by channel participants.

## **Topic Summary**

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The internet increased the power of buyers and suppliers. It also changed the way electronic data interchange is used to establish structural relationships between suppliers and buyers. The major business models used by online intermediaries can be categorized as content sponsorship, direct distribution, infomediary, brokerage models (online exchange and online auction), and agent models (selling agents, manufacturer's agents, shopping agents, buyer's cooperative). Online retailing (e-commerce) is another important model including online sales of digital or tangible products and is done by direct distribution, with intermediaries or by using multichannel marketing.

A distribution channel is a group of interdependent firms that work together to transfer product and information from the supplier to the consumer. The transfer may either be direct or through a number of intermediaries that perform certain marketing functions in the channel between suppliers and customers. By specializing, intermediaries are able to perform functions more efficiently than a supplier could.

Channel intermediaries include wholesalers, retailers, brokers, and agents. The length of a distribution channel refers to the number of intermediaries between the supplier and the consumer. The shortest distribution channel has no intermediaries; the producer deals directly with customers. Indirect channels include one or more intermediaries. Disintermediation describes the process of eliminating traditional intermediaries. Eliminating intermediaries can potentially reduce costs but functions must be performed by someone. Although the Internet was expected to lead to disintermediation and lower prices, new intermediaries are emerging instead.

Three broad types of value-added functions performed in the channel are transactional, logistical, and facilitating functions. Transactional functions refer to making contact with buyers, using marketing communication strategies to raise awareness of products, matching product to buyer needs, negotiating price, and processing transactions. Logistical functions include physical distribution such as transportation and storing inventory and aggregating product; e-marketers often outsource these to third-party logistics providers. Facilitating functions include providing marketing research about buyers and providing financing. The last mile problem is the added expense of delivering small quantities to individual homes or businesses.

The distribution channel is a unified system of interdependent organizations working together to build value as products proceed through the channel from producer to consumer. This perspective recognizes that channels are stronger when they compete in a unified way with other channels. Supply chain management is the coordination of flows of material (e.g., physical product), information (e.g., demand forecast), and financial (e.g., credit terms).

## Topic Outline

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### Opening Vignette: The Dell Story (PPT 12-3, 12-4)

*Dell has become one of the most successful computer companies in the world and a big reason for that is their business model and their distribution channels. How can Dell continue to serve its vast customer base online? Has anyone in class bought from Dell? Was it a good experience? Why is Dell so much more successful than Gateway (a company formed at approximately the same time with the same original business model)? How has the adoption of new products other than PC's affected Dell's distribution model?*

<http://www.dell.com>

## I. Distribution Channel Overview (PPT 12-5)

*A distribution channel is a group of interdependent firms that work together to transfer product and information from the supplier to the consumer.*

- A. Producers
  - 1. Manufacturers
  - 2. Originators of the product or service
- B. Intermediaries
  - 1. A firm that matches buyers and sellers
  - 2. May be independent or represent the parties involved
- C. Buyers
  - 1. The end user
  - 2. Those that consume the product or service
- D. Four major elements combine to form a firm's channel structure
  - 1. Types of channel intermediaries
  - 2. Length of the channel
  - 3. Functions performed by members of the channel
  - 4. Physical and informational systems

## II. Online Channel Intermediaries (PPT 12-6)

- A. Wholesalers
  - 1. Buy products from the manufacturer and resell them to retailers
  - 2. Could be online or offline
- B. Brokers
  - 1. Facilitate transactions between buyers and sellers
  - 2. Do not represent either party
  - 3. Do not take title to the goods

4. Charge a transaction fee for their service

### C. Agents

1. Facilitate transactions between buyers and sellers
2. DO represent one of the parties
  - a. Manufacturer agent – represents the seller
  - b. Purchasing agent – represents the buyer
3. May or may not take title to the goods

### D. Content Sponsorship (PPT 12-8)

1. Firms create Web sites to attract lots of traffic
2. Firms sell advertising on the Web site
3. Most firms use content sponsorship in conjunction with other models to generate multiple revenue streams

### E. Infomediary (PPT 12-9)

1. An online organization that aggregates and distributes information
2. Market research firm that compensates consumers for sharing information

### F. Intermediary Models (PPT 12-10)

1. Brokerage Models – creates a market in which buyers and sellers negotiate and complete transactions. Buyer convenience, speed of order execution, and transaction processing are buyer benefits. Seller benefits are a creation of a pool of buyers (PPT 12-11)
  - a. Online Exchange
    - i. E\*Trade
    - ii. Ameritrade
    - iii. Online brokerages that allow for trading securities
    - iv. AutoByTel allows for brokering of cars
  - b. Online auction
    - i. eBay
    - ii. Amazon
    - iii. iOffer
    - iv. Sell.com
    - v. Ubid
2. Agent Model – agents DO represent either the buyer or the seller, depending on who pays the fee. (PPT 12-12)
  - a. Agent models representing sellers
    - i. Selling agents
      - 1) Represent a single firm
      - 2) Helps them sell products
    - ii. Manufacturer's agents
      - 1) Represent more than one seller
      - 2) Travel agents are examples
      - 3) Also called catalog aggregators
    - iii. Metamediaries
      - 1) Represent a cluster of manufacturers, online retailers, and content providers
      - 2) Solve problems of reducing search times, providing quality assurance, facilitating transactions for a group of related purchases, and providing relevant content information
    - iv. Virtual malls
      - 1) Host multiple online merchants
      - 2) Similar to an offline shopping mall
      - 3) Virtual malls provide multiple customer benefits
  - b. Agent models representing buyers (PPT 12-13)
    - i. Shopping agents
      - 1) Shopping agents measure value, not just price
      - 2) These are called second generation shopping agents
    - ii. Reverse auction
      - 1) The buyer specifies a price and the sellers bid for the buyer's business
      - 2) Priceline.com is a reverse auction

- iii. Buyer cooperative
      - 1) Also known as buyer aggregator
      - 2) Pools buyers together to drive down price on the selected items
- 3. Online Retailing – one of the most visible e-business models. Online stores are setup to sell to consumers or businesses. (PPT 12-14)
  - a. Digital products
    - i. The Internet serves as a medium for distribution of goods and services
    - ii. Online content includes
      - 1) Newspapers
      - 2) Music
      - 3) movies
  - b. Tangible products
    - i. Tangible products are distributed through conventional channels
    - ii. Digital products are still sent through traditional channels

### III. Distribution Channel Length and Functions (PPT 12-15, 12-16)

*The length of the distribution channel refers to the number of intermediaries between the supplier and the consumer. This channel may be direct or indirect. Originally it was thought that the Internet would eliminate intermediaries (a process called disintermediation), but the Internet has actually created new intermediaries, called **metamediaries**.*

- A. Functions of a Distribution Channel – a multitude of operations and functions are performed along the distribution channel, including holding inventory and the pick, pack, and ship functions. These functions can be generally categorized as transactional, logistical, and facilitating. (PPT 12-17)
  - 1. Transactional functions (PPT 12-18)
    - a. Contact with buyers
      - i. The internet provides a new channel for communication
      - ii. Contacts can be customized
    - b. Marketing communications
      - i. Advertising and other product promotions
      - ii. Previously manual labor functions can be automated
      - iii. Communications can be closely monitored and changed
      - iv. The Internet enhances promotional coordination among intermediaries
    - c. Matching product to buyer's needs
      - i. Shopping agents – allow customers to compare prices and features within a product category
      - ii. Collaborative filtering agents – can predict consumer preferences based on past purchase behavior
    - d. Negotiating price
      - i. Involves offers and counter offers
      - ii. Could be in person, over the phone, via e-mail
    - e. Process transactions -- electronic channels lower transaction costs
  - 2. Logistical Functions (PPT 12-19)
    - a. Physical distribution
      - i. Most online products are distributed conventionally
      - ii. Any content that can be digitized can be delivered electronically
    - b. Aggregating product
      - i. Suppliers operate more efficiently when they produce a high volume of narrow range products
      - ii. Consumers prefer to buy small quantities of a wide range of products
      - iii. Channels intermediaries aggregate products from multiple suppliers to give consumers more choices in one location
      - iv. This type of aggregation is known as a category killer
    - c. Third-party logistics – outsourced logistics (PPT 12-20)
      - i. Many companies outsource logistics to a third-party
      - ii. UPS, USPS and FedEx provide third party logistics for many firms
    - d. The last mile problem (PPT 12-21)
      - i. Delivering small quantities cost more money

- ii. 25% of deliveries require more than one delivery attempt
  - iii. 30% of packages are left on door steps, increasing the possibility of theft
3. Facility Functions
- a. Market research (**PPT 12-22**)
    - i. Market research is a major function of the distribution channel
    - ii. The Internet allows for market research in five ways
      - 1) Much of the information on the Internet is free
      - 2) Managers and employees can conduct research from their desk
      - 3) Information on the Internet tends to be more relevant and current
      - 4) Web based information is already in digital format
      - 5) Because of the amount of consumer behavior information available, marketers can receive information in detailed reports
  - b. Financing (**PPT 12-23**)
    - i. Financing is a must is both consumer and business transactions
    - ii. Secure Electronic Transactions (SET) is required for customers to feel comfortable purchasing online

#### B. Distribution System (**PPT 12-24**)

The distribution channel is actually a system of unified organizations working together to build value as products proceed through the channel to the consumer.

To define the scope of the channel as a system:

1. Consider only distribution functions that are downstream from the manufacturer to the consumer
2. Consider only the supply chain upstream from the manufacturer working backward to the raw materials
3. Consider the supply chain, the manufacturer, and the distribution channel as an integrated system called the **value chain**

#### IV. Channel Management and Power (**PPT 12-25, 12-26, 12-27**)

*Just as the Internet has increased the power of buyers by providing access to more information and to more suppliers, it has increased the power of suppliers, as well. Once a channel structure is established, its viability requires a certain measure of coordination, communication, and control to avoid conflict among its members. A channel member must emerge to assume leadership in these measures. A type of business-to-business commerce known as **electronic data interchange (EDI)** is effective in establishing structural relationships between businesses.*

#### V. Distribution Channel Metrics

*Does online commerce work? Firms must consider its effectiveness in terms of reaching target market segments efficiently and enticing them to purchase online to be able to answer this question.*

##### A. B2C Market (**PPT 12-28**)

1. U.S. consumers spent \$114 billion online in 2003
2. A significant growth over the previous year
3. Does not include the brick-and-mortar purchases inspired by online research
4. Two strategies are particularly effective
  - a. A high reach strategy of accumulating large numbers of customers with cost-effective conversion rates for high-frequency purchases of low-margin products and services such as CDs and books (Amazon.com)
  - b. A niche strategy with narrow focus on a particular product or service category such as luxury items or apparel. (Dell.com)
5. Additional measures recommended
  - a. Which affiliations deliver the most users?
  - b. What is happening to users referred from an affiliate site?
  - c. When and how do customers arrive at a Web site?
  - d. How long do users stay at a Web site?
  - e. How is buyer behavior different from other users who do not buy?
  - f. How frequently are visitors converted to customers?
  - g. Which channel partners deliver the most profitable customers? The most loyal ones?
6. Online purchases only accounted for 5.4% of all U.S. retail sales in 2003

B. B2B Market (**PPT** 12-29)

1. B2B customers spent over \$624 billion
2. Impossible to pinpoint an exact figure
3. The Internet is more efficient for firms to order from each other

## Questions for Review

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### 1. What is a distribution channel?

A **distribution channel** is a group of interdependent firms that work together to transfer product and information from the supplier to the consumer. It is composed of the following participants:

- **Producers**, manufacturers, or originators of the product or service;
- **Intermediaries**—the firms that match buyers and sellers and mediate the transactions among them; and
- **Buyers**, customers, or users of the product or service.

### 2. What are the types of intermediaries in a distribution channel?

Intermediaries are the firms that match buyers and sellers and mediate the transactions among them. The types of intermediaries in a distribution channel are wholesalers, retailers, brokers, and agents.

### 3. What are the three major functions of a distribution channel?

The three major functions of a distribution channel are transactional, logistical, and facilitating.

### 4. What is supply chain management (SCM) and why is it important?

The more inclusive definition of the supply chain is used to describe the emerging field of **supply chain management (SCM)**. Supply chain management (SCM) refers to the coordination of flows in three categories: material (e.g., physical product), information (e.g., demand forecast), and financial (e.g., credit terms) (Kalakota 1999). The word *flow* evokes the image of a continuous stream of products, information, and finances flowing among the channel members much as blood and nerve impulses flow through an organism. It is important because it deals with every facet from manufacturer to the end-user.

### 5. Why are e-marketers concerned with the last mile problem?

The last mile problem is the added expense of delivering small quantities of products to individual homes or businesses. One big problem facing online retailers and logistics managers is the added expense of delivering small quantities to individual homes and businesses. It is much less expensive to send cases of product to wholesalers and retailers and let them break the quantities into smaller units for sale.

### 6. What is disintermediation? Give an example.

**Disintermediation** describes the process of eliminating traditional intermediaries. Eliminating an intermediary can potentially reduce costs since each intermediary must add to the price of the product in order to profit. Taken to its extreme, disintermediation allows the supplier to transfer goods and services directly to the consumer in a direct channel. Complete disintermediation tends to be the exception because intermediaries can often handle channel functions more efficiently than producers can handle them. An intermediary that specializes in one function, such as product promotion, tends to become more proficient in that function than a non-specialist. Examples include any major manufacturer who has decided to sell directly to the public rather than through distributors. This could include auto manufacturers, Levi's, computer manufacturers, DSL providers, etc. this of course creates channel conflict because manufacturers can offer lower prices than any of their distributors.

### 7. What is an infomediary? Give an example.

An **infomediary** is an online organization that aggregates and distributes information. One form of infomediary is a market research firm. Usually the infomediary compensates the consumer for sharing her information. For example, a comScore Media Metrix panel member is paid; however, some intermediaries cull the information covertly and without compensation (e.g., DoubleClick uses cookies to track users as they surf the Web).

### 8. What is multichannel marketing? Give an example.

Multichannel marketing is a business offering customers more than one way to buy something. For example, a retail store that also offers the ability to purchase online and sends out catalogs with an 800 number to order over the phone.

**9. How do brokers and agents differ?**

**Brokers** facilitate transactions between buyers and sellers without representing either party. They are market makers and typically do not take title to the goods.

**Agents** usually represent either the buyer or seller, depending upon who hires and pays them. They facilitate transactions between buyers and sellers but do not take title to the goods. **Manufacturer's agents** represent the seller whereas purchasing agents represent the buyer.

**10. What types of distribution channel metrics are used in the B2C market?**

In the B2B market, as in B2C, e-marketers should select metrics that relate to their e-marketing goals, such as sales revenue. It is critical to understand how e-commerce fits into the overall marketing strategy, what the firm expects to accomplish through it, and whether or not it is working. For B2B, metrics may look at time from order to delivery, order fill levels, and other activities that reflect functions performed by channel participants.

**11. Name five ways to keep consumers from abandoning online shopping carts.**

- Show inventory availability on the product page—don't wait until the checkout page.
- Make it obvious where to click next for a smooth checkout process.
- Make it easy for shoppers to edit their shopping cart by adding or deleting items.
- Include a "progress indicator" so customers know where they are in the checkout process.
- Provide a link back to the original product page for re-checking sizes and other options.

## **Discussion Questions**

### **12. How does the value of distribution channel functions change when they become Internet based?**

The value of distribution channel functions generally increases when they become Internet based. This is due to improvements in efficiency and effectiveness when firms perform these functions. More specifically functions can be automated, monitored, made available 24/7, coordinated, and aggregated with far greater ease. Some might argue that the value doesn't change because all functions must be carried out by someone and do not disappear. Consumers have picked up some of the traditional distribution functions (e.g., building assortments).

### **13. Do you agree with the more inclusive definition of the supply chain to include the entire value chain? Support your position.**

Redefining the supply chain to include the entire value chain is now mainstream, reflecting what a great number of practitioners mean when they talk about supply chain management. Thus, value chain, integrated logistics, and supply chain are equivalent terms.

### **14. Although direct selling often results in lower prices, does it have disadvantages for buyers?**

The major costs of direct selling for the buyers include higher search costs to locate individual manufacturers and the time costs of transacting with each manufacturer. Also some intermediaries may provide better customer service and expertise than the original manufacturer. This can be seen in the telecommunication industry where large broadband carriers lease out their lines to smaller Internet Service Providers (ISP). Typically smaller ISP's can handle complaints and outage calls better than the larger carrier.

### **15. Each intermediary in the channel has to mark up a product's price to make a profit. Some retailers sell products for almost double the wholesale cost. What would a retailer have to do to add enough value to justify such a markup?**

Depending on the demand for the product and other market forces, retailers may not necessarily need to add anything significant to justify markups. This can be seen in computer manufacturers that bundle additional proprietary services that users may likely never use. So long as something additional is added, retailers can justify the markup. Ideally a retailer would add something truly value enhancing to the original product; however, often times this is not the case.

### **16. How would you suggest e-marketers solve the last-mile problem?**

The last mile problem is the added expense of delivering small quantities to individual homes or businesses. It is much less expensive to send cases of product to wholesalers and retailers and let them break the quantities into smaller units for sale.

Innovative firms are trying four solutions. First is a smart box. The consumer buys a small steel box that comes with a numeric keypad connected to the Internet via a two-way modem. Delivery people, such as FedEx or the USPS, receive a special code for each delivery and use it to open the box and leave the shipment. This activity is sent via the Internet and recorded in a database. The consumer uses his or her own code to open the box and receive the delivery—also recorded in the database. This solution is efficient and secure for consumers who are willing to pay the hefty box fee. Brivo introduced this technology but no longer offers this product.

A second solution involves a retail aggregator model. Consumers can have packages shipped to participating retailers, such as local convenience stores or service stations, then consumers pick up the package—not as convenient as the current method. In Japan, NTT DoCoMo customers can use their Web-enabled cell phones to order goods for shipment to local 7-Eleven stores. The third solution calls for special *e-stops*, storefronts that exist solely for customer drive-through and package pickup.

Finally, many multichannel retailers allow customers to order online for offline retail delivery. Recreational Equipment, Inc. (REI), the outdoor apparel and gear retailer, began offering this service in its 67 U.S. retail stores in mid-2003. Within one month 25 percent of Web sales were picked up in the offline store with the added bonus of \$32 of impulse buying during the same visit (Budis, 2004).

### **17. What is the future of e-commerce, in your opinion? Will it continue to increase? Will it ever become larger in terms of sales than off-line retailing? Explain your answer.**

Answers will vary depending on one's own opinion. It would be wise to focus on the pendulum shift in the early 2000's before the dot.com crash and examine how the online world has changed since then. It would also be wise to examine the security issues and how that will affect online purchasing in the future.