Part 6 Delivering Value

L.L. Bean has expanded beyond its famed catalog to sell online and through its own stores.

Source: L.L.Bean

In This Chapter, We Will Address the Following **Questions**

1. What is a marketing channel system and value network? (p. 516)
2. What work do marketing channels perform? (p. 521)
3. How should channels be designed? (p. 525)
4. What decisions do companies face in managing their channels? (p. 530)
5. How should companies integrate channels? (p. 534)
6. What are the key channel issues in e-commerce? (p. 536)
7. What are the key channel issues in m-commerce? (p. 538)
8. How should companies manage channel conflict? (p. 540)

17 Designing and Managing Integrated Marketing Channels

Successful value creation needs successful value delivery. Instead of limiting their focus to their immediate suppliers, distributors, and customers, holistic marketers are examining the whole supply chain as a value network, including their suppliers' suppliers upstream and their distributors' customers downstream. They are also looking at how technology is changing the way customers shop and retailers sell and finding new and different means to distribute and service their offerings. Consider how L.L.Bean develops strong customer ties with a well-executed channel strategy.[1]

L.L.Bean's founder Leon Leonwood (L.L.) Bean returned from a Maine hunting trip in 1911 with cold, damp feet—and a revolutionary idea for stitching leather uppers to workmen's rubber boots to create a comfortable, functional boot. To a mailing list of hunters, Bean sent a three-page flier describing the benefits of his new Maine Hunting Shoe and backing it with a complete guarantee. The shoe was not an initial success. Of the first 100 pairs ordered, 90 were returned when the tops and bottoms separated. True to his word, Bean refunded the purchase price and fixed the problem. L.L.Bean quickly became known as a trusted source for reliable outdoor equipment and expert advice. The company's guarantee of 100 percent satisfaction is still at the core of its business, as is its original Golden Rule, "Sell good merchandise at a reasonable profit, treat your customers like human beings, and they will always come back for more." Today, it is a $1.5 billion company, selling through its famous catalogs as well as online and in retail stores. L.L Bean has also expanded globally, with stores in Japan and China. To better meet its U.S. customers' needs, the company launched free shipping in 2011. Online it has opened up to customer ratings and reviews, given customers the opportunity to chat and e-mail with customer service, and introduced a "click to call" system that triggers a customer service call within two minutes. Ranked #1 in customer service by Bloomberg Businessweek, L.L.Bean monitors customer feedback closely. When one of its customer-favorite products, Supima Cotton Fitted Sheets, began to be criticized in online reviews, the company quickly pulled the product from its Web site to investigate. It turned out that a wrinkle-resistance treatment mistakenly added by a contractor was causing the cotton fabric to tear or shred. L.L.Bean immediately offered new sheets to the 6,300 customers who had purchased the defective set and destroyed the remaining faulty products.

With the advent of e-commerce (selling online) and m-commerce (selling via mobile phones and tablets), customers are buying in ways they never have before. Companies today must build and manage a continuously evolving and increasingly complex channel system and value network. In this chapter, we consider strategic and tactical issues in integrating marketing channels and developing value networks. We will examine marketing channel issues from the perspective of retailers, wholesalers, and physical distribution agencies in Chapter 18.

Marketing Channels and Value Networks

Most producers do not sell their goods directly to the final users; between them stands a set of intermediaries performing a variety of functions. These intermediaries constitute a marketing channel (also called a trade channel or distribution channel). Formally, **marketing channels** are sets of interdependent organizations participating in the process of making a product or service available for use or consumption. They are the set of pathways a product or service follows after production, culminating in purchase and consumption by the final end user.[2]

Some intermediaries—such as wholesalers and retailers—buy, take title to, and resell the merchandise; they are called *merchants*. Others—brokers, manufacturers' representatives, sales agents—search for customers and may negotiate on the producer's behalf but do not take title to the goods; they are called *agents*. Still others—transportation companies, independent warehouses, banks, advertising agencies—assist in the distribution process but neither take title to goods nor negotiate purchases or sales; they are called *facilitators*.

Channels of all types play an important role in the success of a company and affect all other marketing decisions. Marketers should judge them in the context of the entire process by which their products are made, distributed, sold, and serviced. We consider all these issues in the following sections.

THE IMPORTANCE OF CHANNELS

A **marketing channel system** is the particular set of marketing channels a firm employs, and decisions about it are among the most critical ones management faces. In the United States, channel members as a group have historically earned margins that account for 30 percent to 50 percent of the ultimate selling price. In contrast, advertising typically has accounted for less than 5 percent to 7 percent of the final price.[3] One of the chief roles of marketing channels is to convert potential buyers into profitable customers. Marketing channels must not just *serve* markets, they must also *make* them.[4]

The channels chosen affect all other marketing decisions. The company's pricing depends on whether it uses online discounters or high-quality boutiques. Its sales force and advertising decisions depend on how much training and motivation dealers need. In addition, channel decisions include relatively long-term commitments with other firms as well as a set of policies and procedures. When an automaker signs up independent dealers to sell its automobiles, it cannot buy them out the next day and replace them with company-owned outlets. But at the same time, channel choices themselves depend on the company's marketing strategy with respect to segmentation, targeting, and positioning. Holistic marketers ensure that marketing decisions in all these different areas are made to maximize value overall.

In managing its intermediaries, the firm must decide how much effort to devote to push and to pull marketing. A **push strategy** uses the manufacturer's sales force, trade promotion money, or other means to induce intermediaries to carry, promote, and sell the product to end users. This strategy is particularly appropriate when there is low brand loyalty in a category, brand choice is made in the store, the product is an impulse item, and product benefits are well understood.

In a **pull strategy** the manufacturer uses advertising, promotion, and other forms of communication to persuade consumers to demand the product from intermediaries, thus inducing the intermediaries to order it. This strategy is particularly appropriate when there is high brand loyalty and high involvement in the category, when consumers are able to perceive differences between brands, and when they choose the brand before they go to the store.

Top marketing companies such as Apple, Coca-Cola, and Nike skillfully employ both push *and* pull strategies. A push strategy is more effective when accompanied by a well-designed and well-executed pull strategy that activates consumer demand. On the other hand, without at least some consumer interest, it can be very difficult to gain much channel acceptance and support, and vice versa for that matter.

MULTICHANNEL MARKETING

Today's successful companies typically employ **multichannel marketing**, using two or more marketing channels to reach customer segments in one market area. HP uses its sales force to sell to large accounts, outbound telemarketing to sell to medium-sized accounts, direct mail with an inbound phone number to sell to small accounts, retailers to sell to still smaller accounts, and the Internet to sell specialty items. Each channel can target a different segment of buyers, or different need states for one buyer, to deliver the right products in the right places in the right way at the least cost.

When this doesn't happen, channel conflict, excessive cost, or insufficient demand can result. Launched in 1976, Dial-a-Mattress successfully grew for three decades by selling mattresses directly over the phone and later online. A major expansion into 50 brick-and-mortar stores in major metro areas was a failure, however. Secondary locations, chosen because management considered prime locations too expensive, could not generate enough customer traffic. The company eventually declared bankruptcy.[5]

On the other hand, when a major catalog and Internet retailer invested significantly in brick-and-mortar stores, different results emerged. Customers near the store purchased through the catalog less frequently, but their online purchases were unchanged. As it turned out, customers who liked to spend time browsing were happy to either use a catalog or visit the store; those channels were interchangeable. Customers who shopped online, on the other hand, were more transaction-focused and interested in efficiency, so they were less affected by the introduction of stores. Returns and exchanges at the stores were found to increase because of ease and accessibility, but extra purchases made by customers returning or exchanging at the store offset any revenue deficit.[6]

Research has shown that multichannel customers can be more valuable to marketers.[7] Nordstrom found that its multichannel customers spend four times as much as those who only shop through one channel, though some academic research suggests that this effect is stronger for hedonic products (apparel and cosmetics) than for functional products (office and garden supplies).[8]

INTEGRATING MULTICHANNEL MARKETING SYSTEMS

Most companies today have adopted multichannel marketing. Disney sells its videos through multiple channels: movie rental merchants such as Netflix and Redbox, Disney Stores (now owned and run by The Children's Place), retail stores such as Best Buy, online retailers such as Disney's own online stores and Amazon.com, and the Disney Club catalog and other catalog sellers. This variety affords Disney maximum market coverage and enables it to offer its videos at a number of price points.[9] Here are some of the channel options for leather-goods maker Coach.[10]

COACH Coach markets a high-end line of luxury handbags, briefcases, luggage, and accessories. In its 2013 fiscal year 10-K, the company describes its multichannel global distribution model as follows: "Coach products are available in image-enhancing locations globally wherever our consumer chooses to shop including: retail stores and factory outlets, directly operated shop-in-shops, online, and department and specialty stores. This allows Coach to maintain a dynamic balance as results do not depend solely on the performance of a single channel or geographic area." The North America segment consists of direct-to-consumer and indirect channels and includes sales to consumers through 351 company-operated retail stores, including the Internet, and sales to wholesale customers and distributors. Coach began as a U.S. wholesaler and still sells to 1,000 U.S. department-store locations, such as Macy's (including Bloomingdale's), Dillard's, Nordstrom, Saks Fifth Avenue, and Lord & Taylor, often within a tightly controlled shop-within-a-shop, as well as on some of those retailer's Web sites. This segment represented approximately 69 percent of the company's total net sales in fiscal 2013. The International segment sells to consumers online and through company-operated stores in Japan and mainland China, Hong Kong, Macau, Singapore, Taiwan, Malaysia, and Korea and to wholesale customers and distributors. Coach also has store-in-store offerings in Japan and China inside major department stores. The International segment represented approximately 31 percent of total net sales in fiscal 2013. Finally, Coach has licensing relationships with Movado (watches), Jimlar (footwear), and Marchon (eyewear). These licensed products are sometimes sold in other channels such as jewelry stores, high-end shoe stores, and optical retailers as Coach continues to broaden its meaning from a "bag brand" to a whole lifestyle brand.

Source: © Jeff Greenberg "0 people images"/Alamy

Coach uses a broad range of channels to better sell its expanding product lines.

Companies are increasingly employing digital distribution strategies, selling directly online to customers or through e-merchants who have their own Web sites. In doing so, these companies are seeking to achieve **omnichannel marketing**, in which multiple channels work seamlessly together and match each target customer's preferred ways of doing business, delivering the right product information and customer service regardless of whether customers are online, in the store, or on the phone.

An **integrated marketing channel system** is one in which the strategies and tactics of selling through one channel reflect the strategies and tactics of selling through one or more other channels. Adding more channels gives companies three important benefits. The first is increased market coverage. Not only are more customers able to shop for the company's products in more places, as noted above, but those who buy in more than one channel are often more profitable than single-channel customers.[11] The second benefit is lower channel cost—selling online or by catalog and phone is cheaper than using personal selling to reach small customers. The third is the ability to do more customized selling—such as by adding a technical sales force to sell complex equipment.

There is a trade-off, however. New channels typically introduce conflict and problems with control and cooperation. Two or more may end up competing for the same customers.[12] Clearly, companies need to think through their channel architecture and determine which channels should perform which functions.[13] Figure 17.1 shows a simple grid to help make channel architecture decisions. It consists of major marketing channels (as rows) and the major channel tasks to be completed (as columns).[14]

The grid illustrates why using only one channel is typically not efficient. Consider a direct sales force. A salesperson would have to find leads, qualify them, presell, close the sale, provide service, and manage account growth. With an integrated multichannel approach, however, the company's marketing department could run a preselling campaign informing prospects about the company's products through advertising, direct mail, and e-mails; generate leads through telemarketing, more e-mails, and trade shows; and qualify leads as hot, warm, or cool. The salesperson enters when the prospect is ready to talk business and invests his or her costly time primarily in closing the sale. This multichannel architecture optimizes coverage, customization, and control while minimizing cost and conflict.

Companies should use different sales channels for different-sized business customers—a direct sales force for large customers, a digital strategy or telemarketing for midsize customers, and distributors for small customers—but be alert for conflict over account ownership. For example, territory-based sales representatives may want credit for all sales in their territories, regardless of the marketing channel used.

Multichannel marketers also need to decide how much of their product to offer in each of the channels. Patagonia views the Web as the ideal channel for showing off its entire line of goods, given that its 88 retail

Demand-generation Tasks

Marketing Channels and Methods		Gather relevant information	Develop & disseminate communications	Reach price agreements	Place orders	Acquire funds for inventories	Assume risks	Facilitate product storage & movement	Facilitate payment	Oversee ownership transfer	
VENDOR	Internet										CUSTOMER
	National account management										
	Direct sales										
	Telemarketing										
	Direct mail										
	Retail stores										
	Distributors										
	Dealers and value-added resellers										

| Fig. 17.1 |

The Hybrid Grid

Source: Adapted from Rowland T. Moriarty and Ursula Moran, "Marketing Hybrid Marketing Systems," *Harvard Business Review*, November–December, 1990, p. 150.

Source: © ZUMA Press, Inc/Alamy

Outdoor equipment supplier REI is known for its seamless blending of online and offline channels.

locations are limited by space to offering a selection only, and even its catalog promotes less than 70 percent of its total merchandise.[15] Other marketers prefer to limit their online offerings, theorizing that customers look to Web sites and catalogs for a "best of" array of merchandise and don't want to have to click through dozens of pages. Here's a company that has carefully managed its multiple channels.[16]

REI Outdoor equipment supplier REI has been lauded by industry analysts for the seamless integration of its retail store, Web site, Internet kiosks, mail-order catalogs, value-priced outlets, mobile app, and toll-free order number. If an item is out of stock in the store, all customers need to do is tap into the store's Internet kiosk to order it from REI's Web site. Less Internet-savvy customers can have clerks place the order for them at the checkout counters. And REI not only generates store-to-Internet traffic, it also sends online shoppers into its stores. If a customer browses REI's site and stops to read an REI "Learn and Share" article on backpacking, the site might highlight an in-store promotion on hiking boots. To create a more common experience across channels, the specific icons and information used in ratings and reviews on REI.com also appear on in-store product displays. Like many retailers, REI has found that dual-channel shoppers spend significantly more than single-channel shoppers, and tri-channel shoppers spend even more. For example, one of every three people who buy something online will spend an additional $90 in the store when they come to pick that purchase up.

VALUE NETWORKS

A supply chain view of a firm sees markets as destination points and amounts to a linear view of the flow of ingredients and components through the production process to their ultimate sale to customers. The company should first think of the target market, however, and then design the supply chain backward from that point. This strategy has been called **demand chain planning**.[17]

A broader view sees a company at the center of a **value network**—a system of partnerships and alliances that a firm creates to source, augment, and deliver its offerings. A value network includes a firm's suppliers and its suppliers' suppliers and its immediate customers and their end customers. It also incorporates valued relationships with others such as university researchers and government approval agencies.

A company needs to orchestrate the work of these parties to deliver superior value to the target market. Oracle relies on 15 million developers—the largest developer community in the world.[18] Apple Developer—where folks create iPhone apps for the Apple operating system—has 275,000 registered iOS members. Developers keep 70 percent of any revenue their products generate; Apple gets 30 percent. After releasing more than 850,000 apps that were downloaded 45 billion times in the first five years, Apple has paid out almost $9 billion.[19]

Demand chain planning yields several insights.[20] First, the company can estimate whether more money is made upstream or downstream, in case it can integrate backward or forward. Second, the company is more aware of disturbances anywhere in the supply chain that might change costs, prices, or supplies. Third, companies can go online with their business partners to speed communications, transactions, and payments; reduce costs; and increase accuracy. Ford not only manages numerous supply chains but also sponsors many B-to-B Web sites and exchanges.

Managing a value network means making increasing investments in information technology (IT) and software. Firms have introduced supply chain management (SCM) software and invited such software firms as SAP and Oracle to design comprehensive *enterprise resource planning* (ERP) systems to manage cash flow, manufacturing, human resources, purchasing, and other major functions within a unified framework. They hope to break up departmental silos—in which each department acts only in its own self-interest—and carry out core business processes more seamlessly. Most, however, are still a long way from truly comprehensive ERP systems.

Marketers, for their part, have traditionally focused on the side of the value network that looks toward the customer, adopting customer relationship management (CRM) software and practices. In the future, they will increasingly participate in and influence their companies' upstream activities and become network managers, not just product and customer managers.

THE DIGITAL CHANNELS REVOLUTION

The digital revolution is profoundly transforming distribution strategies. With customers—both individuals and businesses—becoming more comfortable buying online and the use of smart phones exploding, traditional brick-and-mortar channel strategies are being modified or even replaced.

Online retail sales (or e-commerce) have been growing at a double-digit rate; apparel and accessories, consumer electronics, and computer hardware are the three fastest-growing categories. Skeptics initially felt apparel wouldn't sell well online, but easy returns, try-on tools, and customer reviews have helped counter the inability to try clothes on in the store.

As brick-and-mortar retailers promote their online ventures and other companies bypass retail activity by selling online, they all are embracing new practices and policies. As in all marketing, customers hold the key. Customers want the advantages both of digital—vast product selection, abundant product information, helpful customer reviews and tips—and of physical stores—highly personalized service, detailed physical examination of products, an overall event and experience. They expect seamless channel integration so they can:[21]

- Enjoy helpful customer support in a store, online, or on the phone
- Check online for product availability at local stores before making a trip
- Find out in-store whether a product that is unavailable can be purchased and shipped from another store to home
- Order a product online and pick it up at a convenient retail location
- Return a product purchased online to a nearby store of the retailer
- Receive discounts and promotional offers based on total online and offline purchases

Retailers and manufacturers are responding. Consider some of the changes being made by retail giant Walmart.[22]

WALMART With a huge investment in brick-and-mortar stores, many entrenched executives, and long-established policies, Walmart was slow to embrace online and mobile technology and had online operations accounting for less than 2 percent of its global sales. Then the company decided to make its digital strategy a priority, giving customers anytime, anywhere access to Walmart by combining mobile, online, and physical stores. After acquiring social-media start-up Kosmix, known for its strong expertise in search and analytics, it established its @WalmartLabs group in Silicon Valley, leading to company innovations such as smart-phone payment technology, mobile shopping applications, and Twitter-influenced product selection for stores. Walmart found that many of its core customer group who made $30,000 to $60,000 a year were shopping from its Web site in large numbers and often on smart phones rather than computers. Always a wizard with logistics, Walmart adopted a "ship from store" practice that uses its more than 4,000 U.S. stores as warehouses to fulfill online orders quickly. The company is also exploring same-day shipping. It improved the search engine on its Web site, increasing its "browsers to buyers" conversion by as much as 15 percent; launched its Shopycat gift recommendation app, which uses social media to suggest gifts; introduced its Scan and Go app so customers can automatically apply coupons when checking out; and added an in-aisle mobile-scanning system to speed check-out. A top priority for Walmart is its smart-phone app. Users of the app spend more and frequent the store twice as often as non-users. When near a store, the app flips into "store mode" to help locate items on a shopping list and make additional recommendations, provide a digital version of the latest circulars, and highlight new products available in the store.

Retailers and manufacturers are assembling massive amounts of social, mobile, and location (SoMoLo) information they can mine to learn about their customers. They are using software that closely monitors what's selling where and at what price in order to adjust their offerings and prices.[23] The goal for many marketers is to develop a

Source: © IanDagnall Computing/Alamy

By skillfully combining mobile, online, and physical stores, Walmart's goal is to give customers access to its merchandise anytime, anywhere.

customized "next best offer" (NBO) that takes into account customers' attitudes and behavior, purchase (product or service), and shopping channel (in store or online) and the marketer's goal with respect to those consumers, whether it is to increase sales, say, or build loyalty.[24]

The Role of Marketing Channels

Why does a producer delegate some of the selling job to intermediaries, relinquishing control over how and to whom its products are sold? Through their contacts, experience, specialization, and scale of operation, intermediaries make goods widely available and accessible to target markets, offering more effectiveness and efficiency than the selling firm could achieve on its own.[25]

Source: © michael going/Alamy

Many manufacturers would find it cost prohibitive to open up their own stores—their best options are to tap into established dealer and retailer networks.

TABLE 17.1 Channel Member Functions

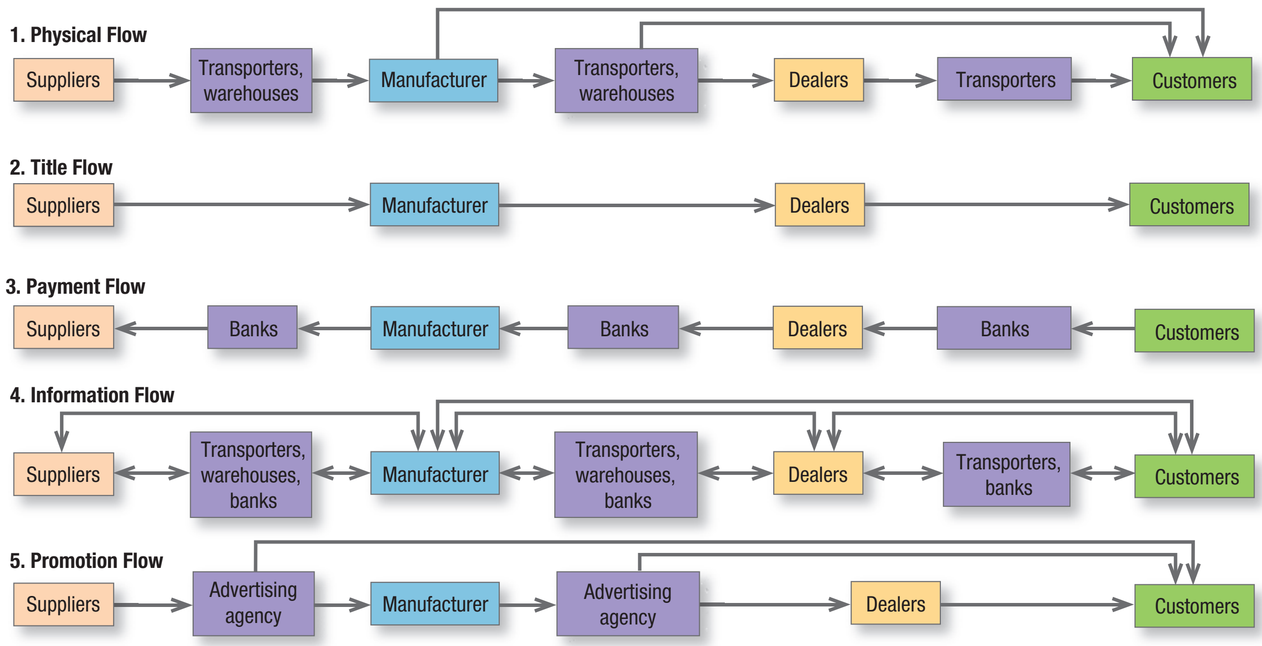
- Gather information about potential and current customers, competitors, and other actors and forces in the marketing environment.
- Develop and disseminate persuasive communications to stimulate purchasing.
- Negotiate and reach agreements on price and other terms so that transfer of ownership or possession can be affected.
- Place orders with manufacturers.
- Acquire the funds to finance inventories at different levels in the marketing channel.
- Assume risks connected with carrying out channel work.
- Provide for the successive storage and movement of physical products.
- Provide for buyers' payment of their bills through banks and other financial institutions.
- Oversee actual transfer of ownership from one organization or person to another.

Many producers lack the financial resources and expertise to sell directly on their own. The William Wrigley Jr. Company would not find it practical to establish small retail gum shops throughout the world or to sell gum online or by mail order. It is easier to work through the extensive network of privately owned distribution organizations. Even Ford would be hard-pressed to replace all the tasks done by its almost 8,500 dealer outlets worldwide.[26]

CHANNEL FUNCTIONS AND FLOWS

A marketing channel performs the work of moving goods from producers to consumers. It overcomes the time, place, and possession gaps that separate goods and services from those who need or want them. Members of the marketing channel perform a number of key functions (see Table 17.1).

Some of these functions (storage and movement, title, and communications) constitute a *forward flow* of activity from the company to the customer; others (ordering and payment) constitute a *backward flow* from customers to the company. Still others (information, negotiation, finance, and risk taking) occur in both directions. Five flows are illustrated in Figure 17.2 for the marketing of forklift trucks. If these flows were superimposed in one diagram, we would see the tremendous complexity of even simple marketing channels.



| Fig. 17.2 |

Five Marketing Flows in the Marketing Channel for Forklift Trucks

A manufacturer selling a physical product and services might require three channels: a *sales channel,* a *delivery channel,* and a *service channel.* To sell its Bowflex fitness equipment, the Nautilus Group historically has emphasized direct marketing via television infomercials and ads, inbound/outbound call centers, response mailings, and the Internet as sales channels; UPS ground service as the delivery channel; and local repair people as the service channel. Reflecting shifting consumer buying habits, Nautilus now also sells Bowflex through regional and national retailers such as Sears and Dick's Sporting Goods as well as through online merchants such as Amazon.com.

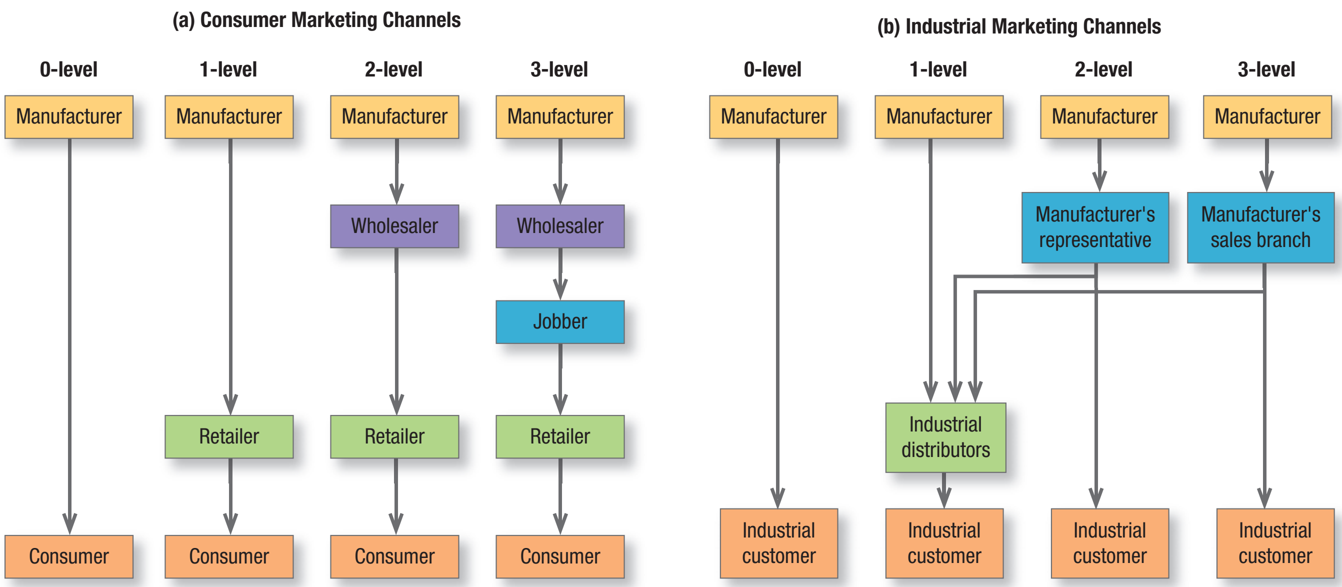
The question for marketers is not *whether* various channel functions need to be performed—they must be—but, rather, *who* is to perform them. All channel functions have three characteristics in common: They use up scarce resources; they can often be performed better through specialization; and they can be shifted among channel members. Shifting some functions to intermediaries lowers the producer's costs and prices, but the intermediary must add a charge to cover its work. If the intermediaries are more efficient than the manufacturer, prices to consumers should be lower. If consumers perform some functions themselves, they should enjoy even lower prices. Changes in channel institutions thus largely reflect the discovery of more efficient ways to combine or separate the economic functions that provide assortments of goods to target customers.

CHANNEL LEVELS

The producer and the final customer are part of every channel. We will use the number of intermediary levels to designate the length of a channel. Figure 17.3(a) illustrates several consumer-goods marketing channels of different lengths.

A **zero-level channel**, also called a **direct marketing channel**, consists of a manufacturer selling directly to the final customer. The major examples are mail order, online selling, TV selling, telemarketing, door-to-door sales, home parties, and manufacturer-owned stores. Traditionally, Franklin Mint sold collectibles through mail order; Red Envelope sold gifts online; Time-Life sold music and video collections through TV commercials or longer "infomercials"; nonprofits and political organizations and candidates use the telephone to raise funds; Avon sales representatives sold cosmetics door to door; Tupperware sold its containers via in-home parties; and Apple sold computers and other consumer electronics through its own stores. Many of these firms now sell directly to customers online and via catalogs. Even traditional consumer-product firms are considering adding direct-to-consumer e-commerce sites to their channel mix. Kimberly-Clark launched an online Kleenex Shop in the United Kingdom.[27]

A *one-level channel* contains one selling intermediary, such as a retailer. A *two-level channel* contains two intermediaries, typically a wholesaler and a retailer, and a *three-level channel* contains three. In the meatpacking industry, wholesalers sell to **jobbers**, essentially small-scale wholesalers, who sell to small retailers. In Japan, food distribution may include as many as six levels. Obtaining information about end users and exercising control become more difficult for the producer as the number of channel levels increases.



| Fig. 17.3 |

Consumer and Industrial Marketing Channels

Figure 17.3(b) shows channels commonly used in B-to-B marketing. An industrial-goods manufacturer can use its sales force to sell directly to industrial customers, or it can sell to industrial distributors who sell to industrial customers, or it can sell through manufacturer's representatives or its own sales branches directly to industrial customers or indirectly to industrial customers through industrial distributors. Zero-, one-, and two-level marketing channels are quite common.

Channels normally describe a forward movement of products from source to user, but *reverse-flow channels* are also important (1) to reuse products or containers (such as refillable chemical-carrying drums), (2) to refurbish products for resale (such as circuit boards or computers), (3) to recycle products, and (4) to dispose of products and packaging. Reverse-flow intermediaries include manufacturers' redemption centers, community groups, trash-collection specialists, recycling centers, trash-recycling brokers, and central processing warehousing.

SERVICE SECTOR CHANNELS

Many of the most successful new banks, insurance and travel companies, and stock brokerages have emerged with strictly or largely online operations, such as Ally banking, Esurance insurance, Expedia travel, and E*TRADE investments. Marketing channels also keep changing for "person marketing." Besides providing live and programmed entertainment, entertainers, musicians, and other artists can reach prospective and existing fans online in many ways—through their own Web sites, on social community sites such as Facebook and Twitter, and through third-party Web sites. Politicians also must choose a mix of channels—mass media, rallies, coffee hours, spot TV ads, direct mail, billboards, faxes, e-mail, blogs, podcasts, Web sites, and social networking sites—for delivering their messages to voters.

Nonprofit service organizations such as schools develop education-dissemination systems and hospitals develop health-delivery systems. These institutions must figure out agencies and locations for reaching a far-flung population.[28]

CLEVELAND CLINIC One of the largest and most highly respected hospitals in the country, Cleveland Clinic provides medical care in a variety of ways and settings. Its main campus in Cleveland, 50 buildings on 166 acres, is its hub for patient care, research, and education. The clinic also operates 16 full-service Family Health Centers in the suburbs, while eight hospitals extend its reach in Northeast Ohio. Community outreach programs in all these areas provide patient education and free health screenings. Cleveland Clinic also offers major medical care in Florida, Toronto, and manages a Mubadala Development Company medical campus in Abu Dhabi, United Arab Eimireates, scheduled to begin seeing patients in 2015. It has a suite of secure online health services for both patients and physicians and is developing partnerships with Google and Microsoft to extend its online capabilities.

Source: © Philip Scalia/Alamy

Cleveland Clinic has a comprehensive health-delivery system to provide different kinds of medical care to different markets.

Channel-Design Decisions

To design a marketing channel system, marketers analyze customer needs and wants, establish channel objectives and constraints, and identify and evaluate major channel alternatives.

ANALYZING CUSTOMER NEEDS AND WANTS

Consumers may choose the channels they prefer based on price, product assortment, and convenience as well as their own shopping goals (economic, social, or experiential).[29] Channel segmentation exists, and marketers must be aware that different consumers have different needs during the purchase process.

Even the same consumer, though, may choose different channels for different reasons.[30] As Chapter 16 described, some consumers are willing to "trade up" to retailers offering higher-end goods such as TAG Heuer watches or Callaway golf clubs and "trade down" to discount retailers for private-label paper towels, detergent, or vitamins.[31] Others may browse a catalog before visiting a store or test-drive a car at a dealership before ordering online. "Marketing Insight: Understanding the Showrooming Phenomena" describes some of the new ways customers are using multiple channels as they make their purchases.

Channels produce five service outputs:

1. ***Desired lot size***—The number of units the channel permits a typical customer to purchase on one occasion. In buying cars for its fleet, Hertz prefers a channel from which it can buy a large lot size; a household wants a channel that permits a lot size of one.

marketing insight

Understanding the Showrooming Phenomena

Consumers have always shopped around to get the best deal or broaden their options, and now e-commerce and m-commerce (selling via mobile phone and tablet) offer them a new twist. **Showrooming** lets them physically examine a product and collect information in a store but make their actual purchase from the retailer later online or, in the store's least desirable outcome, from a different retailer altogether, typically to secure a lower price.

Showrooming has been given a boost by smart phones. Thanks to their mobile devices, consumers in stores have never been better equipped to decide whether they should buy. One study showed that more than half of U.S. mobile phone users, especially younger ones, have used their phones to ask for purchase advice from a friend or family member or to look for reviews or lower prices while shopping.

Retailers used to worry about getting consumers into the store, but experts note they now need to worry instead about selling to consumers who are bringing other stores in with them. Amazon's Price Check phone app, for instance, allows shoppers to instantly compare prices while in a brick-and-mortar store. Online retailers that mobile users can tap offer traditional brick-and-mortar chains serious competition because of their wide selections, lower prices (often with no taxes), and 24/7 convenience.

Mobile has become a top priority for many retailers as a means to combat showrooming. Target has expanded its use of mobile media, incorporating QR codes, text-to-buy features, and new checkout scanners to make mobile coupon redemption easier and faster. Forty percent of PetSmart's Web traffic comes from smart phones and tablets. eBay observed that 60 percent of e-mails sent by its retail clients were opened on mobile devices and more than half the time were transitioned to other devices to make the transaction.[32]

Addressing showrooming head-on, Best Buy and Target announced they would permanently match the prices of online retailers. Others have more closely linked their stores and Web sites in response to the trend. Walmart, Macy's, and Best Buy allow in-store pickup of online orders and returns of online purchases.

Many retailers are making the in-store experience more informative and rewarding. Guess, PacSun, and Aéropostale are equipping in-store sales staff with iPads or tablets for collecting more in-depth product information to share with shoppers. Shoppers enrolled in loyalty programs can also quickly download their purchase histories, product preferences, and other useful background.

The main goal of all these efforts is to hold on to the customer. One study found that 70 percent of a showrooming audience was more likely to buy from retailers with well-designed Web sites and apps, strong multichannel support, and price comparisons via QR codes. Shifting sales from a store to online can actually be more profitable for a retailer if it prevents the customer from buying elsewhere.

Sources: "Showrooming Threat Hits Major Chains," www.warc.com, March 1, 2013; "'Showrooming' Grows in U.S.," www.warc.com, February 4, 2013; "Showrooming to Shape U.S. Holiday Sales," www.warc.com, November 16, 2012; Hadley Malcolm, "Smartphones to Play Bigger Role in Shopping," *USA Today*, November 15, 2012; Maribel Lopez, "Can Omni-Channel Retail Combat Showrooming," *Forbes*, October 22, 2012; Australian School of Business, "Stop Customers Treating Your Business as a Showroom," www.smartcompany.com.au, October 8, 2012.

2. ***Waiting and delivery time***—The average time customers wait for receipt of goods. Customers increasingly prefer faster delivery channels.
3. ***Spatial convenience***—The degree to which the marketing channel makes it easy for customers to purchase the product. Toyota offers greater spatial convenience than Lexus because there are more Toyota dealers, helping customers save on transportation and search costs in buying and repairing an automobile.
4. ***Product variety***—The assortment provided by the marketing channel. Normally, customers prefer a greater assortment because more choices increase the chance of finding what they need, though too many choices can sometimes create a negative effect.[33]
5. ***Service backup***—Add-on services (credit, delivery, installation, repairs) provided by the channel. The more service backup, the greater the benefit provided by the channel.

Providing more service outputs also means increasing channel costs and raising prices. The success of discount stores such as Walmart and Target and extreme examples like Dollar General and Family Dollar indicates that many consumers are willing to accept less service if they can save money.

ESTABLISHING OBJECTIVES AND CONSTRAINTS

Marketers should state their channel objectives in terms of the service output levels they want to provide and the associated cost and support levels. Under competitive conditions, channel members should arrange their functional tasks to minimize costs and still provide desired levels of service. Usually, planners can identify several market segments based on desired service and choose the best channels for each.

Channel objectives vary with product characteristics. Bulky products, such as building materials, require channels that minimize the shipping distance and the amount of handling. Nonstandard products such as custom-built machinery are sold directly by sales representatives. Products requiring installation or maintenance services, such as heating and cooling systems, are usually sold and maintained by the company or by franchised dealers. High-unit-value products such as generators and turbines are often sold through a company sales force rather than intermediaries.

Marketers must adapt their channel objectives to the larger environment. When economic conditions are depressed, producers want to move goods to market using shorter channels and without services that add to the final price. Legal regulations and restrictions also affect channel design. U.S. law looks unfavorably on channel arrangements that substantially lessen competition or create a monopoly.

In entering new markets, firms often closely observe what other firms are doing. French retailer Auchan considered the presence of its French rivals Leclerc and Casino in Poland as key to its decision to also enter that market.[34] Apple's channel objective of creating a dynamic retail experience for consumers was not being met by existing channels, so it chose to open it own stores.[35]

APPLE STORES When Apple launched its stores in 2001, many questioned their prospects; *BusinessWeek* published an article titled "Sorry Steve, Here's Why Apple Stores Won't Work." Just five years later, the company was celebrating the launch of its spectacular Manhattan showcase. By the end of 2013, it had taken in global sales of $16 billion from more than 400 stores in North America, Europe, and Asia, about 20 percent of total corporate revenue. Roughly 30,000 of Apple's 43,000 U.S. employees work in its stores. Annual sales per square foot were estimated to be $4,406 in 2011—the Fifth Avenue location reportedly earns a staggering $35,000 per square foot–compared with Tiffany's $3,070, Coach's $1,776, and Best Buy's $880. Any way you look at them, Apple Stores have also been an unqualified success in fueling excitement for the brand. They let people see and touch the products—and experience what Apple can do for them—making it more likely they'll become customers. They target tech-savvy customers with in-store product presentations and workshops; a full line of Apple products, software, and accessories; and a "Genius Bar" staffed by specialists who provide technical support, often free of charge. Apple's meticulous attention to detail is reflected in the preloaded music and photos on demo devices, innovative touches such as roving credit-card swipers to minimize checkout lines, and hours invested in employee training. Employees receive no sales commissions and have no sales quotas. They are told their mission is to "help customers solve problems." Although the stores initially upset existing Apple retailers, the company worked hard to smooth relationships, in part justifying its decision as a natural evolution of its online sales channel.

Source: © Trevor Mogg/Alamy

Although some predicted it would fail, Apple Stores have become an unqualified success both financially and as a brand builder.

IDENTIFYING MAJOR CHANNEL ALTERNATIVES

Each channel—from sales forces to agents, distributors, dealers, direct mail, telemarketing, and the Internet—has unique strengths and weaknesses. Sales forces can handle complex products and transactions, but they are expensive. The Internet is inexpensive but may not be as effective for complex products. Distributors can create sales, but the company loses direct contact with customers. Several clients can share the cost of manufacturers' reps, but the selling effort is less intense than company reps provide.

Channel alternatives differ in three ways: the types of intermediaries, the number needed, and the terms and responsibilities of each. Let's look at these factors.

TYPES OF INTERMEDIARIES Consider the channel alternatives identified by a consumer electronics company that produces satellite radios. It could sell its players directly to automobile manufacturers to be installed as original equipment, auto dealers, rental car companies, or satellite radio specialist dealers through a direct sales force or through distributors. It could also sell its players through company stores, online retailers, mail-order catalogs, or mass merchandisers such as Best Buy.

Sometimes a company chooses a new or unconventional channel because of the difficulty, cost, or ineffectiveness of working with the dominant channel. When video rental stores were rapidly declining, Coinstar successfully introduced the Redbox chain of conveniently located DVD- and game-rental kiosks.[36] Netflix is quickly moving away from the revolutionary channel that brought it much success—direct mail—to capitalize on a new one.[37]

NETFLIX Convinced that DVDs were the home video medium of the future, Netflix founder Reed Hastings came up with a new form of rental distribution via mail order in 1997. The company quickly developed strong customer loyalty and positive word of mouth with its modest subscription fees (as low as $9 a month), usually overnight delivery, and extensive library of thousands of movies and television episodes with no late fees. The service also had proprietary software that let customers search for obscure films and discover new ones. To improve the quality of its searches, Netflix sponsored a well-publicized million-dollar contest that drew thousands of entrants; the winning solution was expected to make its recommendation algorithm twice as effective. With new competition from thousands of Redbox rental kiosks and Amazon.com's download services, Netflix began emphasizing streaming videos and instantaneous delivery mechanisms. After an initial misstep, the firm split the two businesses and charges roughly $8 a month each for physical DVDs and for a streaming download plan. It is now the single-largest source of download traffic in North America, making up more than a third of the total, but it still anticipates growth in DVD rentals from its more than 40 million subscribers. Netflix's success has also captured Hollywood's attention. The company's online communities of customers who read and post reviews and feedback can be an important source of fans for films. Netflix is also creating its own award-winning television programming and has moved into international markets in Canada, Europe, and Latin America.

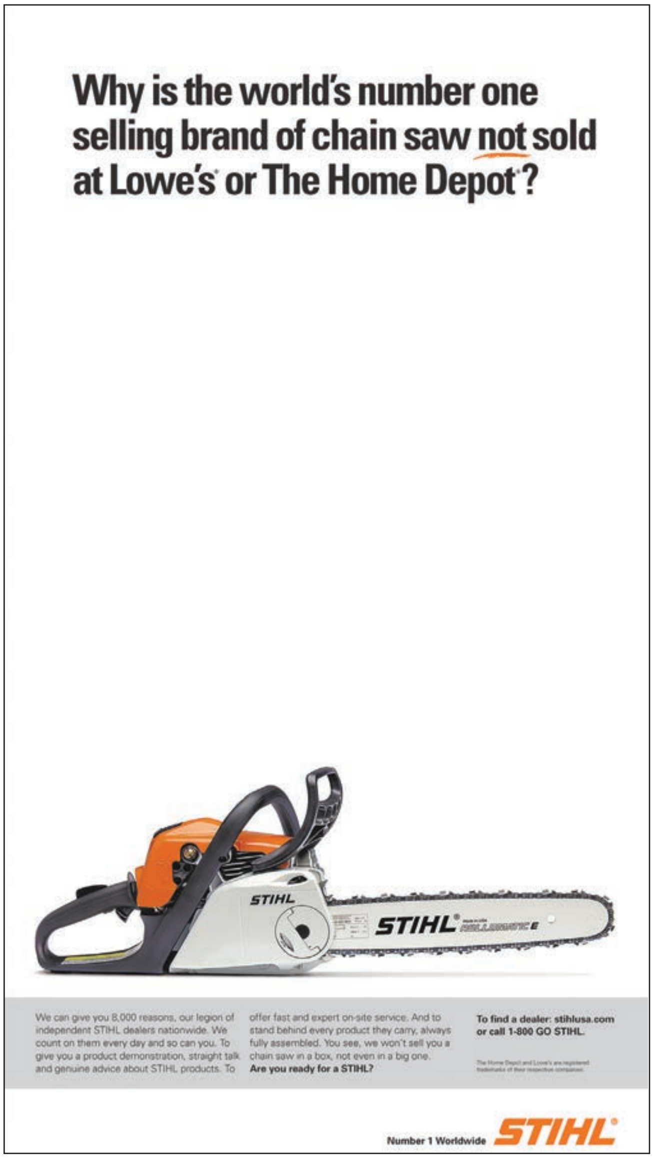
NUMBER OF INTERMEDIARIES Three strategies based on the number of intermediaries are exclusive, selective, and intensive distribution.

Exclusive distribution severely limits the number of intermediaries. It's appropriate when the producer wants to ensure more knowledgeable and dedicated efforts by the resellers, and it often requires a closer partnership with them. Exclusive distribution is used for new automobiles, some major appliances, and some women's apparel brands.

Exclusive distribution often includes *exclusive dealing* arrangements, especially in markets increasingly driven by price. When the legendary Italian designer label Gucci found its image severely tarnished by overexposure from licensing and discount stores, it decided to end contracts with third-party suppliers, control its distribution, and open its own stores to bring back some of the luster.[38]

Selective distribution relies on only some of the intermediaries willing to carry a particular product. Whether established or new, the company does not need to worry about having too many outlets; it can gain adequate market coverage with more control and less cost than intensive distribution. STIHL is a good example of successful selective distribution.[39]

STIHL STIHL manufactures handheld outdoor power equipment. All its products are branded under one name, and it does not make private labels for other companies. Best known for its chain saws, the company has expanded into string trimmers, blowers, hedge trimmers, and cut-off machines. It sells exclusively to six independent U.S. distributors and six company-owned marketing and distribution centers, which sell to a nationwide network of more than 8,000 independent retail dealers offering service. STIHL also exports to 80 countries and is one of the few outdoor-power-equipment companies not selling through mass merchants, catalogs, or the Internet. It even ran an ad campaign called "Why" that touted the strength and support of its independent dealers with headlines such as "Why is the World's No. 1-selling brand of chain saw not sold at Lowe's or The Home Depot?" and "What makes this handblower too powerful to be sold at Lowe's or The Home Depot?"



Source: STIHL Incorporated

Stihl has successfully adopted a selective distribution strategy that bypasses mass merchants, catalogs and the Internet.

Intensive distribution places the goods or services in as many outlets as possible. This strategy serves well for snack foods, soft drinks, newspapers, candies, and gum—products consumers buy frequently or in a variety of locations. Convenience stores such as 7-Eleven and Circle K and gas-station outlets like ExxonMobil's On the Run survive by providing simple location and time convenience.

Manufacturers are constantly tempted to move from exclusive or selective distribution to more intensive distribution to increase coverage and sales. This strategy may help in the short term, but if not done properly, it can hurt long-term performance by encouraging retailers to compete aggressively. Price wars can then erode profitability, dampening retailer interest and harming brand equity. Some firms do not want to be sold everywhere. After Sears acquired discount chain Kmart, Nike pulled all its products from Sears to make sure Kmart could not carry the brand.[40]

TERMS AND RESPONSIBILITIES OF CHANNEL MEMBERS

Each channel member must be treated respectfully and be given the opportunity to be profitable. The main elements in the "trade relations mix" are price policies, conditions of sale, territorial rights, and specific services to be performed by each party.

- ***Price policy*** calls for the producer to establish a price list and schedule of discounts and allowances that intermediaries see as equitable and sufficient.
- ***Conditions of sale*** refers to payment terms and producer guarantees. Most producers grant cash discounts to distributors for early payment. They might also offer a guarantee against defective merchandise or price declines, creating an incentive to buy larger quantities.
- ***Distributors' territorial rights*** define the distributors' territories and the terms under which the producer will enfranchise other distributors. Distributors normally expect to receive full credit for all sales in their territory, whether or not they did the selling.
- ***Mutual services and responsibilities*** must be carefully spelled out, especially in franchised and exclusive-agency channels. McDonald's provides franchisees with a building, promotional support, a record-keeping system, training, and general administrative and technical assistance. In turn, franchisees are expected to satisfy company standards for the physical facilities, cooperate with new promotional programs, furnish requested information, and buy supplies from specified vendors, as well as pay monthly franchisee fees.

EVALUATING MAJOR CHANNEL ALTERNATIVES

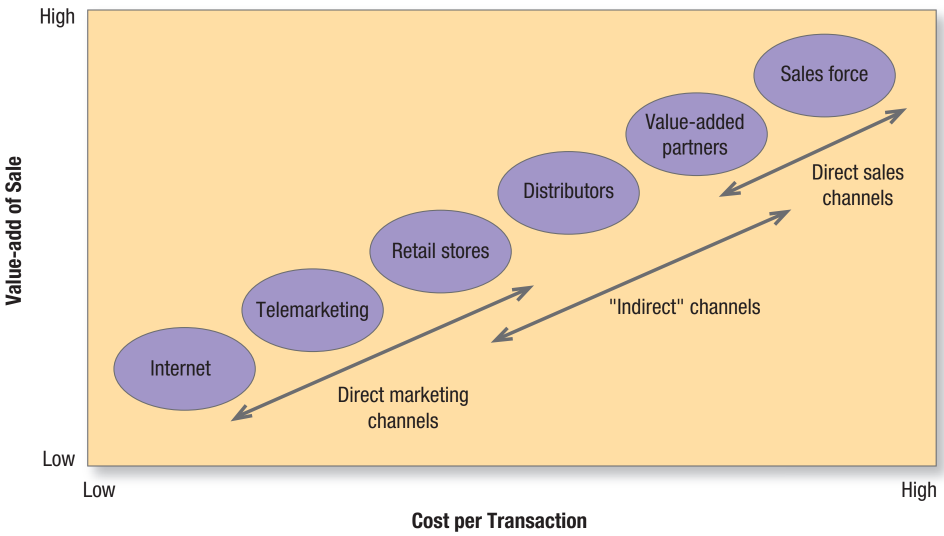
Each channel alternative needs to be evaluated against economic, control, and adaptive criteria.

ECONOMIC CRITERIA Every channel member will produce a different level of sales and costs. Figure 17.4 shows how six different sales channels stack up in terms of the value added per sale and the cost per transaction. For example, in the sale of industrial products costing between $2,000 and $5,000, the cost per transaction has been estimated at $500 (field sales), $200 (distributors), $50 (telesales), and $10 (Internet). A Booz Allen Hamilton study showed that at one time the average transaction at a full-service branch cost a bank $4.07, a phone transaction $.54, and an ATM transaction $.27, but a typical online transaction cost only $.01.[41]

Clearly, sellers try to replace high-cost channels with low-cost channels as long as the value added per sale is sufficient. Consider the following situation:

> A North Carolina furniture manufacturer wants to sell its line to retailers on the West Coast. One alternative is to hire 10 new sales representatives to operate out of a sales office in San Francisco and receive a base salary plus commissions. The other alternative is to use a San Francisco manufacturer's sales agency that has extensive contacts with retailers. Its 30 sales representatives would receive a commission based on their sales.

The first step is to estimate the dollar volume of sales each alternative will likely generate. A company sales force will concentrate on the company's products, be better trained to sell them, be more aggressive, and be more successful because many customers will prefer to deal directly with the company. The sales agency has 30 representatives, however, not just 10; it may be just as aggressive, depending on the commission level; customers may appreciate its independence; and it may have extensive contacts and market knowledge. The marketer needs to evaluate all these factors in formulating a demand function for the two different channels.



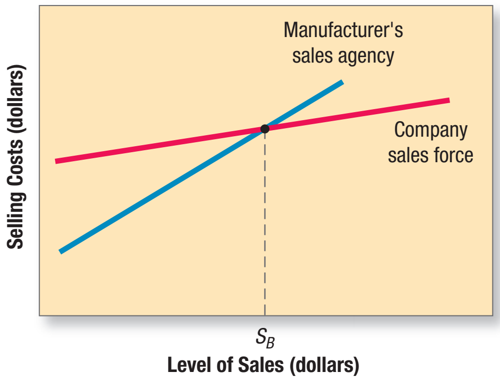
| Fig. 17.4 |

The Value-Adds versus Costs of Different Channels

Source: Oxford Associates, adapted from Dr. Rowland T. Moriarty. Cubex Corp.

| Fig. 17.5 |

Break-Even Cost Chart for the Choice between a Company Sales Force and a Manufacturer's Sales Agency



The next step is to estimate the costs of selling different volumes through each channel. The cost schedules are shown in Figure 17.5. Engaging a sales agency is less expensive, but costs rise faster because sales agents get larger commissions.

The final step is comparing sales and costs. As Figure 17.5 shows, there is one sales level (S_B) at which selling costs for the two channels are the same. The sales agency is thus the better channel for any sales volume below S_B, and the company sales branch is better at any volume above S_B. Given this information, it is not surprising that sales agents tend to be used by smaller firms or by large firms in smaller territories where the volume is low.

CONTROL AND ADAPTIVE CRITERIA Using a sales agency can pose a control problem. Agents may concentrate on the customers who buy the most, not necessarily those who buy the manufacturer's goods. They might not master the technical details of the company's product or handle its promotion materials effectively.

To develop a channel, members must commit to each other for a specified period of time. Yet these commitments invariably reduce the producer's ability to respond to change and uncertainty. The producer needs channel structures and policies that provide high adaptability.

Channel-Management Decisions

After a company has chosen a channel system, it must select, train, motivate, and evaluate intermediaries for each channel. It must also modify channel design and arrangements over time, including the possibility of expansion into international markets.

SELECTING CHANNEL MEMBERS

To customers, the channels are the company. Consider the negative impression customers would get of McDonald's, Shell Oil, or Mercedes-Benz if one or more of their outlets or dealers consistently appeared dirty, inefficient, or unpleasant.

To facilitate channel member selection, producers should determine what characteristics distinguish the better intermediaries—number of years in business, other lines carried, growth and profit record, financial strength, cooperativeness, and service reputation. If the intermediaries are sales agents, producers should evaluate the number and character of other lines carried and the size and quality of the sales force. If the intermediaries are department stores that want exclusive distribution, their locations, future growth potential, and type of clientele will matter.

TRAINING AND MOTIVATING CHANNEL MEMBERS

A company needs to view its intermediaries the same way it views its end users. It should determine their needs and wants and tailor its channel offering to provide them with superior value.

Carefully implemented training, market research, and other capability-building programs can motivate and improve intermediaries' performance. The company must constantly communicate that intermediaries are crucial partners in a joint effort to satisfy end users of the product. Microsoft requires its third-party service engineers to complete a set of courses and take certification exams. Those who pass are formally recognized as Microsoft Certified Professionals and can use this designation to promote their own business. Other firms use customer surveys rather than exams.

CHANNEL POWER Producers vary greatly in their skill in managing distributors. **Channel power** is the ability to alter channel members' behavior so they take actions they would not have taken otherwise.[42] Manufacturers can draw on the following types of power to elicit cooperation:

- ***Coercive power.*** A manufacturer threatens to withdraw a resource or terminate a relationship if intermediaries fail to cooperate. This power can be effective, but its exercise produces resentment and can lead the intermediaries to organize countervailing power.
- ***Reward power.*** The manufacturer offers intermediaries an extra benefit for performing specific acts or functions. Reward power typically produces better results than coercive power, but intermediaries may come to expect a reward every time the manufacturer wants a certain behavior to occur.
- ***Legitimate power.*** The manufacturer requests a behavior that is warranted under the contract. As long as the intermediaries view the manufacturer as a legitimate leader, legitimate power works.
- ***Expert power.*** The manufacturer has special knowledge the intermediaries value. Once the intermediaries acquire this expertise, however, expert power weakens. The manufacturer must continue to develop new expertise so intermediaries will want to continue cooperating.
- ***Referent power.*** The manufacturer is so highly respected that intermediaries are proud to be associated with it. Companies such as IBM, Caterpillar, and Hewlett-Packard have high referent power.[43]

Coercive and reward power are objectively observable; legitimate, expert, and referent power are more subjective and depend on the ability and willingness of parties to recognize them.

Most producers see gaining intermediaries' cooperation as a huge challenge. They often use positive motivators, such as higher margins, special deals, premiums, cooperative advertising allowances, display allowances, and sales contests. At times they will apply negative sanctions, such as threatening to reduce margins, slow down delivery, or terminate the relationship. The weakness of this approach is that the producer is using crude, stimulus-response thinking.

In many cases, retailers hold the power. One estimate is that manufacturers offer the nation's supermarkets between 150 and 250 new items each week, of which store buyers reject more than 70 percent. Manufacturers need to know the acceptance criteria buyers, buying committees, and store managers use. ACNielsen interviews found that store managers were most influenced by strong evidence of consumer acceptance, a well-designed advertising and sales promotion plan, and generous financial incentives.

CHANNEL PARTNERSHIPS More sophisticated companies try to forge a long-term partnership with distributors.[44] The manufacturer clearly communicates what it wants from its distributors in the way of market coverage, inventory levels, marketing development, account solicitation, technical advice and services, and marketing information and may introduce a compensation plan for adhering to the policies.

To streamline the supply chain and cut costs, many manufacturers and retailers have adopted *efficient consumer response (ECR) practices* to organize their relationships in three areas: (1) *demand-side management,* or collaborative practices to stimulate consumer demand by promoting joint marketing and sales activities, (2) *supply-side management,* or collaborative practices to optimize supply (with a focus on joint logistics and supply chain activities), and (3) *enablers and integrators*, or collaborative information technology and process improvement tools to support joint activities that reduce operational problems, allow greater standardization, and so on.

Research has shown that although ECR has a positive impact on manufacturers' economic performance and capability development, manufacturers may also feel they are inequitably sharing the burdens of adopting it and not getting as much as they deserve from retailers.[45]

EVALUATING CHANNEL MEMBERS

Producers must periodically evaluate intermediaries' performance against such standards as sales-quota attainment, average inventory levels, customer delivery time, treatment of damaged and lost goods, and cooperation in promotional and training programs. A producer will occasionally discover it is overpaying particular intermediaries for what they are actually doing. One manufacturer compensating a distributor for holding inventories found its goods were being held in a public warehouse at its own expense. Producers should set up functional discounts in which they pay specified amounts for the trade channel's performance of each agreed-upon service. Underperformers need to be counseled, retrained, motivated, or terminated.

MODIFYING CHANNEL DESIGN AND ARRANGEMENTS

No channel strategy remains effective over the whole product life cycle. In competitive markets with low entry barriers, the optimal channel structure will inevitably change over time. New technologies have created digital channels undreamed of years ago. The change could mean adding or dropping individual market channels or channel members or developing a totally new way to sell goods. When new competition from Best Buy and Costco forced one-third of Leica's U.S. dealers to close, the high-end camera maker decided to open its own stylish stores to appeal to serious photographers.[46]

CHANNEL EVOLUTION A new firm typically starts as a local operation selling in a fairly circumscribed market, using a few existing intermediaries. Identifying the best channels might not be a problem; the problem is often to convince the available intermediaries to handle the firm's line.

If the firm is successful, it might branch into new markets with different channels. In smaller markets, it might sell directly to retailers; in larger markets, through distributors. In rural areas, it might work with general-goods merchants; in urban areas, with limited-line merchants. It may choose to create its own online store to sell directly to customers. It might grant exclusive franchises or sell through all willing outlets. In one country, the firm might use international sales agents; in another, it might partner with a local firm.

Early buyers might be willing to pay for high-value-added channels, but later buyers will switch to lower-cost channels. Small office copiers were first sold by manufacturers' direct sales forces, later through office equipment dealers, still later through mass merchandisers, and now by mail-order firms and Internet marketers. In short, the channel system evolves as a function of local opportunities and conditions, emerging threats and opportunities, and company resources and capabilities.

CHANNEL MODIFICATION DECISIONS

A producer must periodically review and modify its channel design and arrangements.[47] The distribution channel may not work as planned, consumer buying patterns change, the market expands, new competition arises, innovative distribution channels emerge, and the product moves into later stages in the product life cycle.[48]

To add or drop individual channel members, the company needs to make an incremental analysis. Customer databases and sophisticated analysis tools can provide guidance.[49] A basic question is: What would the firm's sales and profits look like with and without this intermediary? Perhaps the most difficult decision is whether to revise the overall channel strategy.[50] Avon's door-to-door system for selling cosmetics was modified as more women left the house and entered the paid workforce.

GLOBAL CHANNEL CONSIDERATIONS

International markets pose distinct challenges, including variations in customers' shopping habits and the need to gain social acceptance or legitimacy among others, but opportunities do exist.[51] U.S. retailers such as The Limited and the Gap have become globally prominent. Dutch retailer Ahold and Belgian retailer Delhaize earn almost two-thirds and three-quarters of their sales, respectively, in nondomestic markets. Among foreign-based global retailers in the United States are Italy's Benetton, Sweden's IKEA home furnishings stores, and Japan's UNIQLO casual apparel retailer.

Developing markets have become a target for many retailers. Franchised companies such as Subway sandwich shops have experienced double-digit growth overseas, especially in Brazil and Central and Eastern Europe. In some cases, *master franchisees* pay a significant fee to acquire a territory or country where they operate as "mini-franchisers" in their own right. More knowledgeable about local laws, customs, and consumer needs than foreign companies, they sell and oversee franchises and collect royalties.[52]

In India, sales from "organized retail"—hypermarkets, supermarkets, and department stores—make up only a small percentage of the huge market. As Chapter 8 noted, most shopping still takes place in millions of independent grocery stores or *kirana* shops, which are run by their owners and are popular because they extend credit and deliver even small orders. India's complex regulations, poor infrastructure, and expensive real estate also make it a difficult market for retail chains to enter.[53]

China has similar logistical challenges, though a growing middle class offers opportunity and firms such as Best Buy, Coach, and the Gap are meeting with some success.[54] But many pitfalls exist in global expansion. The world's top three retailers—U.S.-based Walmart, UK-based Tesco, and France-based Carrefour—all have struggled to enter certain overseas markets. Consider the plight of Tesco.[55]

Source: © TJP/Alamy

Despite much consumer research and a sizable investment, British retailing giant Tesco's entry into the U.S. market, Fresh & Easy neighborhood markets, ultimately failed.

TESCO Tesco introduced its Fresh & Easy gourmet mini-supermarkets into California after much research that included spending time with U.S. families and videotaping the contents of their refrigerators. Fresh & Easy's 200 or so stores were roughly 10,000 square feet, about one-fifth the size of a standard U.S. supermarket but much bigger than a convenience store, with a focus on fresh-food offerings. Yet, after five unprofitable years and more than $1.6 billion in losses, Tesco decided to exit the market in 2013. A host of problems plagued the retailer. Its U.S. customers were unaccustomed to British-style ready meals, self-service cash registers, and unorthodox store layouts. Other complaints were that the product range was too narrow, there was no bakery and an underwhelming flower department, and the stores were physically too cold. The United States was not the only trouble spot for Tesco. The company had exited Japan the preceding year and was finding trouble in Central and Eastern Europe. While it focused on geographical expansion, its core supermarket business in the United Kingdom was neglected. Stores weren't properly staffed, fresh food was not properly maintained, and new private-label products were not introduced. The attempt to add non-grocery items like clothing and electronics proved difficult in a recession, and entry into new areas like banking and telephony was a distraction. After enduring six consecutive quarters of same-store sales declines in its home market, Tesco announced a $1.7 billion program to refresh its UK stores and a pull-back of its global ambitions.

The problems Tesco courted in the United Kingdom are a common downside of overly aggressive global expansion. Selling everything from food to televisions, Carrefour, the world's second-biggest retailer, has also encountered stiff competition at home, from smaller supermarkets for groceries and from specialist retailers such as IKEA for other goods. Although strong in some parts of Europe and Asia, Carrefour (which means "crossroads" in French) has been forced to cease operations in Japan, South Korea, Mexico, Czech Republic, Slovakia, Switzerland, and Portugal.[56]

The first step in global channel planning, as so often in marketing, is to get close to customers. To adapt its clothing lines to European tastes, Philadelphia-based Urban Outfitters set up a separate design and merchandising unit in London before it opened its first store in Europe. Although it increased costs, the distinctive blend of U.S. and European looks helped the retailer stand out, and it was one of the few fashion retailers to build strength during the recent recession.[57]

A good retail strategy that offers customers a positive shopping experience and unique value, if properly adapted, is likely to find success in more than one market. Take Topshop, for instance.[58]

Urban Outfitters carefully studied the European market to ensure its blend of fashion merchandise would appeal to consumer tastes there.

Source: © Loop Images Ltd/Alamy

TOPSHOP Founded by Sir Richard Green in 1994, British clothing retailer Topshop is a chain of more than 300 UK stores and 130 franchise stores in 37 countries that commands intense loyalty from its trendy, style-obsessed customer base. Selling primarily women's party clothes, accessories, and daywear, the chain blends English street fashion, reasonable prices, and fun services. A higher-end, quirkier version of fast-fashion chains H&M and Zara, it allows middle-market consumers to dress trendily and affordably, in punk-inspired pinafores or ladylike tweed. New products are flown in two to three times a week, and store selections are updated multiple times in a day. Partnering with style icons Kate Moss, Stella Vine, and Celia Birtwell to create the latest designs, Topshop offers style advisors, Topshop-to-Go (a Tupperware-type party that brings a style advisor to a customer's home with outfits for as many as 10 people), and Topshop Express (an express delivery service via Vespa scooters for fashion "emergencies"). The company's Topman chain caters to a male audience. It seeks prime locations for its stores and complements them with an online store. The 60,000-square-foot store on Broadway in New York City is Topshop's second biggest and the first flagship store outside the United Kingdom. It has shop-in-shop locations in Nordstrom department stores throughout the United States and in the Karstadt department store chain in Germany.

Channel Integration and Systems

Distribution channels don't stand still. We'll look at the recent growth of vertical, horizontal, and multichannel marketing systems. After considering some e-commerce and m-commerce issues, we next examine how these systems cooperate, conflict, and compete.

VERTICAL MARKETING SYSTEMS

A **conventional marketing channel** consists of an independent producer, wholesaler(s), and retailer(s). Each is a separate business seeking to maximize its own profits, even if this goal reduces profit for the system as a whole. No channel member has complete or substantial control over other members.

A **vertical marketing system (VMS)**, by contrast, includes the producer, wholesaler(s), and retailer(s) acting as a unified system. One channel member, the *channel captain,* sometimes called a *channel steward*, owns or franchises the others or has so much power that they all cooperate. Stewards accomplish channel coordination without issuing commands or directives by persuading channel partners to act in the best interest of all.[59]

A channel steward might be the maker of the product or service (Procter & Gamble or American Airlines), the maker of a key component (microchip maker Intel), the supplier or assembler (Dell or Arrow Electronics), or the distributor (W.W. Grainger) or retailer (Walmart). Within a company, stewardship might rest with the CEO, a top manager, or a team of senior managers.

Channel stewardship has two important outcomes. First, it expands value for the steward's customers, enlarging the market or increasing existing customers' purchases through the channel. Second, it creates a more tightly woven and yet adaptable channel in which valuable members are rewarded and the less valuable are weeded out.

VMSs arose from strong channel members' attempts to control channel behavior and eliminate conflict over independent members pursuing their own objectives. These systems achieve economies through size, bargaining power, and elimination of duplicated services. Business buyers of complex products and systems value the extensive exchange of information they can offer.[60] VMSs have become the dominant mode of distribution in the U.S. consumer marketplace, serving 70 percent to 80 percent of the market. There are three types: corporate, administered, and contractual.

CORPORATE VMS A *corporate VMS* combines successive stages of production and distribution under single ownership. For years, Sears obtained more than half the goods it sells from companies it partly or wholly owned. Sherwin-Williams makes paint but also owns and operates 3,500 retail outlets.

ADMINISTERED VMS An *administered VMS* coordinates successive stages of production and distribution through the size and power of one of the members. Manufacturers of dominant brands can secure strong trade cooperation and support from resellers. Thus, Frito-Lay, Procter & Gamble, and Campbell Soup command high levels of cooperation from their resellers in the matter of displays, shelf space, promotions, and price policies. The most advanced supply-distributor arrangement for administered VMSs relies on **distribution programming**, which builds a planned, professionally managed, vertical marketing system that meets the needs of both manufacturer and distributors.

CONTRACTUAL VMS A *contractual VMS* consists of independent firms at different levels of production and distribution integrating their programs on a contractual basis to obtain more economies or sales impact than they could achieve alone.[61] Sometimes thought of as "value-adding partnerships" (VAPs), contractual VMSs come in three types:

1. ***Wholesaler-sponsored voluntary chains***—Wholesalers organize voluntary chains of independent retailers to help standardize their selling practices and achieve buying economies in competing with large chain organizations.
2. ***Retailer cooperatives***—Retailers take the initiative and organize a new business entity to carry on wholesaling and possibly some production. Members concentrate their purchases through the retailer co-op and plan their advertising jointly, sharing in profits in proportion to their purchases. Nonmember retailers can also buy through the co-op but do not share in the profits.
3. ***Franchise organizations***—A channel member called a *franchisor* might link several successive stages in the production-distribution process. Franchising has been the fastest-growing retailing development in recent years.

Although the basic idea is an old one, some forms of franchising are quite new. The traditional system is the *manufacturer-sponsored retailer franchise.* Ford licenses independent businesspeople to sell its cars who agree to meet specified conditions of sales and services. Another system is the *manufacturer-sponsored wholesaler franchise.* Coca-Cola licenses bottlers (wholesalers) in various markets that buy its syrup concentrate and then carbonate, bottle, and sell it to retailers in local markets. A newer system is the *service-firm-sponsored retailer franchise,* organized by a service firm to bring its service efficiently to consumers. We find examples in auto rental (Hertz and Avis), fast food (McDonald's and Burger King), and the motel business (Howard Johnson and Ramada Inn). In a dual distribution system, firms use both vertical integration (the franchisor actually owns and runs the units) and market governance (the franchisor licenses the units to other franchisees).[62]

THE NEW COMPETITION IN RETAILING Many independent retailers that have not joined VMSs have developed specialty stores serving special market segments. The result is a polarization in retailing between large vertical marketing organizations and independent specialty stores, which creates a problem for manufacturers. They are strongly tied to independent intermediaries but must eventually realign themselves with the high-growth vertical marketing systems on less attractive terms. Furthermore, vertical marketing systems constantly threaten to bypass large manufacturers and set up their own manufacturing. The new competition in retailing is no longer between independent business units but between whole systems of centrally programmed networks (corporate, administered, and contractual), competing against one another to achieve the best cost economies and customer response.

HORIZONTAL MARKETING SYSTEMS

Another channel development is the **horizontal marketing system**, in which two or more unrelated companies put together resources or programs to exploit an emerging marketing opportunity. Each company lacks the capital, know-how, production, or marketing resources to venture alone, or it is afraid of the risk. The companies might work together on a temporary or permanent basis or create a joint venture company.

For example, many supermarket chains have arrangements with local banks to offer in-store banking. Citizens Bank has more than 500 branches in supermarkets, making up roughly one-third of its branch network. Citizens's staff members in these locations are more sales oriented, younger, and more likely to have some retail sales background than staff in the traditional brick-and-mortar branches.[63]

E-Commerce Marketing Practices

E-commerce uses a Web site to transact or facilitate the sale of products and services online. Online retail sales have exploded, and it is easy to see why. Online retailers can predictably provide convenient, informative, and personalized experiences for vastly different types of consumers and businesses. By saving the cost of retail floor space, staff, and inventory, they can also profitably sell low-volume products to niche markets.

While consumers often go online to try to find lower prices,[64] online retailers in fact compete in three key aspects of a transaction: (1) customer interaction with the Web site, (2) delivery, and (3) ability to address problems when they occur.[65]

We can distinguish between **pure-click** companies, those that have launched a Web site without any previous existence as a firm, and **brick-and-click** companies, existing companies that have added an online site for information or e-commerce.

PURE-CLICK COMPANIES

There are several kinds of pure-click companies: search engines, Internet service providers (ISPs), commerce sites, transaction sites, content sites, and enabler sites. Commerce sites sell all types of products and services, notably books, music, toys, insurance, stocks, clothes, financial services, and so on. They use various strategies to compete: AutoNation is a leading metamediary of car buying and related services; Hotels.com is the information leader in hotel reservations; Buy.com leads on price.

E-COMMERCE SUCCESS FACTORS Companies must set up and operate their e-commerce Web sites carefully. Customer service is critical. Online shoppers may select an item for purchase but fail to complete the transaction. Worse, only 2 percent to 3 percent of visits to online retailers lead to sales, compared with 5 percent of visits to department stores.[66]

To improve conversion rates, firms should make the Web site fast, simple, and easy to use. Something as simple as enlarging product images on screen can increase perusal time and the amount customers buy.[67] Some of the larger e-commerce firms such as eBay and Amazon are offering same-day delivery in major markets.[68] A good return policy is also crucial.[69] To drive traffic to a site, many firms employ affiliate marketing, paying online content providers to drive business to their brands' sites.[70]

Consumer surveys suggest that the most significant inhibitors of online shopping are the absence of pleasurable experiences, social interaction, and personal consultation with a company representative.[71] Firms have responded. Many now offer live online chat to give potential customers immediate advice about products and suggest additional items. When a representative is active in the sale, the average dollar amount per order is typically higher. B-to-B marketers also need to put a human face on their e-commerce presence, and some are taking advantage of technologies such as virtual environments, blogs, online videos, and click-to-chat.

To increase customer satisfaction and the entertainment and information value of online shopping experiences, some firms are employing *avatars,* animated characters that act as company representatives, personal shopping assistants, Web site guides, or conversation partners. Avatars can enhance the effectiveness of an online sales channel, especially if they are seen as expert or attractive.[72]

Ensuring security and privacy online remains important. Customers must find the Web site trustworthy, even if it represents an already highly credible offline firm. Investments in Web site design and security can help reassure customers sensitive to online risk.[73]

B-TO-B E-COMMERCE Although business-to-consumer (B-to-C) Web sites have attracted much attention in the media, even more activity is being conducted on business-to-business (B-to-B) sites, which are changing the supplier–customer relationship in profound ways.

In the past, buyers exerted a lot of effort to gather information about worldwide suppliers. B-to-B sites make markets more efficient, giving buyers easy access to a great deal of information from (1) supplier Web sites; (2) *infomediaries,* third parties that add value by aggregating information about alternatives; (3) *market makers,* third parties that link buyers and sellers; and (4) *customer communities*, where buyers can swap stories about suppliers' products and services.[74]

Firms are using B-to-B auction sites, spot exchanges, online product catalogs, barter sites, and other online resources to obtain better prices. Ironically, the largest of the B-to-B market makers is Alibaba, homegrown in China where businesses have faced decades of Communist hostility to private enterprise.[75]

ALIBABA The brainchild of Jack Ma, Alibaba began in 1999 and has grown through the years to become the world's largest online marketplace, allowing people and businesses to buy and sell any type of product—from Fuji apples to Boeing 737s. Its numbers are staggering. The $15 billion company has 500 million registered users on nine platforms in 220 countries and regions and enjoys about 80 percent of the Chinese e-commerce market. On Singles' Day on November 11, 2012—a local twist on Valentine's Day and China's biggest online shopping day—Taoboa (a consumer-to-consumer marketplace) and Tmall (a business-to-consumer marketplace), Alibaba's two main platforms, topped $5.75 billion in sales from 400 million unique visitors in 24 hours. More than 10 million of the 16 million parcels delivered in China each day originate from Taobao and Tmall, so logistics providers are crucial (there are no UPS or FedEx counterparts). A cross between Amazon.com, eBay, Rackspace, and PayPal, Alibaba makes money primarily from commissions and from advertising by buyers and sellers exchanging goods. To establish customer trust, the company set up TrustPass, in which users pay Alibaba a fee to hire a third party that verifies them. Users must have five people vouch for them and provide a list of all their certificates/business licenses. Anyone who has done business with a user is encouraged to comment, in the same way buyers comment on sellers in Amazon.com's or eBay's marketplace. The company is valued at more than $120 billion, making Yahoo's 24 percent stake in it a very wise investment.

The effect of these B-to-B mechanisms is to make prices more transparent. For undifferentiated products, price pressure will increase. For highly differentiated products, buyers will gain a better picture of the items' true value. Suppliers of superior products will be able to offset price transparency with value transparency; suppliers of undifferentiated products will need to drive down their costs in order to compete.

BRICK-AND-CLICK COMPANIES

Although many brick-and-mortar companies once hesitated to open an e-commerce channel for fear of conflict with their channel partners, most have added the Internet after seeing how much business was generated online.[76] Even Procter & Gamble, which used traditional physical channels of distribution exclusively for years, is selling some big brands such as Tide, Pampers, and Olay online via its P&G e-store, in part to be able to examine consumer shopping habits more closely.[77] One study showed that more than a third of Internet users have made purchases directly from brand Web sites.[78]

Managing the online and offline channels has thus become a priority for many firms.[79] There are at least three strategies for trying to gain acceptance from intermediaries. One, offer different brands or products online and offline. Two, offer offline partners higher commissions to cushion the negative impact on sales. Three, take orders on the Web site but have retailers deliver and collect payment. Harley-Davidson decided to tread carefully before going online.[80]

HARLEY-DAVIDSON Given that Harley-Davidson sells more than $1 billion worth of parts and accessories and general merchandise to its loyal followers—generating roughly one-quarter of its annual revenue—an online venture to reach even more customers was an obvious next step. The company needed to be careful, however, to avoid the wrath of its 850 dealers who benefit from high margins on their sales. Its solution was to prompt online customers to select a participating Harley dealer from which to purchase, ensuring that the dealer remains the focal point of the customer experience. Dealers, in turn, agreed to a number of standards, such as checking for orders twice a day and shipping promptly. In-store pickup is also an option, and some products are available only in-store.

Harley-Davidson made sure to not anger its loyal dealer network when it expanded online distribution for its parts and accessories and general merchandise.

Source: © picturesbyrob/Alamy

M-Commerce Marketing Practices

Mobile channels and media can keep consumers as connected and interacting with a brand as they choose. By mid-2013, more than half of all online U.S. buyers had made a purchase on a mobile device, and m-commerce accounted for more than 11 percent of all e-commerce.[81] Tablets are expected to overtake smart phones for mobile shopping, and one estimate says tablets will make up more than 70 percent of mobile retail sales by 2017.[82]

In some parts of the world, m-commerce is very well established. Asian consumers use their mobile phones as their main computers and benefit from a well-developed mobile infrastructure. Mobile ads are well accepted by consumers and relatively inexpensive for firms. In South Korea, Tesco created virtual subway stores for commuters traveling on Seoul's underground transportation system. Interactive, lifelike store aisles with a wide range of product and brand images were superimposed on walls. Consumers could order products for home delivery by simply snapping photos with their phones.[83]

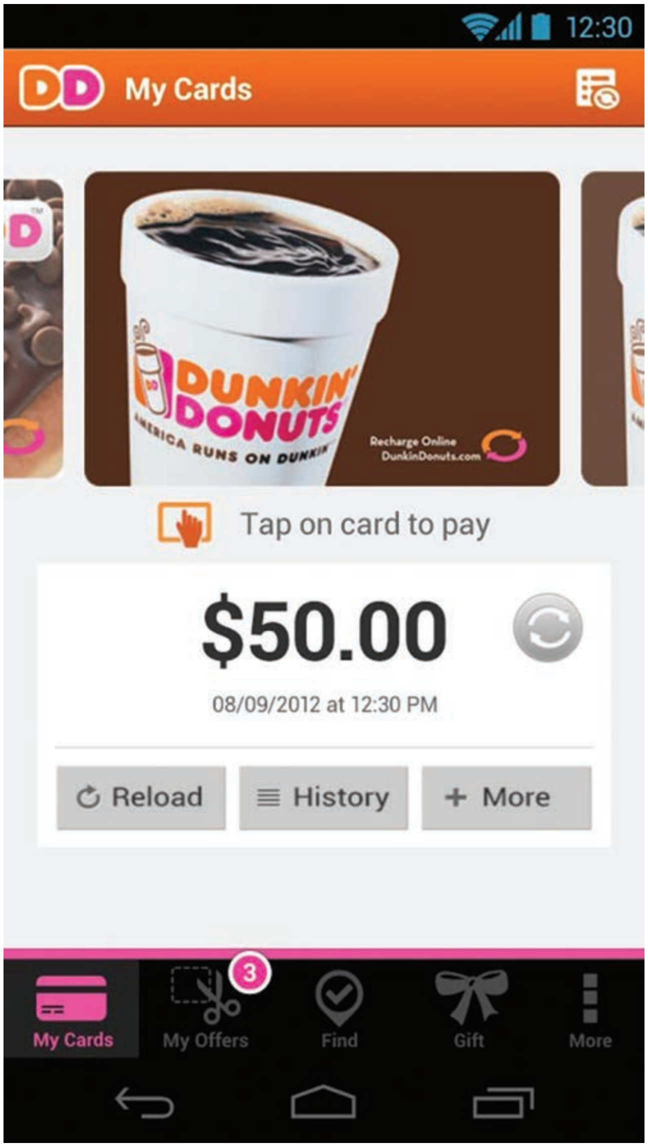
Millions of Japanese teenagers carry DOCOMO phones available from NTT (Nippon Telephone and Telegraph), the country's largest mobile service provider with an ultra-high-speed LTE network. They can also use their phones to order goods. Each month, subscribers receive a bill from NTT listing the monthly subscriber fee, usage fee, and cost of all m-commerce transactions.[84]

M-commerce is well-established in South Korea where virtual stores have been introduced into underground subway stations.

Source: ASSOCIATED PRESS

In the United States, mobile marketing is becoming more prevalent and taking all forms. It is easy to understand how entertainment, travel, sporting events, and other time-sensitive categories can benefit from mobile phone apps, but the impact of m-commerce extends far beyond these. Consumers and companies are adapting.[85] Look at Dunkin' Donuts.[86]

DUNKIN' DONUTS An early mobile marketer, Dunkin' Donuts has refined its DD Perks program as part of its corporate goal to lead in digital mobility in the QSR (Quick Serve Restaurant) industry. The DD program was integrated into the company's unified point-of-sales and mobile app to reward loyal customers and encourage them to visit more often and spend more on each visit. The mobile app received 3.5 million downloads in the first year alone. By constructing a purchase history and profile for customers, Dunkin' Donuts can offer more customized and geographically targeted offers that change as customers go from market to market. The app includes a store locator feature and lets customers pay for drinks and meals with a bar code scanned at the point of sale. The company also uses Twitter to run quick, fun promotions and sweepstakes for its on-the-go customers.



Source: Dunkin' Donuts

Dunkin' Donuts is determined to be a market leader in digital mobility for its products and brands.

CHANGES IN CUSTOMER AND COMPANY BEHAVIOR

Consumers are fundamentally changing the way they shop in stores, increasingly using a cell phone to text a friend or relative about a product while shopping in stores. Fifty percent of all Google searches are done on mobile phones.[87] Women may use smart phones more than men in all phases of the shopping experience, making shopping lists and product wish lists, collecting coupons, and sharing photos of their purchases.[88]

Companies are trying to give their customers more control over their shopping experiences by bringing Web technologies into the store, especially via mobile apps. Consider these two examples:

- Although Nordstrom expected its app to be used remotely, many customers launched it while shopping in a store rather than approaching a salesperson. As one executive noted, "A lot of customers like to touch and feel and try on the merchandise, but they also want the information they get online." Nordstrom has added Wi-Fi to almost all its stores, in part so its app will work fast.[89]
- American Express launched its "Link-Like-Love" social commerce program, which sends cardmembers couponless personalized offers from merchants based on their Facebook "likes" and Facebook Places check-ins that are automatically redeemed through card use. Via a partnership with Foursquare, cardmembers could also automatically receive and redeem promotional offers from merchants based on their Foursquare activity.[90]

M-COMMERCE MARKETING PRACTICES

Marketers are using a number of new and traditional practices in m-marketing.

ADVERTISING AND PROMOTION Understanding how consumers want to use their smart phones is critical to understanding the role of advertising. Given the small screen and fleeting attention paid, fulfilling advertising's traditional role of informing and persuading is more challenging for m-commerce marketers. On the plus side, consumers are more engaged and attentive with their smart phones than when they are online.[91] Nevertheless, a number of m-commerce companies are eliminating ads to allow consumers to make purchases with as few clicks as possible.[92]

Outdoor supplier North Face targets customers with mobile promotions at parks and ski resorts as well as near its stores.

Promotions are a different story. Consumers often use their smart phones to find deals or capitalize on them: the redemption rate for mobile coupons (10 percent) far exceeds that of paper coupons (1 percent).[93] For retailers, research has shown that mobile promotions can get consumers to travel greater distances within a store and make more unplanned purchases.[94]

GEOFENCING The idea of *geofencing* is to target customers with a mobile promotion when they are within a defined geographical space, typically near or in a store. The local-based service requires just an app and GPS coordinates, but consumers have to opt in. Consider these applications: [95]

- Neiman-Marcus is piloting geofencing in its stores so its salespeople know when their more valuable customers are on the premises and can look at their purchase history to provide more personalized service.
- Outdoor supplier North Face uses geofences around parks and ski resorts in addition to its stores.
- Cosmetics brand retailer Kiehl's uses geofencing around its free-standing stores and kiosks within other stores. It advertises the alerts at its cash register and on social media pages and e-mails list, and it offers customers a free lip balm for enrolling. Thousands have done so, but the company limits it texts to three per month to avoid being intrusive.

PRIVACY

The fact that a company can pinpoint a customer's or employee's location with GPS technology raises privacy issues. Like so many new technologies, such location-based services have potential for good and harm and will ultimately warrant public scrutiny and regulation.

Many consumers are happy to tolerate cookies, profiles, and other online tools that let e-commerce businesses know who they are and when and how they shop, but they are nevertheless concerned when such tracking occurs in the store. When Nordstrom informed customers it was testing new technology to track customers' movements by following the Wi-Fi signals from their smart phones, some consumers objected, leading Nordstrom to drop the experiment.[96]

Conflict, Cooperation, and Competition

No matter how well channels are designed and managed, there will be some conflict, if only because the interests of independent business entities do not always coincide. **Channel conflict** is generated when one channel member's actions prevent another channel member from achieving its goal. Software giant Oracle Corp., plagued by conflict between its high-powered sales force and its vendor partners, has tried a number of solutions, including rolling out new

"All Partner Territories" where all deals except for specific strategic accounts go through select Oracle partners and allowing partners to secure bigger $1 billion-plus accounts.[97]

Channel coordination occurs when channel members are brought together to advance the goals of the channel instead of their own potentially incompatible goals.[98] Here we examine three questions: What types of conflict arise in channels? What causes conflict? What can marketers do to resolve it?

TYPES OF CONFLICT AND COMPETITION

Suppose a manufacturer sets up a vertical channel consisting of wholesalers and retailers hoping for channel cooperation and greater profits for each member. Yet horizontal, vertical, and multichannel conflict can occur.

- *Horizontal channel conflict* occurs between channel members at the same level. Some Pizza Inn franchisees complained about others cheating on ingredients, providing poor service, and hurting the overall brand image.
- *Vertical channel conflict* occurs between different levels of the channel. When Estée Lauder set up a Web site to sell its Clinique and Bobbi Brown brands, the department store Dayton Hudson reduced the space it gave the company's products.[99] Greater retailer consolidation—the 10 largest U.S. retailers account for more than 80 percent of the average manufacturer's business—has led to increased price pressure and influence from retailers.[100] Walmart, for example, is the principal buyer for many manufacturers, including Disney, Procter & Gamble, and Revlon, and is able to command reduced prices or quantity discounts from these and other suppliers.[101]
- *Multichannel conflict* exists when the manufacturer has established two or more channels that sell to the same market.[102] It's likely to be especially intense when the members of one channel get a lower price (based on larger-volume purchases) or work with a lower margin. When Goodyear began selling its popular tire brands through Sears, Walmart, and Discount Tire, it angered its independent dealers and eventually placated them by offering exclusive tire models not sold in other retail outlets.

CAUSES OF CHANNEL CONFLICT

Some causes of channel conflict are easy to resolve; others are not. Conflict may arise from:

- ***Goal incompatibility.*** The manufacturer may want to achieve rapid market penetration through a low-price policy. Dealers, in contrast, may prefer to work with high margins and pursue short-run profitability.
- ***Unclear roles and rights.*** HP may sell laptops to large accounts through its own sales force, but its licensed dealers may also be trying to sell to large accounts. Territory boundaries and credit for sales often produce conflict.
- ***Differences in perception.*** The manufacturer may be optimistic about the short-term economic outlook and want dealers to carry higher inventory, while the dealers may be pessimistic. In the beverage category, it is not uncommon for disputes to arise between manufacturers and their distributors about the optimal advertising strategy.
- ***Intermediaries' dependence on the manufacturer.*** The fortunes of exclusive dealers, such as auto dealers, are profoundly affected by the manufacturer's product and pricing decisions. This situation creates a high potential for conflict.

MANAGING CHANNEL CONFLICT

Some channel conflict can be constructive and lead to better adaptation to a changing environment, but too much is dysfunctional.[103] The challenge is not to eliminate all conflict, which is impossible, but to manage it better. Verbal reprimands, fines, withheld bonuses, and other remedies can punish a firm in violation and deter others.[104] Table 17.2 lists some mechanisms for effective conflict management that we discuss next.[105]

Strategic Justification In some cases, a convincing strategic justification that they serve distinctive segments and do not compete as much as they might think can reduce potential for conflict among channel members. Developing special versions of products for different channel members—branded variants as described in Chapter 11—is a clear way to demonstrate that distinctiveness.[106]

Dual Compensation Dual compensation pays existing channels for sales made through new channels. When Allstate started selling insurance online, it agreed to pay agents a 2 percent commission for face-to-face service to customers who got their quotes online. Although lower than the agents' typical 10 percent commission for offline transactions, it did reduce tensions.[107]

TABLE 17.2 Strategies to Manage Channel Conflict

Strategic justification
Dual compensation
Superordinate goals
Employee exchange
Joint memberships
Co-optation
Diplomacy, mediation, or arbitration
Legal recourse

Superordinate Goals Channel members can come to an agreement on the fundamental or superordinate goal they are jointly seeking, whether it is survival, market share, high quality, or customer satisfaction. They usually do this best when the channel faces an outside threat, such as a more efficient competing channel, an adverse piece of legislation, or a shift in consumer desires.

Employee Exchange A useful step is to exchange persons between two or more channel levels. GM's executives might agree to work for a short time in some dealerships, and some dealership owners might work in GM's dealer policy department. Thus participants can grow to appreciate each other's point of view.

Joint Memberships Similarly, marketers can encourage joint memberships in trade associations. Good cooperation between the Grocery Manufacturers of America and the Food Marketing Institute, which represents most of the food chains, led to the development of the universal product code (UPC). The associations can consider issues between food manufacturers and retailers and resolve them in an orderly way.

Co-optation **Co-optation** is an effort by one organization to win the support of the leaders of another by including them in advisory councils, boards of directors, and the like. If the organization treats invited leaders seriously and listens to their opinions, co-optation can reduce conflict, but the initiator may need to compromise its policies and plans to win outsiders' support.

Diplomacy, Mediation, and Arbitration When conflict is chronic or acute, the parties may need to resort to stronger means. **Diplomacy** takes place when each side sends a person or group to meet with its counterpart to resolve the conflict. **Mediation** relies on a neutral third party skilled in conciliating the two parties' interests. In **arbitration**, two parties agree to present their arguments to one or more arbitrators and accept their decision.

Sometimes channel conflicts have to be settled by legal recourse as with Coca-Cola and its dispute with Walmart over Powerade.

Source: Getty Images News

Legal Recourse If nothing else proves effective, a channel partner may choose to file a lawsuit.[108] When Coca-Cola decided to distribute Powerade thirst quencher directly to Walmart's regional warehouses, 60 bottlers complained the practice would undermine their core direct-store-distribution (DSD) duties and filed suit. A settlement allowed for the mutual exploration of new service and distribution systems to supplement the DSD system.[109]

DILUTION AND CANNIBALIZATION

Marketers must be careful not to dilute their brands through inappropriate channels, particularly luxury brands whose images often rest on exclusivity and personalized service. Calvin Klein and Tommy Hilfiger both took a hit when they sold too many of their products in discount channels.

Given the lengths to which they go to pamper customers in their stores—with doormen, glasses of champagne, and extravagant surroundings—luxury brands have had to work hard to provide a high-quality digital experience. They aren't forgetting their stores, though, and are increasingly blending the two. Gucci partnered with Samsung Electronics to create an immersive in-store experience for its timepieces and jewelry that combines physical and mobile commerce. Stores feature transparent displays that show images on the screen without obscuring the products behind them and a digital shop-in-shop section where customers can use tablet computers to browse.[110] To reach affluent customers who work long hours and have little time to shop, many high-end fashion brands such as Dior, Louis Vuitton, and Fendi have unveiled e-commerce sites for researching items before visiting a store—and a means to combat fakes sold online.

LEGAL AND ETHICAL ISSUES IN CHANNEL RELATIONS

Companies are generally free to develop whatever channel arrangements suit them. The law seeks to prevent only exclusionary tactics that might keep competitors from using a channel. Here we briefly consider the legality of certain practices, including exclusive dealing, exclusive territories, tying agreements, and dealers' rights.

We saw earlier that in *exclusive distribution*, only certain outlets are allowed to carry a seller's products, and that requiring these dealers not to handle competitors' products is called *exclusive dealing*. Both channel partners benefit from exclusive arrangements: The seller obtains more loyal and dependable outlets, and the dealer gets a steady supply of special products and stronger seller support. Exclusive arrangements are legal as long as they do not substantially lessen competition or tend to create a monopoly and as long as both parties enter into them voluntarily.

Exclusive dealing often includes exclusive territorial agreements. The producer may agree not to sell to other dealers in a given area, or the buyer may agree to sell only in its own territory. The first practice increases dealer enthusiasm and commitment. It is also perfectly legal—a seller has no legal obligation to sell through more outlets than it wishes. The second practice, whereby the producer tries to keep a dealer from selling outside its territory, has become a major legal issue.

Producers of a strong brand sometimes sell it to dealers only if they will take some or all of the rest of the line. This practice is called *full-line forcing*. Such **tying agreements** are not necessarily illegal, but they do violate U.S. law if they tend to lessen competition substantially.

Producers are free to select their dealers, but their right to terminate them is somewhat restricted. In general, sellers can drop dealers "for cause," but not if, for example, a dealer refuses to cooperate in a doubtful legal arrangement, such as exclusive dealing or tying agreements.

Summary

1. Most producers do not sell their goods directly to final users. Between producers and final users stands one or more marketing channels, a host of marketing intermediaries performing a variety of functions.
2. Marketing channel decisions are among the most critical decisions facing management. The company's chosen channel(s) profoundly affect all other marketing decisions.
3. Companies use intermediaries when they lack the financial resources to carry out direct marketing, when direct marketing is not feasible, and when they can earn more by doing so. The most important functions performed by intermediaries are information, promotion, negotiation, ordering, financing, risk taking, physical possession, payment, and title.

4. Manufacturers have many alternatives for reaching a market. They can sell direct or use one-, two-, or three-level channels. Deciding which type(s) of channel to use calls for analyzing customer needs, establishing channel objectives, and identifying and evaluating the major alternatives, including the types and numbers of intermediaries involved in the channel.
5. Effective channel management calls for selecting intermediaries and training and motivating them. The goal is to build a long-term partnership that will be profitable for all channel members.
6. Marketing channels are characterized by continuous and sometimes dramatic change. Three of the most important trends are the growth of vertical marketing systems, horizontal marketing systems, and multichannel marketing systems.
7. E-commerce has become firmly established as more companies have adopted "brick-and-click" channel systems. M-commerce (selling via smart phones and tablets) is also gaining in importance. Some consumers engage in showrooming by which they shop in stores to inspect products but buy online later to seek a lower price.
8. Channel integration must recognize the distinctive strengths of online, offline, and mobile selling and maximize their joint contributions.
9. All marketing channels have the potential for conflict and competition resulting from goal incompatibility, poorly defined roles and rights, perceptual differences, and interdependent relationships. Companies can try to manage conflict through dual compensation, superordinate goals, employee exchange, co-optation, and other means.
10. Channel arrangements are up to the company, but certain legal and ethical issues to be considered include exclusive dealing or territories, tying agreements, and dealers' rights.

MyMarketingLab

Go to **mymktlab.com** to complete the problems marked with this icon ✪ as well as for additional Assisted-graded writing questions.

Applications

Marketing Debate

Does It Matter Where You Sell?

Some marketers feel that the image of the particular channel in which they sell their products does not matter—all that matters is that the right customers shop there and the product is displayed in the right way. Others maintain that channel images—such as a retail store—can be critical and must be consistent with the image of the product.

Take a position: Channel images do not much affect the brand images of the products they sell *versus* Channel images must be consistent with the brand image.

Marketing Discussion

Channel Integration

✪ Think of your favorite retailers. How have they integrated their channel system? How would you like their channels to be integrated? Do you use multiple channels from them? Why?

Marketing Excellence

>> Amazon.com

Founded by Jeff Bezos in 1995, Amazon.com started as the "world's largest bookstore" and, ironically, owned no books. Bezos promised to revolutionize retailing, however, and over the years he has blazed a trail of e-commerce innovations that many executives have studied and companies have followed.

Amazon initially set out to create personalized storefronts for each customer by providing more useful information and more choices than found in a neighborhood bookstore. Readers could review books and evaluate them on a one- to five-star rating scale, while fellow browsers could rate the reviews for helpfulness. The company's personal recommendation service aggregated buying-pattern data to infer who might like which book. Amazon also introduced its revolutionary one-click shopping, which allowed buyers to make purchases effortlessly with a single click.

Amazon started to diversify its product line in the late 1990s, first with DVDs and videos and then with consumer electronics, games, toys, software, video games, and gifts. The company continued to expand its product offerings and in 2007 launched Amazon Video On Demand, allowing consumers to rent or purchase films and television shows to watch on their computers or televisions. Later that year, it introduced Amazon MP3, which competed directly with Apple's iTunes and had participation from all the major music labels.

Amazon's most successful product launch was the Kindle, its branded electronic book reader that delivered hundreds of thousands of books, magazines, blogs, and newspapers in a matter of seconds. As thin as a magazine and light as a paperback, the device has been the company's best-selling product since 2009. Today, you can find virtually anything you want on Amazon.com. The company has successfully established itself as the biggest online retailer in the world by enabling merchants of all kinds to sell items on the site.

In addition to its core business, Amazon also runs an "Associates" program that allows independent sellers and businesses to receive commissions for referring customers to the site in a variety of ways, including direct links and banner ads as well as Amazon Widgets, mini-applications that feature the company's wide selection of products. Associates can create an Amazon-operated online store easily, with low risk and no additional cost or programming knowledge. Fulfillment by Amazon (FBA) takes care of picking, packing, and shipping the merchant's products to its customers.

One consistent key to Amazon's success is its willingness to invest in the latest technology to make shopping online faster, easier, and more personally rewarding for its customers and third-party merchants. During peak season in 2012, the company sold approximately 306 items per second, or 26 million items per day. Small wonder that it continually looks for ways to improve delivery. For a $99 annual fee, Amazon Prime provides unlimited free express shipping for millions of items. While free shipping and price cuts are sometimes unpopular with investors, Bezos believes they build customer satisfaction, loyalty, and frequency of purchase orders.

In 2013, Amazon.com announced a partnership with the U.S. Postal Service to begin delivering orders on Sundays. Bezos also predicted on *60 Minutes* that the company may use drones in the near future to make same-day delivery of lightweight products within short distances of distribution warehouses. (Critics find this unlikely for many reasons, though.)

Amazon has also maintained competitive and low prices throughout its product expansion. The company understands how important it is to keep its prices low in order to drive the volume it needs to remain a market leader and expand geographically. Amazon's practice of selling books at heavily discounted prices, however, has upset some of its channel partners in publishing, as have its attempts to become a publisher in its own right.

From the beginning, Bezos has said that even though he started an online bookstore, he eventually wanted to sell *everything to everyone* through Amazon.com. The company continues to invest significantly in technology, is focused on the long term, and has successfully positioned itself as a technology company with its wide range of Amazon Web Services. This growing collection of infrastructure applications meets the retailing needs of companies of virtually all sizes. Amazon has successfully reinvented itself time and again and created a critical channel for merchants around the world who are able to reach more than 244 million customers worldwide.

Questions

1. Why has Amazon succeeded online when so many other companies have failed?
2. Will the Kindle revolutionize the book industry? Why or why not?
3. What's next for Amazon? Where else can it grow?

Sources: "Click to Download," *Economist,* August 19, 2006, pp. 57–58; Robert D. Hof, "Jeff Bezos' Risky Bet," *BusinessWeek,* November 13, 2006; Erick Schonfield, "The Great Giveaway," *Business 2.0,* April 2005, pp. 80–86; Elizabeth West, "Who's Next?," *Potentials,* February 2004, pp. 7–8; Robert D. Hof, "The Wizard of Web Retailing," *BusinessWeek,* December 20, 2004, p. 18; Chris Taylor, "Smart Library," *Time,* November 17, 2003, p. 68; Deborah Solomon, "Questions for Jeffrey P. Bezos," *New York Times,* December 2, 2009; Patrick Seitz, "Amazon.com Whiz Jeff Bezos Keeps Kindling Hot Concepts," *Investors' Daily Business*, December 31, 2009; Alistair Barr, "Amazon Starts Sunday Delivery with U.S. Postal Service," *USA Today,* November 25, 2013; Adam Lashinsky, "Amazon's Jeff Bezos: The Ultimate Disrupter," *Fortune,* November 16, 2012; Michael Wolf, "Here's Why Amazon Drone Package Delivery May Never Happen," *Forbes,* December 2, 2013; Holman Jenkins Jr., "Jeff Bezos's Mysterious Amazon," *Wall Street Journal,* December 6, 2013; "Amazon's Jeff Bezos Looks to the Future," *60 Minutes*, CBS.com, December 1, 2013; Amazon 2012 Annual Report; George Parker, "Cheap Words," *New Yorker*, February 17, 2014.

Marketing Excellence

>> Tesco

Tesco's main purpose is to earn a customer's lifetime loyalty by creating value. To achieve this goal, the company has adopted the values of understanding customers, being the first to meet their needs, and acting responsibly in the communities they serve.

Tesco was founded in 1919 by Jack Kohen, who began to sell surplus groceries from a stall in London's East End. On his first day, Kohen had sales of roughly \$6.40 and a profit of \$1.60. In fiscal year 2014, Tesco Group had sales of \$111 billion, with a profit before taxes of \$4.78 billion and sales growth of around 1 percent. The firm employs more than 597,784 people and occupies 41 million square feet of selling space in 12 countries.

Tesco's success comes from years of building customer loyalty through merchandising and pricing strategy. Over the years, the company has expanded its range of products and services from simple grocery items to almost everything, including PCs and peripherals, cameras, phones, home electrical appliances, televisions, AV equipment, furniture, kitchen appliances, and home furnishings, so customers can buy everything under one roof. Tesco also offers services that include petrol stations, opticians, and pharmacies.

Tesco started expanding overseas in 1995, starting with Hungary, and now has a presence in China, the Czech Republic, Hungary, India, Japan, Malaysia, Poland, Ireland, Slovakia, Thailand, and Turkey. In the United States, it operates under the name Fresh & Easy Neighborhood Market.

In trying to understand its customers based on their total spending, Tesco found that the top 100 customers were worth the same as the bottom 4,000. The bottom 25 percent of customers represented only 2 percent of sales, whereas the top 5 percent accounted for 20 percent. This showed the firm that all customers are not equal; as a result, it started to measure its more valuable customers by frequency of purchase and value of expenditure.

Tesco began its customer relationship management program in 1995 by introducing Clubcard, which offered loyal shoppers points on purchases and small rebates. Stores captured valuable information with every swipe of the card and built a powerful customer database that could show what products customers were and were not buying, and where they were spending their time in the store (measured by what they spent their money on). Clubcard customers received vouchers for items they specifically liked to buy, rather than general vouchers sent to all customers. Different lifestyle magazines were created for different customers. High-value shoppers received calls from store managers, valet parking when they came to shop, and other privileges so they would feel special and continue to be loyal to Tesco. Tesco now has more than 16 million cardholders and sends about 8 million unique coupon variations with each Clubcard mailing, to ensure that everybody who gets an offer receives an appropriate one. The Clubcard data provides Tesco with detailed information about customers' purchasing behavior. In addition to this data, the company polls around 12,000 customers in their annual Customer Question Time. They receive more direct feedback on products, price, quality, service, and the company's role within the community.

Stores are designed based on consumers' needs. The smallest floor plan, called 'Express', is less than 600 square feet and sells only grocery and food items; the largest 'Home Plus' stores are more than 50,000 square feet in size and sell only non-food items. In 1999, Tesco opened its online store and online banking initiatives. In 2000, it opened Tesco.com. Tesco Direct, another online initiative, sells over 12,500 nonfood products, guaranteeing next-day delivery for store pickup. It is also experimenting with "drive-thru" supermarket service for customers who order through Tesco Direct and can pick up the items within a two-hour block at designated parking spots without getting out of their cars.

In 2009, Tesco branched out to the iPhone by launching three different applications. The first allowed customers to scan their Clubcards using the iPhone's camera, so they didn't have to carry the card on a shopping trip. The second was a Storefinder that allowed customers to find a nearby Tesco outlet. The third, a wine application, allowed customers to take a photograph of a wine they liked, so that they could read product information and place an order using the phone.

In 2010, Tesco created a new mobile Web site to facilitate easy shopping for non-food and household items using smart phones. This followed the launch of a grocery application that allowed barcode scanning by the iPhone. Using the mobile Web site, customers can now conveniently search and buy everything, from televisions to tables to toys. This initiative is part of a commitment to make Tesco available to everyone, anywhere, at any time—whether through the catalog, in-store, online, or by phone.

Tesco also concentrates on providing efficient service. Under its "one-in-front" plan, for instance, if there is more than one customer at a single checkout counter, another counter will be opened. A number of self-service checkouts are also available in all stores. With improved CRM and service, Tesco has become a leading supermarket in the United Kingdom and is now expanding to other parts of the world.

Questions

1. As Tesco expands overseas, can it succeed by using the same strategies it has used in the United Kingdom? Why or why not? What factors should it take into account while formulating strategies in global markets?
2. What are the ways in which Tesco connects with its customers to provide more value for them?

Sources: "Tesco—The brand experience is everything," Branding Asia, www.brandingasia.com/cases/tesco.htm; Tesco, www.tescoplc.com.

With an unconventional marketing strategy blending fashion, value, customer experience, and social responsibility, Warby Parker has made a splash in the staid eyewear category.

Source: Courtesy of Warby Parker. Photgrapher: Collin Hughes.

In This Chapter, We Will Address the Following **Questions**

1. What major types of marketing intermediaries occupy this sector? (p. 549)
2. What major changes are occurring in the modern retail marketing environment with respect to competitive market structure and technology? (p. 554)
3. What marketing decisions do marketing intermediaries make? (p. 557)
4. What does the future hold for private label brands? (p. 563)
5. What are some of the important issues in wholesaling? (p. 565)
6. What are some important issues in logistics? (p. 567)

18 Managing Retailing, Wholesaling, and Logistics

In the preceding chapter, we examined marketing intermediaries primarily from the viewpoint of manufacturers that want to build and manage marketing channels. In this chapter, we view these intermediaries—retailers, wholesalers, and logistical organizations—as requiring and forging their own marketing strategies in a rapidly changing world. Intermediaries also strive for marketing excellence and can reap the benefits like any other type of company. Consider the runaway success of Warby Parker.[1]

Started by four Wharton MBA graduates while they were still in school, lifestyle brand Warby Parker is challenging eyewear mammoth Luxottica with a marketing strategy that cleverly combines fashion, value, customer experience, and social responsibility. The company designs its own glasses with a hip if nerdy chic and a fashion ethic that promises, "We will not develop anything that you will be embarrassed to wear in 20 years." With material for frames from a family-owned Italian company, assembly in China, and no middleman, it promises quality comparable to that of well-known designers at a fraction of the cost. Warby Parker eyeglasses start at $95, with free shipping, free exchanges, and free returns. To assess fit, customers can use a virtual try-on tool employing facial recognition technology, have up to five sample pairs shipped to try on in person (free of charge), or visit a retail location. Promoting "eyewear with a purpose," Warby Parker works with a non-profit partner to distribute one pair for every pair sold. To expand reach and engagement beyond its stylish and easy-to-use Web site, the company has launched shops within shops in selected cities, a flagship store in the SoHo area of New York City, and several retail locations across the country. Word of mouth is critical for the brand—50 percent of Web site traffic comes from recommendations by friends and family.

The retail market can be unforgiving. While innovative retailers such as Zappos, Sweden's H&M, Spain's Zara and Mango, and Britain's Topshop have thrived in recent years, others such as former U.S. stalwarts JCPenney, Kohl's, and Kmart have struggled. The more successful use strategic planning, state-of-the-art technology, advanced information systems, and sophisticated marketing tools. They segment their markets, improve their market targeting and positioning, and connect with their customers through memorable experiences, relevant and timely information, and of course the right products and services. In this chapter, we consider marketing excellence in retailing, wholesaling, and logistics.

Retailing

Retailing includes all the activities in selling goods or services directly to final consumers for personal, nonbusiness use. A **retailer** or **retail store** is any business enterprise whose sales volume comes primarily from retailing.

Any organization selling to final consumers—whether it is a manufacturer, wholesaler, or retailer—is doing retailing. It doesn't matter *how* the goods or services are sold (in person, by mail, by telephone, by vending machine, or online) or *where* (in a store, on the street, or in the consumer's home).

Retailing is a fast-moving, challenging industry. Consider the plight of Sears.[2]

SEARS Sears is a classic U.S. company. It was one of the first to sell goods through a mail-order catalog, and for more than 100 years, it was one of the strongest department store brands, associated with high-quality merchandise and responsive customer service. However, in the early 2000s, the company began facing financial difficulties, and to keep its earnings stable, it started aggressively selling assets and cutting costs. Customers began complaining about inattentive sales associates, disorganized sales racks, and stores in disrepair. Sears was spending only $2 to $3 per square foot in annual maintenance and repair of its stores, far less than the $6 to $8 per square foot spent by competitors Target and Walmart. "[T]hey weren't keeping [their] promise. Consumers are pretty sophisticated, and they walked into these stores and it was the same old place . . . without the freshness, the excitement or the interactivity of the experience." According to the ACS index of customer satisfaction, in 2012, Sears ranked 10th among 11 Department and Discount Stores. Given that same-store sales have declined for so many years, many feel Sears' disillusioned customers may not be coming back.

At the same time, there are many retailing success stories. "Marketing Memo: Innovative Retail Organizations" highlights four examples of innovative retail organizations that have experienced market success in recent years. After reviewing the different types of retailers and some important characteristics of the modern retail marketing environment, we examine in detail the marketing decisions retailers make.

TYPES OF RETAILERS

Consumers today can shop for goods and services at store retailers, nonstore retailers, and retail organizations.

STORE RETAILERS Perhaps the best-known type of store retailer is the department store. Japanese department stores such as Takashimaya and Mitsukoshi attract millions of shoppers each year and feature art galleries, restaurants, cooking classes, fitness clubs, and children's playgrounds. The most important types of major store retailers are summarized in Table 18.1.

Different formats of store retailers will have different competitive and price dynamics. Discount stores, for example, historically have competed much more directly with each other than with other formats, though that is

Sears has struggled to stay competitive in the dynamic, constantly changing world of retail.

Source: © Helen Sessions/Alamy

marketing memo — Innovative Retail Organizations

GameStop. Video game and entertainment software retailer GameStop has more than 6,600 convenient locations in malls and shopping strips all over the United States, staffed by hard-core gamers who like to connect with customers. The company boasts a trade-in policy that gives credit for an old game exchanged for a new one. To keep track of the activities of its 25 million customers, it also has a successful data-driven loyalty program, PowerUp Rewards, which offers reward points and allows members to manage their gaming interests with the online Game Library to showcase games members have had in the past, that they currently have, and that they wish they had.

Dick's Sporting Goods. Dick's Sporting Goods has grown from a single bait-and-tackle store in Binghamton, New York, into the largest U.S.-based full-line sporting goods retailer, with approximately 574 stores in 44 states. Part of its success springs from the interactive features of its stores. Customers can test golf clubs in indoor ranges, sample shoes on its footwear track, and shoot bows in its archery range. With an advertising tag line of "Every Season Starts at Dick's," the retailer is also emphasizing the fundamental goal of sports achievement and improvement to establish a stronger emotional connection with customers.

Lumber Liquidators. Lumber Liquidators is the largest hardwood flooring specialty retailer in the United States, with more than 345 locations. The company buys excess wood directly from lumber mills at a discount and stocks almost 350 kinds of flooring, about the same as Lowe's and Home Depot. It sells at lower prices because it keeps operating costs down by cutting out the middlemen and locating stores in inexpensive locations. Lumber Liquidators also knows a lot about its customers, such as the fact that shoppers who request product samples have a 30 percent likelihood of buying within a month and that most tend to renovate one room at a time, not the entire home at once.

Net-a-Porter. London-based Net-a-Porter is an online luxury clothing and accessories retailer whose Web site combines the style of an fashion magazine with the thrill of a chic boutique. Seen by its loyal customers as an authoritative fashion voice, the company publishes its interactive magazine weekly and stocks more than 300 international brands, including Jimmy Choo, Alexander McQueen, Stella McCartney, Givenchy, and Marc Jacobs, as well as many up-and-comers. It ships to 170 countries and offers same-day delivery in London and Manhattan; the average order is $250. A new site, Mr. Porter, targets men.

Sources: *GameStop*: Steve Peterson, "GameStop Sees Targeted Marketing on the Rise," www.thealistdaily.com, September 26, 2013; Jeanine Poggi, "GameStop Revamps Business to Ensure Success in a Digital Future," *Advertising Age*, April 9, 2012; Chris Daniels, "GameStop CMO Sees CRM as Key," *Direct Marketing News*, October 2011; Devin Leonard, "GameStop Racks Up the Points," *Fortune*, June 9, 2008, pp. 109–22; *Dick's Sporting Goods*: "Brand Genius: Lauren Hobart, Chief Marketing Officer, Dick's Sporting Goods," *Adweek*, September 23, 2013; Matt Townsend, "Dick's Channels 'Rudy' in New Branding Strategy," www.bloomberg.com, March 1, 2012; "Dick's Sporting Goods Details Growth Strategy to Reach $10 Billion in Sales and 10.5% Operating Margin by the End of Fiscal 2017," *PR Newswire*, August 3, 2013; *Lumber Liquidators*: Mark Heschmeyer, "Lumber Liquidators Planning to Spruce Up Retail Image, www.costar.com, January 30, 2013; Marilyn Much, "Lumber Liquidators' New CEO Helps Drive Sales Surge," *Investor's Business Daily*, May 17, 2012; Helen Coster, "Hardwood Hero," *Forbes*, November 30, 2009, pp. 60–62; *Net-a-Porter*: David Moth, "How Net-a-Porter Plans to Build on Its Mobile Success in 2013," www.econsultancy.com, March 18, 2013; Christina Binkley, "Finding an Audience for Edgy Runway Styles," *Wall Street Journal*, March 28, 2012; Paul Sonne, "Richemont to Buy Net-a-Porter," *Wall Street Journal*, April 2, 2010; John Brodie, "The Amazon of Fashion," *Fortune*, September 14, 2009, pp. 86–95.

changing, as we'll see below.[3] Retailers also meet widely different consumer preferences for service levels and specific services. Specifically, they position themselves as offering one of four levels of service:

1. ***Self-service***—Self-service is the cornerstone of all discount operations. Many customers are willing to carry out their own "locate-compare-select" process to save money.
2. ***Self-selection***—Customers find their own goods, though they can ask for assistance.
3. ***Limited service***—These retailers carry more shopping goods and services such as credit and merchandise-return privileges. Customers need more information and assistance.
4. ***Full service***—Salespeople are ready to assist in every phase of the "locate-compare-select" process. Customers who like to be waited on prefer this type of store. The high staffing cost and many services, along with the higher proportion of specialty goods and slower-moving items, result in high-cost retailing.

NONSTORE RETAILING Although the overwhelming bulk of goods and services is sold through stores, *nonstore retailing* has been growing much faster than store retailing, especially given e-commerce and m-commerce

TABLE 18.1 Major Types of Store Retailers
Specialty store: Narrow product line. The Limited, The Body Shop.
Department store: Several product lines. JCPenney, Bloomingdale's.
Supermarket: Large, low-cost, low-margin, high-volume, self-service store designed to meet total needs for food and household products. Kroger, Safeway.
Convenience store: Small store in residential area, often open 24/7, limited line of high-turnover convenience products plus takeout. 7-Eleven, Circle K.
Drug store: Prescription and pharmacies, health and beauty aids, other personal care, small durable, miscellaneous items. CVS, Walgreens.
Discount store: Standard or specialty merchandise; low-price, low-margin, high-volume stores. Walmart, Kmart.
Extreme value or hard-discount store: A more restricted merchandise mix than discount stores but at even lower prices. Aldi, Lidl, Dollar General, Family Dollar.
Off-price retailer: Leftover goods, overruns, irregular merchandise sold at less than retail. Factory outlets; independent off-price retailers such as TJ Maxx; warehouse clubs such as Costco.
Superstore: Huge selling space, routinely purchased food and household items, plus services (laundry, shoe repair, dry cleaning, check cashing). Category killer (deep assortment in one category) such as Staples; combination store such as Jewel-Osco; hypermarket (huge stores that combine supermarket, discount, and warehouse retailing) such as Carrefour in France.
Catalog showroom: Broad selection of high-markup, fast-moving, brand-name goods sold by catalog at a discount. Customers pick up merchandise at the store. Inside Edge Ski and Bike.

as Chapter 17 outlined. Nonstore retailing falls into four major categories: direct marketing (which includes telemarketing and online selling), direct selling, automatic vending, and buying services:

1. ***Direct marketing*** has roots in direct-mail and catalog marketing (Lands' End, L.L.Bean); it includes *telemarketing* (1-800-FLOWERS), *television direct-response marketing* (HSN, QVC), and *online shopping* (Amazon.com, Autobytel.com). People are ordering a greater variety of goods and services from a wider range of Web sites. In the United States, online sales were estimated to be $225 billion in 2012, approaching 6 percent of total retail sales.[4]
2. ***Direct selling,*** also called *multilevel selling* and *network marketing*, is a multibillion-dollar industry, with companies selling door to door or through at-home sales parties. Well-known in such one-to-one selling are Avon, Electrolux, and Southwestern Company of Nashville (Bibles). Tupperware and Mary Kay Cosmetics are sold one-to-many: A salesperson goes to the home of a host who has invited friends; the salesperson demonstrates the products and takes orders. Pioneered by Amway, the multilevel (network) marketing sales system works by recruiting independent businesspeople who act as distributors. The distributor's compensation includes a percentage of sales made by those he or she recruits as well as earnings on his or her own direct sales to customers. These direct-selling firms, now finding fewer consumers at home, are developing multi-distribution strategies.
3. ***Automatic vending*** offers a variety of merchandise, including impulse goods such as soft drinks, coffee, candy, newspapers, magazines, and other products such as hosiery, cosmetics, hot food, and paperbacks. Vending machines are found in factories, offices, large retail stores, gasoline stations, hotels, restaurants, and many other places. They offer 24-hour selling, self-service, and merchandise that is stocked to be fresh. With more than 5 million units, Japan has the highest per-capita coverage of vending machines in the world. You can buy everything from fresh eggs to pet rhinoceros beetles. Coca-Cola has close to 1 million machines there and annual vending sales of $50 billion—twice its U.S. figures.[5]
4. ***Buying service*** is a storeless retailer serving a specific clientele—usually employees of large organizations—who are entitled to buy from a list of retailers that have agreed to give discounts in return for membership.

Without question, online nonstore retailing has been exploding and is taking many different forms. Consider the success of flash-sales Web sites such as Gilt.[6]

GILT During the recent recession, many designer brands found themselves with excess inventory they badly needed to move. Third-party "flash-sales" sites, offering deep discounts for luxury products and other goods for only a short period of time each day, allowed them to do so in a controlled manner less likely to hurt their brands. Modeled in part after France's flash-sales pioneer Vente-Privée, Gilt was launched in November 2007 to sell fashionable women's clothing from top designer labels for up to 60 percent off, but on a limited-time basis and only to those who joined the online site. Members were alerted of deals and their deadlines via e-mails that conveyed a sense of immediacy and urgency. Adding luxury brands such as Theory and Louis Vuitton, the firm grew to more than 8 million members and an estimated value of $1 billion. As the recession wound down, however, Gilt found itself challenged by dwindling inventory, growing competition from other sites, and its own aggressive expansion strategy, which included men's clothes, kids' products, home products, travel packages, and food. The company responded by focusing more on its core strength in women's fashion and developing tighter relationships with customers via personalized e-mails to announce its sales.

Source: © VisualJapan/Alamy

Vending machines can be found almost anywhere in Japan, selling almost any kind of merchandise, including umbrellas.

CORPORATE RETAILING AND FRANCHISING Although many retail stores are independently owned, an increasing number are part of a **corporate retailing** organization. These organizations achieve economies of scale, greater purchasing power, wider brand recognition, and better-trained employees than independent stores can usually gain alone. The major types of corporate retailing—corporate chain stores, voluntary chains, retailer and consumer cooperatives, franchises, and merchandising conglomerates—are described in Table 18.2.

Franchise businesses such as Hampton, Jiffy-Lube, Subway, Supercuts, 7-Eleven, and many others account for more than 10 percent of businesses with paid employees in the 295 industries for which franchising data are collected by the U.S. Census Bureau.[7]

TABLE 18.2 Major Types of Corporate Retail Organizations
Corporate chain store: Two or more outlets owned and controlled, employing central buying and merchandising, and selling similar lines of merchandise. Gap, Pottery Barn.
Voluntary chain: A wholesaler-sponsored group of independent retailers engaged in bulk buying and common merchandising. Independent Grocers Alliance (IGA).
Retailer cooperative: Independent retailers using a central buying organization and joint promotion efforts. Unified Grocers, ACE Hardware.
Consumer cooperative: A retail firm owned by its customers. Members contribute money to open their own store, vote on its policies, elect a group to manage it, and receive dividends. Local cooperative grocery stores can be found in many markets.
Franchise organization: Contractual association between a franchisor and franchisees, popular in a number of product and service areas. Dunkin' Donuts, Marriott, H&R Block, and The UPS Store.
Merchandising conglomerate: A corporation that combines several diversified retailing lines and forms under central ownership, with some integration of distribution and management. Federated Department Stores renamed itself after one of its best-known retailers, Macy's, but also owns other retailers such as Bloomingdale's.

In a franchising system, individual *franchisees* are a tightly knit group of enterprises whose systematic operations are planned, directed, and controlled by the operation's innovator, called a *franchisor*. Franchises are distinguished by three characteristics:

1. The franchisor owns a trade or service mark and licenses it to franchisees in return for royalty payments.
2. The franchisee pays for the right to be part of the system. Start-up costs include rental and lease equipment and fixtures and usually a regular license fee. McDonald's franchisees typically invest about $1.5 million in total start-up costs and fees. The franchisee then pays McDonald's a certain percentage of sales plus a monthly rent.[8]
3. The franchisor provides its franchisees with a system for doing business. McDonald's requires franchisees to attend "Hamburger University" in Oak Brook, Illinois, for two weeks to learn how to manage the business. Franchisees must follow certain procedures in buying materials.[9]

Franchising benefits both parties. Franchisors gain the motivation and hard work of employees who are entrepreneurs rather than "hired hands," the franchisees' familiarity with local communities and conditions, and the enormous purchasing power of being a franchisor. Franchisees benefit from buying into a business with a well-known and accepted brand name. They find it easier to borrow money for their business from financial institutions, and they receive support in areas ranging from marketing and advertising to site selection and staffing.

Franchisees do walk a fine line between independence and loyalty to the franchisor. Some franchisors are giving their franchisees freedom to run their own operations, from personalizing store names to adjusting offerings and price. Great Harvest Bread believes in a "freedom franchise" approach that encourages its franchisee bakers to create new items for their store menus and to share with other franchisees if they are successful.[10]

THE MODERN RETAIL MARKETING ENVIRONMENT

The retail marketing environment is dramatically different today from what it was just a decade or so ago. Here we focus on two areas that have seen enormous change: competitive retail market structure and the role of technology.

COMPETITIVE RETAIL MARKET STRUCTURE The retail market is very dynamic, and a number of new types of competitors and competition have emerged in recent years. Here are five important developments (see Table 18.3 for a summary).

- ***New Retail Forms and Combinations.*** To better satisfy customers' need for convenience, a variety of new retail forms have emerged. Bookstores feature coffee shops. Gas stations include food stores. Loblaw's Supermarkets have fitness clubs. Shopping malls and bus and train stations have peddlers' carts in their aisles. Retailers are also experimenting with "pop-up" stores that let them promote brands to seasonal shoppers for a few weeks in busy areas. Pop-up stores are designed to create buzz often through interactive experiences. Internet companies such as Amazon.com and Google use pop-up stores as an easy way to establish a physical presence during holiday shopping seasons.[11]
- ***Growth of Giant Retailers.*** Through their superior information systems, logistical systems, and buying power, giant retailers such as Walmart are able to deliver good service and immense volumes of product to masses of consumers at appealing prices. They are crowding out smaller manufacturers that cannot deliver enough quantity and often dictate to the most powerful ones what to make, how to price and promote it, when and how to ship, and even how to improve production and management. Without these accounts, manufacturers would lose 10 percent to 30 percent of the market.

  Some giant retailers are *category killers* that concentrate on one product category, such as pet food (PETCO), home improvement (Home Depot), or office supplies (Staples). Others are *supercenters* that combine grocery items with a huge selection of nonfood merchandise (Walmart). With their broad product assortments, reasonable prices, and convenient service, category killers wiped out many smaller specialty

TABLE 18.3 Recent Retail Developments

- New Retail Forms and Combinations
- Growth of Giant Retailers
- Growth of Intertype Competition
- Emergence of Fast Retailing
- Decline of Middle-Market Retailers

Source: © Daily Mail/Rex/Alamy

Many firms set up temporary pop-up stores to create special shopping experiences, especially at Christmas.

retailers. The rise of Amazon.com and other online retailers has nullified their advantages, however, and some category killers such as Borders, Circuit City, and Tweeter have even gone out of business.[12]

- ***Growth of Intertype Competition.*** One consequence of the growth of the supercenters is that department stores can't worry just about other department stores—discount chains such as Walmart and Tesco are expanding into product areas such as clothing, health, beauty, and electrical appliances.[13] Supermarkets also have to worry about these supercenters. Grocery products accounted for 56 percent of Walmart's U.S. sales in 2012, up from 41 percent just six years ago. The reality is that different types of stores can all compete for the same consumers by carrying the same type of merchandise.
- ***Emergence of Fast Retailing.*** An important trend in fashion retailing in particular, but with broader implications, is the emergence of fast retailing. Here retailers develop completely different supply chain and distribution systems to allow them to offer consumers constantly changing product choices. Fast retailing requires thoughtful decisions in a number of areas, including new product development, sourcing, manufacturing, inventory management, and selling practices. As Chapter 12 described, consumers have been attracted to fast-fashion retailers such as H&M, Zara, Uniqlo, Top Shop, and Forever 21 because of the novelty, value, and fashion sense of their offerings and have made them successful. Critics, however, pan fast fashion for its planned obsolescence and the resulting disposability and waste.[14]
- ***Decline of Middle-Market Retailers.*** We can characterize the retail market today as hourglass or dog-bone shaped: Growth seems to be centered at the top (with luxury offerings from retailers such as Tiffany and Neiman Marcus) and at the bottom (with discount pricing from retailers such as Walmart and Dollar General). As discount retailers improve their quality and image, consumers have been willing to trade down. Target offers Phillip Lim, Jason Wu, and Missoni designs, and Kmart sells an extensive line of Joe Boxer underwear and sleepwear. At the other end of the spectrum, Coach converted 40 of its nearly 300 stores to a more upscale format that offers higher-priced bags and concierge services. Opportunities are scarcer in the middle, where once-successful retailers like JCPenney, Kohl's, Sears, CompUSA, RadioShack, and Montgomery Ward have struggled or even gone out of business. Supermarket chains like Supervalu and Safeway have found themselves caught in the middle between the affluent appeal of chains like Whole Foods and the discount appeal of Aldi and Walmart. Compounding problems is the plight of the middle class—the 40 percent of U.S. consumers with annual incomes between $50,000 and $140,000—who have seen their buying power shrink due to slumping housing prices and stagnating incomes.[15]

ROLE OF TECHNOLOGY Technology is profoundly affecting the way retailers conduct virtually every facet of their business. Almost all now use technology to produce forecasts, control inventory costs, and order from suppliers, reducing the need to discount and run sales to clear out languishing products.

Technology is also directly affecting the consumer shopping experience inside the store. Electronic shelf labeling allows retailers to change price levels instantaneously at need.[16] In-store programming on plasma TVs can run continual demonstrations or promotional messages. Retailers are experimenting with virtual shopping screens, audio/video presentations, and QR code integration.

For flagship stores in Taipei, Hong Kong, London, and Chicago, Burberry made "virtual rain" with a 360° film, as part of its digital "Burberry World Live" program showcasing its rain gear. The UK's Marks & Spencer installed

marketing
insight

The Growth of Shopper Marketing

Buoyed by research suggesting that as many as 70 percent to 80 percent of purchase decisions are made inside the store, firms are increasingly recognizing the importance of influencing consumers at the point of purchase. **Shopper marketing** is the way manufacturers and retailers use stocking, displays, and promotions to affect consumers actively shopping for a product.

Where and how a product is displayed and sold can have a significant effect on sales. A strong proponent of shopper marketing, Procter & Gamble calls the store encounter the "first moment of truth" (product use and consumption are the second). P&G observed the power of displays in a Walmart project designed to boost sales of premium diapers such as Pampers. By creating the first baby center in which infant products—previously spread across the store—were united in a single aisle, the new shelf layout encouraged parents to linger longer and spend more money, increasing Pampers sales. Another successful promotion, this one for P&G's Cover Girl cosmetics brand, tapped into a fashion trend for a "smoky eye" look by developing kits for Walmart and connecting with potential customers on Facebook with instructions, blogs, and a photo gallery.

Retailers are also using technology to influence customers as they shop. Some supermarkets are employing mobile phone apps or "smart shopping carts" that help customers locate items in the store, find out about sales and special offers, and pay more easily. One academic research study found that real-time spending feedback from a smart shopping cart stimulated budget shoppers to spend more (by buying more national brands) but led non-budget shoppers to spend less (by replacing national brands with store brands).

Kraft Foods spinoff Mondelēz uses "smart shelf" technology by putting sensors on shelves near check-out that can detect the age and sex of a consumer and, by virtue of advanced analytics, target them with ads and promotions for a likely snack candidate on a video screen.[18]

Technology is also playing a crucial research role in the design of shopper marketing programs. Some retailers outfit their aisles with sensors or use video from security cameras or other means to monitor shoppers' movements. Others use infrared goggles or wearable video cameras to record what test customers actually see. One finding was that many shoppers ignored products at eye level—the optimal location was between waist and chest level.

Other academic research found that unplanned purchases increased the more a product is touched, the longer a purchase is considered, the closer a customer is to the shelf, the fewer the shelf displays in sight, and the more quickly shoppers can reference external information. To capitalize on these findings, researchers recommend that retailers put Quick Response (QR) codes next to products to be scanned with smart phones. Even the simple act of touching a product on a tablet screen has been shown in research to increase purchase intent.

Sources: Megan Woolhouse, "Tablets Facilitate Impulse Shopping for Many," *Boston Globe*, December 18, 2013; Elizabeth Dwoskin and Greg Bensinger, "Tracking Technology Sheds Light on Shopper Habits," *Wall Street Journal*, December 9, 2013; S. Adam Brasel and Jim Gips, "Tablets, Touchscreens, and Touchpads: How Varying Touch Interfaces Trigger Psychological Ownership and Endowment" *Journal of Consumer Psychology* 24 (April 2014), pp. 226–33; Koert van Ittersum, Brian Wansink, Joost M. E. Pennings, and Daniel Sheehan, "Smart Shopping Carts: How Real-Time Feedback Influences Spending," *Journal of Marketing* 77 (November 2013), pp. 21–36; Barry Silverstein, "Will Mondelez's 'Smart Shelves' Change Retail or Just Add to Privacy Woes," www.brandchannel.com, October 13, 2013; Noreen O'Leary, "Shopper Marketing Goes Mainstream," *Adweek*, May 20, 2013, p. 19; Yanliu Huang, Sam K. Hui, J. Jeffrey Inman, and Jacob A. Suher, "Capturing the 'First Moment of Truth': Understanding Point-of-Purchase Drivers of Unplanned Consideration and Purchase," MSI Report 12-101, www.msi.org, 2012; Pat Lenius, "P&G Leverages Facebook to Enhance Promotions in Walmart," www.cpgmatters.com, November 2011; Venkatesh Shankar, "Shopper Marketing: Current Insights, Emerging Trends, and Future Directions," *MSI Relevant Knowledge Series Book,* www.msi.org, 2011; Anthony Dukes and Yunchuan Liu, "In-Store Media and Distribution Channel Coordination," *Marketing Science* 29 (January–February 2010), pp. 94–107; Richard Westlund, "Bringing Brands to Life: The Power of In-Store Marketing," Special Advertising Supplement to *Adweek*, January 2010; Pierre Chandon, J. Wesley Hutchinson, Eric T. Bradlow, and Scott H. Young, "Does In-Store Marketing Work? Effects of the Number and Position of Shelf Facings on Brand Attention and Evaluation at the Point of Purchase," *Journal of Marketing Research* 73 (November 2009), pp. 1–17; Michael C. Bellas, "Shopper Marketing's Instant Impact," *Beverage World*, November 2007, p. 18; Michael Freedman, "The Eyes Have It," *Forbes*, September 4, 2006, p. 70.

Source: ASSOCIATED PRESS

Smart shopping carts are just one of the technological innovations transforming supermarkets.

virtual mirrors in some of its stores so that, just as on its Web site, customers can see what an eye shadow or lipstick would look like for them without having to physically put it on.[17]

After encountering problems measuring store traffic in the aisles—GPS on shopping carts didn't work because consumers tended to abandon their carts, and thermal imaging couldn't tell the difference between babies and turkeys—bidirectional infrared sensors sitting on store shelves have proven successful. "Marketing Insight: The Growth of Shopper Marketing" describes the important role technology is taking in the aisles.

Retailers are also developing fully integrated digital communication strategies with well-designed Web sites, e-mails, search strategies, and social media campaigns. Social media are especially important for retailers during the holiday season when shoppers are seeking information and sharing successes. For the 2013 holiday season, Toys "R" Us focused on YouTube; Sears used Instagram and hosted holiday parties on Twitter; Target used Pinterest as well as six or seven other social media options.[19] Beyond the holidays, many retailers are linking to customer photos supporting their brands on Instagram, Pinterest, and other sites to create social engagement.[20]

MARKETING DECISIONS

With this new retail environment as a backdrop, we now examine retailers' marketing decisions in some key areas: target market, channels, product assortment, procurement, prices, services, store atmosphere, store activities and experiences, communications, and location. We discuss private labels in the next section.

TARGET MARKET Until it defines and profiles the target market, the retailer cannot make consistent decisions about product assortment, store decor, advertising messages and media, price, and service levels. Whole Foods has succeeded by offering a unique shopping experience to a customer base interested in organic and natural foods.[21]

WHOLE FOODS MARKET

In 284 stores in North America and the United Kingdom, Whole Foods creates celebrations of food. Its markets are bright and well staffed, and food displays are colorful, bountiful, and seductive. Whole Foods is the largest U.S. organic and natural foods grocer, offering more than 2,400 items in four lines of private-label products that add up to 11 percent of sales: the premium Whole Foods Market, Whole Kitchen, and Whole Market lines and the low-priced 365 Everyday Value line. Whole Foods also offers lots of information about its food. If you want to know, for instance, whether the chicken in the display case lived a happy, free-roaming life, you can get a 16-page booklet and an invitation to visit the farm in Pennsylvania where it was raised. For other help, you have only to ask a knowledgeable and easy-to-find employee. A typical Whole Foods has more than 200 employees, almost twice as many as Safeway. The company works hard to create an inviting store atmosphere with prices scrawled in chalk, cardboard boxes and ice everywhere, and other creative display touches to make the shopper feel at home. Its approach is working, especially for consumers who view organic and artisanal food as an affordable luxury. From 1991 to 2009, sales grew at a 28 percent compounded annual growth rate (CAGR). Although the recession hit the retailer hard, it did emerge with more double-digit growth.

Source: Courtesy of Whole Foods Market. "Whole Foods Market" is a registered trademark of Whole Foods Market IP, L.P.

Whole Foods selects merchandise and creates a homey in-store atmosphere to appeal to organic and natural foods lovers.

Mistakes in choosing target markets can be costly. When historically mass-market jeweler Zales decided to chase upscale customers, it replaced one-third of its merchandise, dropping inexpensive, low-quality diamond jewelry for high-margin, fashionable 14-karat gold and silver pieces and shifting its ad campaign in the process. The move was a disaster. Zales lost many of its traditional customers without winning over the new customers it hoped to attract.[22]

To better hit their targets, retailers are slicing the market into ever-finer segments and introducing new lines of stores to exploit niche markets with more relevant offerings: Gymboree launched Janie and Jack, selling apparel and gifts for babies and toddlers; Hot Topic introduced Torrid, selling fashions for plus-sized teen girls; and Limited Brand's Tween Brands began to sell lower-priced fashion to tween girls through its Justice stores and tween boys through its BROTHER shops.

CHANNELS Based on a target market analysis and other considerations we reviewed in Chapter 17, retailers must decide which channels to employ to reach their customers. Increasingly, the answer is multiple channels. Staples sells through its traditional retail brick-and-mortar channel, a direct-response Internet site, virtual malls, and thousands of links on affiliated sites.

As Chapter 17 also explained, channels should be designed to work together effectively. Although some experts predicted otherwise, catalogs have actually grown in an Internet world as more firms have revamped them to use them as branding devices and to complement online activity.[23] Victoria's Secret's integrated multichannel approach of retail stores, catalog, and Internet has played a key role in its brand development.[24]

VICTORIA'S SECRET Victoria's Secret, purchased by Limited Brands in 1982, has become one of the most identifiable brands in retailing through skillful marketing of women's clothing, lingerie, and beauty products. Most U.S. women a generation ago did their underwear shopping in department stores and owned few items that could be considered "lingerie." After witnessing women buying expensive lingerie as fashion items from small boutiques in Europe, Limited Brands founder Leslie Wexner felt a similar store model could work on a mass scale in the United States, though such a store format was unlike anything the average shopper would have encountered amid the bland racks at department stores. Wexner, however, had reason to believe U.S. women would relish the opportunity to have a European-style lingerie shopping experience with soft pink wallpaper, inviting fitting rooms, and attractive and attentive staff. "Women need underwear, but women want lingerie," he observed. Wexner's assumption proved correct: A little more than a decade after he bought the business, Victoria's Secret's average customer bought eight to 10 bras per year, compared with the national average of two. To enhance its upscale reputation and glamorous appeal, the brand is endorsed by high-profile supermodels in ads and televised fashion show extravaganzas. Victoria's Secret sells through its stores, Web site, and catalog, mailing 325 million U.S. catalogs a year at a cost of $200 million. Web and catalog sales account for 25 percent of the company's $5 billion in revenue. Overseas expansion is being led by "store within a store" beauty boutiques to reduce risk.

PRODUCT ASSORTMENT The retailer's product assortment must match the target market's shopping expectations in *breadth* and *depth*.[25] A restaurant can offer a narrow and shallow assortment (small lunch counters), a narrow and deep assortment (delicatessen), a broad and shallow assortment (cafeteria), or a broad and deep assortment (large restaurant).

Destination categories may play a particularly important role because they have the greatest impact on where households choose to shop and how they view a particular retailer. A supermarket could be known for the freshness of its produce or for the variety and deals its offers in soft drinks and snacks.[26]

Identifying the right product assortment can be especially challenging in fast-moving industries such as technology or fashion. At one point, Urban Outfitters ran into trouble when it strayed from its "hip but not too hip" formula, embracing new styles too quickly.[27] On the other hand, active and casual apparel retailer Aéropostale has succeeded by carefully matching its product assortment to its young teen needs.[28]

AÉROPOSTALE Fourteen- to 17-year-olds, especially those on the young end, often want to look like other teens. So while Abercrombie and American Eagle might reduce the number of cargo pants on the sales floor, Aéropostale embraces this key reality of its target market and will keep an ample supply on hand at an affordable price. Staying on top of the right trends isn't easy, but the company is among the most diligent of teen retailers when it comes to consumer research. In addition to running high-school focus groups and in-store product tests, it launched an online program that seeks the input of 10,000 of its best customers in creating new styles. An average of 3,500 participate in each of 20 tests a year. Aéropostale maintains control over its proprietary brands by designing, sourcing, marketing, and selling all its own merchandise. The company's products can be purchased only in its own stores and online. Aéropostale has gone from a lackluster performer with only 100 stores to a powerhouse with more than 1,000 outlets in the United States, Puerto Rico, and Canada. One hundred new P.S. from Aéropostale stores target 4- to 12-year-olds with a strong value emphasis. Net sales totaled more than $2.6 billion in 2012, with net sales from e-commerce contributing more than $180 billion.

Source: © Kumar Sriskandan/Alamy

Apparel retailer Aeropostale studies its young teen market carefully as it strives to stock and display the right product assortment.

The real challenge begins after defining the store's product assortment, when the retailer must develop a product-differentiation strategy. Here are some possibilities:

- ***Feature exclusive national brands not available at competing retailers.*** Saks might get exclusive rights to carry the dresses of a well-known international designer.
- ***Feature mostly private-label merchandise.*** Benetton and Gap design most of the clothes carried in their stores. Many supermarket and drug chains carry private-label merchandise.
- ***Feature blockbuster distinctive-merchandise events.*** Bloomingdale's ran a month-long celebration for the Barbie doll's 50th anniversary.
- ***Feature surprise or ever-changing merchandise.*** Off-price apparel retailer TJ Maxx offers surprise assortments of distress merchandise (goods the owner must sell immediately because it needs cash), overstocks, and closeouts sourced from more than 16,000 vendors and priced 20 percent to 60 percent below department and specialty store regular prices online and at its 1000-plus stores.
- ***Feature the latest or newest merchandise first.*** Zara excels in and profits from being first to market with appealing new looks and designs.
- ***Offer merchandise-customizing services.*** Harrods of London will make custom-tailored suits, shirts, and ties for customers in addition to ready-made menswear.
- ***Offer a highly targeted assortment.*** Lane Bryant carries goods for the larger woman. Brookstone offers unusual tools and gadgets for the person who wants to shop in a "toy store for grown-ups."

Merchandise may also vary by geographical market. Macy's and Ross Stores employ *micro-merchandising* and let managers select a significant percentage of store assortments.[29]

PROCUREMENT After deciding on the product-assortment strategy, the retailer must establish merchandise sources, policies, and practices. In the corporate headquarters of a supermarket chain, specialist buyers (sometimes called *merchandise managers*) are responsible for developing brand assortments and listening to presentations from their suppliers' salespeople.

Retailers are rapidly improving their skills in demand forecasting, merchandise selection, stock control, space allocation, and display. They use sophisticated software to track inventory, compute economic order quantities, order goods, and analyze dollars spent on vendors and products. Supermarket chains use scanner data to manage their merchandise mix on a store-by-store basis.

Some stores are using radio frequency identification (RFID) systems made up of "smart" tags—microchips attached to tiny radio antennas—and electronic readers to facilitate inventory control and product replenishment. The smart tags can be embedded on products or stuck on labels, and when the tag is near a reader, it transmits a unique identifying number to its computer database. Coca-Cola and Gillette have used them to monitor inventory and track goods in real time as they move from factories to supermarkets to shopping baskets.[30]

ALDI's unique procurement strategy emphasizes a constantly rotating group of select private label branded products.

Source: © Lisa S./Shutterstock

Stores are using **direct product profitability (DPP)** to measure a product's handling costs (receiving, moving to storage, paperwork, selecting, checking, loading, and space cost) from the time it reaches the warehouse until a customer buys it in the retail store. They learn to their surprise that the gross margin on a product often bears little relation to the direct product profit. Some high-volume products may have such high handling costs that they are less profitable and deserve less shelf space than low-volume products.

ALDI has differentiated itself on its innovative procurement strategy.[31]

ALDI The ALDI success story started in 1913 with a single small food market in Germany. Today, ALDI has two divisions, ALDI North and ALDI South, and 9,600 stores in 18 countries. While other food retailers carry thousands of products, ALDI's product range is very narrow. With about 1,000 core products, dominated by ALDI-exclusive private labels, ALDI is very focused on products with high turnover, which it can source in high quantities at low prices. Logistics, weekly promotions, and store displays of products in transport boxes are designed to keep costs as low as possible in order to provide value. Customer perception of ALDI and its products has improved significantly over the years. High quality at low prices is the brand promise, and ALDI brands have reached top ratings in many independent product tests. To its suppliers, ALDI is known as a tough but reliable partner. Price negotiations are known to be very demanding. ALDI also expects suppliers to guarantee high standards of quality, and it constantly monitors quality throughout its whole supply chain.

Source: ASSOCIATED PRESS

Target's "mass with class" assortment and pricing strategy features designers like popular entertainer Gwen Stefani.

PRICES Prices are a key positioning factor and must be set in relationship to the target market, product-and-service assortment mix, and competition.[32] All retailers would like high *turns* × *earns* (high volumes and high gross margins), but the two don't usually go together. Most retailers fall into the *high-markup, lower-volume* group (fine specialty stores) or the *low-markup, higher-volume* group (mass merchandisers and discount stores). Within each of these groups are further gradations.

At one end of the price spectrum is by-appointment-only Bijan on Rodeo Drive in Beverly Hills, known as the most expensive store in the world. The original cost of its cologne was $1,500 for six ounces, and its suits are priced at $25,000, ties at $1,200, and socks at $100.[33] At the other end of the scale, Target has skillfully combined a hip image with discount prices to offer customers a strong value proposition. It first introduced a line of products from world-renowned designers such as Michael Graves, Isaac Mizrahi, and Liz Lange and has continued to add high-profile names, such as singer Gwen Stefani to sell hip children's clothes.[34]

Most retailers will put low prices on some items to serve as traffic builders (or loss leaders) or to signal their pricing policies.[35] They will run storewide sales. They will plan markdowns on slower-moving merchandise. Shoe retailers, for example, expect to sell 50 percent of their shoes at the normal markup, 25 percent at a 40 percent markup, and the remaining 25 percent at cost. A store's average price level and discounting policies will affect its price image with consumers, but non-price-related factors such as store atmosphere and levels of service also matter.[36]

As Chapter 16 noted, some retailers such as Walmart have abandoned "sale pricing" in favor of everyday low pricing (EDLP). EDLP can lead to lower advertising costs, greater pricing stability, a stronger image of fairness and reliability, and higher retail profits. Supermarket chains practicing everyday low pricing can be more profitable than those practicing high–low sale pricing, but only in certain circumstances, such as when the market is characterized by many "large basket" shoppers who tend to buy many items on any one trip.[37]

All retailers are seeking to cut costs to improve margins. Some do so in an environmentally friendly way. Walmart has cut energy use by more than 50 percent and maintenance by more than 30 percent by painting store roofs white to reflect sunlight and reduce the use of air conditioning; capturing rain in storage tanks for flushing toilets and other uses that do not require drinking-quality water; and installing LED lights in parking lots.[38]

SERVICES Another differentiator is unerringly reliable customer service, whether face to face, across phone lines, or via online chat. Retailers must decide on the *services mix* to offer customers:

- *Prepurchase services* include accepting telephone and mail orders, advertising, window and interior display, fitting rooms, shopping hours, fashion shows, and trade-ins.
- *Postpurchase services* include shipping and delivery, gift wrapping, adjustments and returns, alterations and tailoring, installations, and engraving.
- *Ancillary services* include general information, check cashing, parking, restaurants, repairs, interior decorating, credit, rest rooms, and baby-attendant service.

Due to consumer complaints, many retailers have loosened up their returns policies in recent years. To reduce any possible impediment to sales and to improve their image with consumers, these firms are also eliminating restocking fees and extending return periods. Some policies have necessarily stayed in place, though, to combat frauds such as "wardrobing"—the practice of wearing and then returning clothing items.[39] Gift cards remain another popular service offering; consumers spend more than $100 billion on cards annually.[40]

STORE ATMOSPHERE Every store has a look and a physical layout that makes it hard or easy to move around (see "Marketing Memo: Helping Stores to Sell"). Kohl's floor plan is modeled after a racetrack loop and is designed to convey customers smoothly past all the merchandise in the store. It includes a middle aisle that hurried shoppers can use as a shortcut and yields higher spending levels than many competitors.[41]

Retailers must consider all the senses in shaping the customer's experience. Varying the tempo of music affects average time and dollars spent in the supermarket—slow music can lead to higher sales. Bloomingdale's uses different essences or scents in different departments: baby powder in the baby store; suntan lotion in the bathing suit area; lilacs in lingerie; and cinnamon and pine scent during the holiday season. Other retailers such as Victoria's Secret and Juicy Couture use their own distinctive branded perfumes, which they also sell.[42]

STORE ACTIVITIES AND EXPERIENCES The growth of e-commerce has forced traditional brick-and-mortar retailers to respond. In addition to their natural advantages, such as products that shoppers can actually see, touch, and test; real-life customer service; and no delivery lag time for most purchases, stores also provide a shopping experience as a strong differentiator.

The store atmosphere should match shoppers' basic motivations—if customers are likely to be in a task-oriented and functional mind-set, then a simpler, more restrained in-store environment may be better.[43] On the other hand, some retailers of experiential products are creating in-store entertainment to attract customers who want fun and excitement.[44] REI, seller of outdoor gear and clothing products, allows consumers to test climbing equipment on 25-foot or even 65-foot walls in the store and to try GORE-TEX raincoats under a simulated rain shower. Bass Pro Shops also offers rich customer experiences.[45]

BASS PRO SHOPS Bass Pro Shops, a retailer of outdoor sports equipment, caters to hunters, campers, fisherman, boaters, and outdoors fans of any type. Its Outdoor World superstores feature 200,000 square feet or more of giant aquariums, waterfalls, trout ponds, archery and rifle ranges, fly-tying demonstrations, indoor driving range and putting greens, and classes in everything from ice fishing to conservation—all free. Every department is set up to replicate the corresponding outdoor experience in support of product demonstrations and testing. During the summer, parents can bring their kids to the free in-store Family Summer Camp with a host of activities in all departments. Bass Pro Shops builds a strong connection to its loyal customers from the moment they enter the store—through a turnstile designed to highlight that "they are entering an attraction, not just a retail space"—and are greeted by the irreverent sign saying "Welcome Fishermen, Hunters, and Other Liars." One hundred and sixteen million people shopped at a Bass Pro Shop in 2012; the average customer drove more than 50 miles and stayed for more than two hours. The showroom in Missouri—the first and largest—is the number-one tourist destination in the state.

COMMUNICATIONS Retailers use a wide range of communication tools to generate traffic and purchases. They place ads, run special sales, issue money-saving coupons, send e-mail promotions, and run frequent-shopper-reward programs, in-store food sampling, and coupons on shelves or at check-out points. They work with manufacturers to design point-of-sale materials that reflect both their images. They time the arrival of their e-mails and design them with attention-grabbing subject lines and animation and personalized messages and advice.

Retailers are also using interactive and social media to pass on information and create communities around their brands. They study the way consumers respond to their e-mails, not only where and how messages are opened but

marketing memo

Helping Stores to Sell

In pursuit of higher sales volume, retailers are studying their store environments for ways to improve the shopper experience. Paco Underhill is a pioneer in that field and managing director of the retail consultant Envirosell, whose clients include McDonald's, Starbucks, Estée Lauder, Gap, Burger King, CVS, and Wells Fargo. Using a combination of in-store video recording and observation tracking of as many as 40 different behaviors, Underhill and his colleagues study 50,000 people each year as they shop. He offers the following advice for fine-tuning retail space:

- *Attract shoppers and keep them in the store.* The amount of time shoppers spend in a store is perhaps the single most important factor in determining how much they buy. To increase shopping time, give shoppers a sense of community; recognize them in some way; make them comfortable, such as by providing chairs in convenient locations for spouses, children, or bags; and make the environment both familiar and fresh each time they come in.
- *Honor the "transition zone."* On entering a store, people need to slow down and sort out the stimuli, which means they will likely be moving too fast to respond positively to signs, merchandise, or sales clerks in the zone they cross before making that transition. Make sure there are clear sight lines. Create a focal point for information within the store. Most right-handed people turn right upon entering a store.
- *Avoid overdesign.* Store fixtures, point-of-sales information, packaging, signage, and flat-screen televisions can combine to create a visual riot. Use crisp and clear signage—"Our Best Seller" or "Our Best Student Computer"—located where people feel comfortable stopping and facing the right way. Window signs, displays, and mannequins communicate best when angled 10 to 15 degrees to face the direction in which people are moving.
- *Don't make them hunt.* Put the most popular products up front to reward busy shoppers and encourage leisurely shoppers to look more. At Staples, ink cartridges are one of the first products shoppers encounter after entering.
- *Make merchandise available to the reach and touch.* It is hard to overemphasize the importance of customers' hands. A store can offer the finest, cheapest, sexiest goods, but if the shopper cannot reach them or pick them up, much of their appeal can be lost.
- *Make kids welcome.* If kids feel welcome, parents will follow. Take a 3-year-old's perspective and make sure there are engaging sights at eye level. A virtual hopscotch pattern or dinosaur on the floor can turn a boring shopping trip for a child into a friendly experience.
- *Note that men do not ask questions.* Men always move faster than women do through a store's aisles. In many settings, it is hard to get them to look at anything they had not intended to buy. Men also do not like asking where things are. If a man cannot find the section he is looking for, typically he will wheel about once or twice, then leave the store without ever asking for help.
- *Remember women need space.* A shopper, especially a woman, is far less likely to buy an item if her body is brushed, even lightly, by another customer when she is looking at a display. Keeping aisles wide and clear is crucial. With women playing an increasingly more significant buying role than men, designing retail experiences to satisfy them is crucial. Cleanliness, control, safety, and consideration are among the important retail decision factors for women.
- *Make check-out easy.* Be sure to have the right high-margin goods near cash registers to satisfy impulse shoppers. People love to buy candy when they check out—so satisfy their sweet tooth.

Sources: Paco Underhill, *What Women Want: The Science of Female Shopping* (New York: Simon & Schuster, 2011); Paco Underhill, *Call of the Mall: The Geography of Shopping* (New York: Simon & Schuster, 2004); Paco Underhill, *Why We Buy: The Science of Shopping* (New York: Simon & Schuster, 1999). See also Gloria Moss, "Time for Gatherers to Have More Clout in the Boardroom!," *Huffington Post*, June 3, 2012; Brian Tarren, "Watchman," *Research*, July 17, 2012; Susan Berfield, "Getting the Most Out of Every Shopper, *BusinessWeek*, February 9, 2009, pp. 45–46; Kenneth Hein, "Shopping Guru Sees Death of Detergent Aisle," *Brandweek*, March 27, 2006, p. 11.

also which words and images led to a click. Macy's segments customers into more than a dozen groups and sends different e-mails for different products.[46] Casual dining chain Houlihan's social network site, HQ, gains immediate, unfiltered feedback from 10,500 invitation-only "Houlifan" customers in return for insider information about recipes and redesigns.[47]

Source: Bart Ah You/ZUMApress/Newscom

Bass Pro Shops brings outdoor experiences into different departments of its stores.

With 15 percent of a retailer's most loyal customers accounting for as much as half its sales, reward programs are becoming increasingly sophisticated. Consumers who choose to share personal information can receive discounts, secret or advance sales, exclusive offers, and store credits. CVS has 70 million loyalty club members who can use in-store coupon centers and receive coupons with their sales receipts.[48]

Many retailers are using Twitter to connect with customers and send ads to targeted groups.[49] Some local retailers are using digital daily-deal services from Groupon, LivingSocial, and others, although recently many have soured on the approach due to a lack of profitability.[50]

LOCATION The three keys to retail success are often said to be "location, location, and location." Department store chains, oil companies, and fast-food franchisers exercise great care in selecting regions of the country in which to open outlets, then particular cities, and then particular sites. Retailers can place their stores in the following locations:

- ***Central business districts.*** The oldest and most heavily trafficked city areas, often known as "downtown"
- ***Regional shopping centers.*** Large suburban malls containing 40 to 200 stores, typically featuring one or two nationally known anchor stores, such as Macy's or Lord & Taylor or a combination of big-box stores such as PETCO, Payless Shoes, or Bed Bath & Beyond, and a great number of smaller stores, many under franchise operation.[51]
- ***Community shopping centers.*** Smaller malls with one anchor store and 20 to 40 smaller stores
- ***Shopping strips.*** A cluster of stores, usually in one long building, serving a neighborhood's needs for groceries, hardware, laundry, shoe repair, and dry cleaning
- ***A location within a larger store.*** Smaller concession spaces taken by well-known retailers like McDonald's, Starbucks, Nathan's, and Dunkin' Donuts within larger stores, airports, or schools or "store-within-a-store" specialty retailers located within a department store such as with Gucci within Neiman Marcus
- ***Stand-alone stores.*** Some retailers such as Kohl's and JCPenney are avoiding malls and shopping centers in favor of freestanding storefronts so they are not connected directly to other retail stores.

In view of the relationship between high traffic and high rents, retailers must decide on the most advantageous locations for their outlets, using traffic counts, surveys of consumer shopping habits, and analysis of competitive locations.

Private Labels

A **private-label brand** (also called a reseller, store, house, or distributor brand) is a brand that retailers and wholesalers develop. Benetton, The Body Shop, and Marks & Spencer carry mostly own-brand merchandise. In grocery stores in Europe and Canada, store brands account for as much as 40 percent of the items sold. In Britain, roughly half of what Sainsbury and Tesco, the largest food chains, sell is store-label goods. Germany and Spain are also European markets with a high percentage of private-label sales.[52]

For many manufacturers, retailers are both collaborators and competitors. According to the Private Label Manufacturers' Association, store brands now account for one of every five items sold in U.S. supermarkets, drug chains, and mass merchandisers. In one study, seven of 10 shoppers believed the private-label products they bought were as good as, if not better than, their national-brand counterparts, and virtually every household purchases private-label brands from time to time.[53] The stakes in private-label marketing are high. A one-percentage-point shift from national brands to private labels in food and beverages is estimated to add $5.5 billion in revenue for supermarket chains.[54]

Private labels are rapidly gaining ground in a way that has many manufacturers of name brands running scared. Recessions increase private-label sales, and once some consumers switch to a private label, they don't always go back.[55] But some experts believe 50 percent is the natural limit on how much private-label volume to carry because (1) consumers prefer certain national brands, and (2) many product categories are not feasible or attractive on a private-label basis. In supermarkets, private labels are big sellers in milk and cheese, bread and baked goods, medications and remedies, paper products, fresh produce, and packaged meats.[56]

ROLE OF PRIVATE LABELS

Why do intermediaries sponsor their own brands?[57] First, these brands can be more profitable. Intermediaries may be able to use manufacturers with excess capacity that will produce private-label goods at low cost. Other costs, such as research and development, advertising, sales promotion, and physical distribution, are also much lower, so private labels can generate a higher profit margin.[58] Retailers also develop exclusive store brands to differentiate themselves from competitors. Many price-sensitive consumers prefer store brands in certain categories. These preferences give retailers increased bargaining power with marketers of national brands.

We should distinguish private-label or store brands from generics. **Generics** are unbranded, plainly packaged, less expensive versions of common products such as spaghetti, paper towels, and canned peaches. They offer standard or lower quality at a price that may be as much as 20 percent to 40 percent lower than nationally advertised brands and 10 percent to 20 percent lower than the retailer's private-label brands. The lower price is made possible by lower-cost labeling and packaging and minimal advertising and sometimes lower-quality ingredients.

Generics can be found in a wide range of different products, even medicines. Pharma giant Novartis is one of the world's top five makers of branded drugs, with such successes as Diovan for high blood pressure and Gleevec for cancer, but it has also become the world's second-largest maker of generic drugs following its acquisition of Sandoz, HEXAL, Eon Labs, and others.[59]

PRIVATE-LABEL SUCCESS FACTORS

In the battle between manufacturers' and private labels, retailers have increasing market power. Because shelf space is scarce, many supermarkets charge a *slotting fee* for accepting a new brand to cover the cost of listing and stocking it. Retailers also charge for special display space and in-store advertising space. They typically give more prominent display to their own brands and make sure they are well stocked.

Retailers are building better quality into their store brands and emphasizing attractive, innovative packaging. Supermarket retailers are adding premium store-brand items. When Kroger's switched to new vendors to supply better-quality cheeses, meats, and veggies for its upscale private-label pizza, sales soared; the supermarket chain now owns 60 percent of the premium pizza market in its stores.[60] One of the most successful supermarket retailers with private labels is Canada's Loblaw.[61]

LOBLAW Since 1984, when its President's Choice line of foods made its debut, the term *private label* has brought Loblaw instantly to mind. The Toronto-based company's Decadent Chocolate Chip Cookie quickly became a Canadian leader and showed how innovative store brands could compete effectively with national brands by matching or even exceeding their quality. A finely tuned brand strategy for its premium President's Choice line and its no-frills, yellow-labeled No Name line (which the company relaunched with a vengeance during the recent recession) has helped differentiate its stores and built Loblaw into a powerhouse in Canada and the United States. The President's Choice line has become so successful that Loblaw is licensing it to noncompetitive retailers in other countries. To complete a "good, better, best" brand portfolio, Loblaw has also introduced an "affordable luxury" line of more than 200 President's Choice food products under a distinctive "Black Label" design. Each one—from eight-year-old cheddar and ginger-spiced chocolate sauce to bacon marmalade—is marketed with a story about where it's from, who produces it, and why it was chosen. To capitalize on the overall strength of its private labels, Loblaw launched a Food Network reality TV show, *Recipe to Riches*, where contestants compete to have their homemade recipes developed into an actual President's Choice product available to purchase the very next day at Loblaw's stores.

Although retailers get credit for the success of private labels, the growing power of store brands has also benefited from the weakening of national brands. Many consumers have become more price sensitive, a trend reinforced by the continuous barrage of coupons and price specials that has trained a generation to buy on price. Competing manufacturers and national retailers copy and duplicate the quality and features of the best brands in marketing insight

Manufacturer's Response to the Private-Label Threat

To stay a step ahead of store brands, leading brand marketers are investing significantly in R&D to bring out new brands, line extensions, features, and quality improvements. They are also investing in strong "pull" advertising programs to maintain high brand recognition and consumer preference and to overcome the in-store marketing advantage private labels can enjoy.

Top-brand marketers also are seeking to partner with major mass distributors in a joint search for logistical economies and competitive strategies that produce savings for both sides. Cutting all unnecessary costs allows national brands to command a price premium, though price can't exceed consumers' perception of value.

Creating strong consumer demand is crucial. When Walmart decided to pull Hefty and Glad food bags from its shelves, selling just Ziploc and its own Great Value brand, Hefty and Glad stood to lose because the retail giant accounted for a third of their sales. When consumers complained about the loss of these and other brands and switched some of their shopping to other stores, Walmart relented and put them back on the shelves.

Effective positioning is crucial. Despite holding a hefty 60 percent price premium over its private-label competitors, Pepto-Bismol gained market share during the recession. A clever advertising campaign portraying the product as an effective multipurpose "insurance policy" for gastrointestinal maladies struck a chord with value-minded consumers.

University of North Carolina's Jan-Benedict E. M. Steenkamp and London Business School's Nirmalya Kumar offer four strategic recommendations for manufacturers to compete against or collaborate with private labels.

- *Fight selectively* when manufacturers can win against private labels and add value for consumers, retailers, and shareholders. This typically occurs when the brand is number one or two in the category or occupying a premium niche position. Procter & Gamble rationalized its portfolio, selling off various brands such as Sunny Delight juice drink, Jif peanut butter, and Crisco shortening, in part so it could concentrate on strengthening its 20-plus brands with more than $1 billion in sales.
- *Partner effectively* by seeking win-win relationships with retailers through strategies that complement the retailer's private labels. Estée Lauder created four brands (American Beauty, Flirt, Good Skin, and Grassroots) exclusively for Kohl's to help the retailer generate volume and protect its more prestigious brands in the process. Manufacturers selling through hard discounters such as Lidl and Aldi have increased sales by finding new customers who have not previously bought the brand.
- *Innovate brilliantly* with new products to help beat private labels. Continuously launching incrementally new products keeps the manufacturer brands looking fresh, but the firm must also periodically launch radically new products and protect the intellectual property of all brands. Kraft doubled its number of patent lawyers to make sure its innovations were legally protected as much as possible.
- *Create winning value propositions* by imbuing brands with symbolic imagery as well as functional quality that beats private labels. Too many manufacturer brands have let private labels equal and sometimes better them on functional quality. In addition, to have a winning value proposition, marketers need to monitor pricing and ensure that perceived benefits equal the price premium.

Sources: Tony Fanin, "Brands Still Mean Something at Walmart," www.bebranded.wordpress.com, March 22, 2010; Parija Kavilanz, "Dumped! Brand Names Fight to Stay in Stores," *USA Today,* February 16, 2010; Jan-Benedict E. M. Steenkamp and Nirmalya Kumar, "Don't Be Undersold," *Harvard Business Review*, December 2009, p. 91; Jack Neff, "Pepto Beats Private Label despite 60% Price Premium," *Wall Street Journal*, September 21, 2009; Nirmalya Kumar and Jan-Benedict E. M. Steenkamp, *Private Label Strategy: How to Meet the Store-Brand Challenge* (Boston: Harvard Business School Press, 2007); Nirmalya Kumar, "The Right Way to Fight for Shelf Domination," *Advertising Age*, January 22, 2007; James A. Narus and James C. Anderson, "Contributing as a Distributor to Partnerships with Manufacturers," *Business Horizons* (September–October 1987).

a category, reducing physical product differentiation. Moreover, by cutting marketing communication budgets, some firms have made it harder to create any intangible differences in brand image. A steady stream of brand extensions and line extensions has blurred brand identity at times and led to a confusing amount of product proliferation.

Bucking these trends, many manufacturers or national brands are fighting back. "Marketing Insight: Manufacturer's Respond to the Private-Label Threat," describes the strategies and tactics being taken to compete more effectively with private labels.[62]

Wholesaling

Wholesaling includes all the activities in selling goods or services to those who buy for resale or business use. It excludes manufacturers and farmers because they are engaged primarily in production, and it excludes retailers. The major types of wholesalers are described in Table 18.4.

TABLE 18.4	Major Wholesaler Types

Merchant wholesalers: Independently owned businesses that take title to the merchandise they handle. They are full-service and limited-service jobbers, distributors, and mill supply houses.
Full-service wholesalers: Carry stock, maintain a sales force, offer credit, make deliveries, provide management assistance. Wholesale merchants sell primarily to retailers: Some carry several merchandise lines, some carry one or two lines, others carry only part of a line. Industrial distributors sell to manufacturers and also provide services such as credit and delivery.
Limited-service wholesalers: *Cash and carry wholesalers* sell a limited line of fast-moving goods to small retailers for cash. *Truck wholesalers* sell and deliver a limited line of semiperishable goods to supermarkets, grocery stores, hospitals, restaurants, and hotels. *Drop shippers* serve bulk industries such as coal, lumber, and heavy equipment. They assume title and risk from the time an order is accepted to its delivery. *Rack jobbers* serve grocery retailers in nonfood items. Delivery people set up displays, price goods, and keep inventory records; they retain title to goods and bill retailers only for goods sold to the end of the year. *Producers' cooperatives* assemble farm produce to sell in local markets. *Mail-order wholesalers* send catalogs to retail, industrial, and institutional customers; orders are filled and sent by mail, rail, plane, or truck.
Brokers and agents: Facilitate buying and selling, on commission of 2 percent to 6 percent of the selling price; limited functions; generally specialize by product line or customer type. *Brokers* bring buyers and sellers together and assist in negotiation; they are paid by the party hiring them—food brokers, real estate brokers, insurance brokers. *Agents* represent buyers or sellers on a more permanent basis. Most manufacturers' agents are small businesses with a few skilled salespeople: Selling agents have contractual authority to sell a manufacturer's entire output; purchasing agents make purchases for buyers and often receive, inspect, warehouse, and ship merchandise; commission merchants take physical possession of products and negotiate sales.
Manufacturers' and retailers' branches and offices: Wholesaling operations conducted by sellers or buyers themselves rather than through independent wholesalers. Separate branches and offices are dedicated to sales or purchasing. Many retailers set up purchasing offices in major market centers.
Specialized wholesalers: Agricultural assemblers (buy the agricultural output of many farms), petroleum bulk plants and terminals (consolidate the output of many wells), and auction companies (auction cars, equipment, etc., to dealers and other businesses).

Wholesalers (also called *distributors*) differ from retailers in a number of ways. First, wholesalers pay less attention to promotion, atmosphere, and location because they are dealing with business customers rather than final consumers. Second, wholesale transactions are usually larger than retail transactions, and wholesalers usually cover a larger trade area than retailers. Third, wholesalers and retailers are subject to different legal regulations and taxes.

Why do manufacturers not sell directly to retailers or final consumers? Why use wholesalers at all? In general, wholesalers can more efficiently perform one or more of the following functions:

- ***Selling and promoting.*** Wholesalers' sales forces help manufacturers reach many small business customers at a relatively low cost. They have more contacts, and buyers often trust them more than they trust a distant manufacturer.
- ***Buying and assortment building.*** Wholesalers are able to select items and build the assortments their customers need, saving them considerable work.
- ***Bulk breaking.*** Wholesalers achieve savings for their customers by buying large carload lots and breaking the bulk into smaller units.
- ***Warehousing.*** Wholesalers hold inventories, thereby reducing inventory costs and risks to suppliers and customers.
- ***Transportation.*** Wholesalers can often provide quicker delivery to buyers because they are closer to the buyers.
- ***Financing.*** Wholesalers finance customers by granting credit and finance suppliers by ordering early and paying bills on time.

- ***Risk bearing.*** Wholesalers absorb some risk by taking title and bearing the cost of theft, damage, spoilage, and obsolescence.
- ***Market information.*** Wholesalers supply information to suppliers and customers regarding competitors' activities, new products, price developments, and so on.
- ***Management services and counseling.*** Wholesalers often help retailers improve their operations by training sales clerks, helping with store layouts and displays, and setting up accounting and inventory-control systems. They may help industrial customers by offering training and technical services.

TRENDS IN WHOLESALING

Wholesaler-distributors have faced mounting pressures in recent years from new sources of competition, demanding customers, new technologies, and more direct-buying programs by large industrial, institutional, and retail buyers. Manufacturers' major complaints against wholesalers are: They don't aggressively promote the manufacturer's product line and they act more like order takers; they don't carry enough inventory and therefore don't fill customers' orders fast enough; they don't supply the manufacturer with up-to-date market, customer, and competitive information; they don't attract high-caliber managers to bring down their own costs; and they charge too much for their services.

Savvy wholesalers have rallied to the challenge and adapted their services to meet their suppliers' and target customers' changing needs. They recognize that they must add value to the channel. Arrow Electronics has done just that.[63]

ARROW ELECTRONICS Arrow Electronics is a global provider of products, services, and solutions to the electronic component and computer product industries. It serves as a supply-channel partner for more than 100,000 original-equipment manufacturers, contract manufacturers, and commercial customers through a global network of 470 locations in 55 countries and territories. With huge contract manufacturers buying more parts directly from suppliers, however, distributors like Arrow are being squeezed out. To better compete, the company has embraced services, providing financing, on-site inventory management, parts-tracking software, and chip programming. Services helped quadruple its share price over a five-year stretch, and the company topped $21.4 billion in sales in 2013.

Wholesalers have worked to increase asset productivity by better managing inventories and receivables. They're also reducing operating costs by investing in more advanced materials-handling technology, information systems, and the Internet. Finally, they're improving their strategic decisions about target markets, product assortment and services, price, communications, and distribution.

Academic experts Jim Narus and Jim Anderson interviewed leading industrial distributors and identified four ways they strengthened their relationships with manufacturers:[64]

1. They sought a clear agreement with their manufacturers about their expected functions in the marketing channel.
2. They gained insight into the manufacturers' requirements by visiting their plants and attending manufacturer association conventions and trade shows.
3. They fulfilled their commitments to the manufacturer by meeting the volume targets, paying bills promptly, and feeding back customer information to their manufacturers.
4. They identified and offered value-added services to help their suppliers.

The wholesaling industry remains vulnerable to one of the most enduring trends—fierce resistance to price increases and the winnowing out of suppliers based on cost and quality. The trend toward vertical integration, in which manufacturers try to control or own their intermediaries, is still strong.

Market Logistics

Physical distribution starts at the factory. Managers choose a set of warehouses (stocking points) and transportation carriers that will deliver the goods to final destinations in the desired time or at the lowest total cost. Physical distribution has now been expanded into the broader concept of **supply chain management (SCM)**. Supply chain management starts before physical distribution and includes strategically procuring the right inputs (raw materials, components, and capital equipment), converting them efficiently into finished products, and dispatching them to the final destinations. An even broader perspective looks at how the company's suppliers themselves obtain their inputs.

The supply chain perspective can help a company identify superior suppliers and distributors and then help it improve productivity and reduce costs. Firms with top supply chains include Apple, McDonald's, Amazon.com, Unilever, Intel, Procter & Gamble, Cisco Systems, and Samsung Electronics.[65] Some companies choose to partner with and outsource to third-party logistics specialists for help with transportation planning, distribution center management, and other valued-added services that go beyond shipping and storing.[66]

Getting the supply chain right can have huge payoffs. In 2005, Whirlpool found itself with a hodgepodge of warehouses, transport depots, and factory-distribution centers. After a four-year, $600 million investment in a new state-of-the-art distribution system built from scratch, the company reduced its annual inventory by about $250 million a year and now realizes a savings of $100 million a year in increased efficiency while being able to deliver products in 48 to 72 hours.[67]

Market logistics includes planning the infrastructure to meet demand, then implementing and controlling the physical flows of materials and final goods from points of origin to points of use to meet customer requirements at a profit. Market logistics planning has four steps:[68]

1. Deciding on the company's value proposition to its customers. (What on-time delivery standard should we offer? What levels should we attain in ordering and billing accuracy?)
2. Selecting the best channel design and network strategy for reaching the customers. (Should the company serve customers directly or through intermediaries? What products should we source from which manufacturing facilities? How many warehouses should we maintain, and where should we locate them?)
3. Developing operational excellence in sales forecasting, warehouse management, transportation management, and materials management
4. Implementing the solution with the best information systems, equipment, policies, and procedures

Studying market logistics leads managers to find the most efficient way to deliver value. For example, a software company traditionally produced and packaged software disks and manuals, shipped them to wholesalers, which shipped them to retailers, which sold them to customers, who brought them home to download onto their PCs. Market logistics offered two superior delivery systems. The first let the customer download the software directly onto his or her computer. The second allowed the computer manufacturer to download the software onto its products. Both solutions eliminated the need for printing, packaging, shipping, and stocking millions of disks and manuals and have quickly become the norm of the industries.

INTEGRATED LOGISTICS SYSTEMS

The market logistics task calls for **integrated logistics systems (ILS)**, which include materials management, material flow systems, and physical distribution, aided by information technology (IT). Information systems play a critical role in managing market logistics, especially via computers, point-of-sale terminals, uniform product bar codes, satellite tracking, electronic data interchange (EDI), and electronic funds transfer (EFT). These developments have shortened the order-cycle time, reduced clerical labor, reduced errors, and provided improved control of operations. They have enabled companies to promise "the product will be at dock 25 at 10:00 AM tomorrow" and to deliver on that promise.

Market logistics encompass several activities. The first is sales forecasting, on the basis of which the company schedules distribution, production, and inventory levels. Production plans indicate the materials the purchasing department must order. These materials arrive through inbound transportation, enter the receiving area, and are stored in raw-material inventory. Raw materials are converted into finished goods. Finished-goods inventory is the link between customer orders and manufacturing activity. Customers' orders draw down the finished-goods inventory level, and manufacturing activity builds it up. Finished goods flow off the assembly line and pass through packaging, in-plant warehousing, shipping-room processing, outbound transportation, field warehousing, and delivery and service.

Management has become concerned about the total cost of market logistics, which can amount to as much as 30 to 40 percent of the product's cost. In the U.S. grocery business, waste or "shrink" affects 8 to 10 percent of perishable goods, costing $20 billion annually. Stop & Shop, a $16 billion grocery chain, discovered that large, mountainous displays of fruits and veggies and other perishables don't necessarily equal more sales. Instead it often led to spoilage on the shelf, displeasing customers and requiring more staff to sort out the perished items. After an analysis of the perishable departments, Stop & Shop cut the number of foods on display—8 avocados instead of 24, 4 salmon filets instead of 12, for example—and saved an estimated annual $100 million by reducing shrink and improving customer satisfaction. [69]

Source: Stop & Shop

By cutting the number of perishable fruits and vegetables on display, Stop & Shop saves an estimated $100 million annually.

Many experts call market logistics "the last frontier for cost economies," and firms are determined to wring every unnecessary cost out of the system: In 1982, logistics represented 14.5 percent of U.S. GDP; by 2012, the share had dropped to about 8.5 percent.[70] Lowering these costs yields lower prices, higher profit margins, or both. Even though the cost of market logistics can be high, a well-planned program can be a potent tool in competitive marketing.

Many firms are embracing **lean manufacturing**, originally pioneered by Japanese firms such as Toyota, to produce goods with minimal waste of time, materials, and money. CONMED's disposable devices are used by a hospital somewhere in the world every 90 seconds to insert and remove fluid around joints during orthoscopic surgery.[71]

CONMED To streamline production, medical manufacturer CONMED set out to link its operations as closely as possible to the ultimate buyer of its products, applying lean manufacturing and Six Sigma philosophies to boost productivity, improve its use of floor space, and cut inventory. Rather than moving manufacturing to China, which might have lowered labor costs but could have also risked long lead times, inventory buildup, and unanticipated delays, the firm put new production processes into place to assemble its disposable products only after hospitals placed orders. Some 80 percent of orders were predictable enough that demand forecasts updated every few months could set hourly production targets. As proof of CONMED's new efficiency, the assembly area for fluid-injection devices went from covering 3,300 square feet and stocking $93,000 worth of parts to 650 square feet and $6,000 worth of parts. Output per worker increased 21 percent. Similarly, its shaver blade factory increased production while decreasing costs by as much as 30 percent in some cases.

Lean manufacturing must be implemented thoughtfully and monitored closely. Toyota's crisis in product safety, which resulted in extensive product recalls, has been attributed in part to the fact that some aspects of lean manufacturing—eliminating overlap by using common parts and designs across multiple product lines and reducing the number of suppliers to procure parts with greater economies of scale—can backfire when quality-control issues arise.[72]

MARKET-LOGISTICS OBJECTIVES

Many companies state their market-logistics objective as "getting the right goods to the right places at the right time for the least cost." Unfortunately, this objective provides little practical guidance. No system can simultaneously maximize customer service and minimize distribution cost. Maximum customer service implies large inventories, premium transportation, and multiple warehouses, all of which raise market-logistics costs.

Nor can a company achieve market-logistics efficiency by asking each market-logistics manager to minimize his or her own logistics costs. Market-logistics costs interact and are often negatively related. For example:

- The traffic manager favors rail shipment over air shipment because rail costs less. However, because the railroads are slower, rail shipment ties up working capital longer, delays customer payment, and might send customers to competitors who offer faster service.
- The shipping department uses cheap containers to minimize shipping costs. Cheaper containers lead to a higher rate of damaged goods and customer ill will.
- The inventory manager favors low inventories. This increases stock-outs, back orders, paperwork, special production runs, and high-cost, fast-freight shipments.

Given these trade-offs, managers must make decisions on a total-system basis. The starting point is to study what customers require and what competitors are offering. Customers are interested in on-time delivery, help meeting emergency needs, careful handling of merchandise, and quick return and replacement of defective goods.

The wholesaler must then research the relative importance of these service outputs. For example, service-repair time is very important to buyers of copying equipment. Xerox developed a service delivery standard that "can put a disabled machine anywhere in the continental United States back into operation within three hours after receiving the service request." It then designed a service division of technicians, parts, and locations to deliver on this promise.

The company must also consider competitors' service standards. It will normally want to match or exceed these, but the objective is to maximize profits, not sales. Some companies offer less service and charge a lower price; other companies offer more service and charge a premium price.

The company ultimately must establish some promise it makes to the market. Some companies define standards for each service factor. One appliance manufacturer promises to deliver at least 95 percent of the dealer's orders within seven days of order receipt, to fill them with 99 percent accuracy, to deal with inquiries about order status within three hours, and to ensure that merchandise damaged in transit does not exceed 1 percent.

MARKET-LOGISTICS DECISIONS

The firm must make four major decisions about its market logistics: (1) How should we handle orders (order processing)? (2) Where should we locate our stock (warehousing)? (3) How much stock should we hold (inventory)? and (4) How should we ship goods (transportation)?

ORDER PROCESSING Most companies today are trying to shorten the *order-to-payment cycle*—that is, the time between an order's receipt, delivery, and payment. This cycle has many steps, including order transmission by the salesperson, order entry and customer credit check, inventory and production scheduling, order and invoice shipment, and receipt of payment. The longer this cycle takes, the lower the customer's satisfaction and the lower the company's profits.

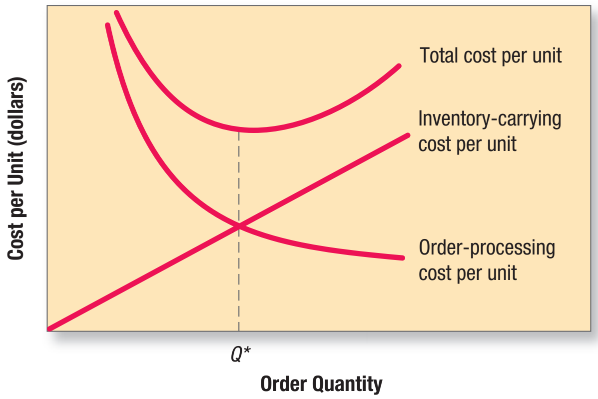
WAREHOUSING Every company must store finished goods until they are sold because production and consumption cycles rarely match. More stocking locations mean goods can be delivered to customers more quickly, but warehousing and inventory costs are higher. To reduce these costs, the company might centralize its inventory in one place and use fast transportation to fill orders. To better manage inventory, many department stores such as Nordstrom and Macy's now ship online orders from individual stores.[73]

Some warehouses are now taking on activities formerly done in the plant, including product assembly, packaging, and construction of promotional displays. Moving these activities to the warehouse can save costs and match the offerings more closely to demand.

INVENTORY Salespeople would like their companies to carry enough stock to fill all customer orders immediately. However, this is not cost effective. Inventory cost increases at an accelerating rate as the customer-service level approaches 100 percent. Management needs to know how much sales and profits would increase as a result of carrying larger inventories and promising faster order fulfillment times and then make a decision.

As inventory draws down, management must know at what stock level to place a new order. This stock level is called the *order* (or *reorder) point.* An order point of 20 means reordering when the stock falls to 20 units. The order point should balance the risks of stock-out against the costs of overstock. The other decision is how much to order. The larger the quantity ordered, the less frequently an order needs to be placed.

The company needs to balance order-processing costs and inventory-carrying costs. *Order-processing costs* for a manufacturer consist of *setup costs* and *running costs* (operating costs when production is running) for the item. If setup costs are low, the manufacturer can produce the item often, and the average cost per item is stable and



| Fig. 18.1 |

Determining Optimal Order Quantity

equal to the running costs. If setup costs are high, however, the manufacturer can reduce the average cost per unit by producing a long run and carrying more inventory.

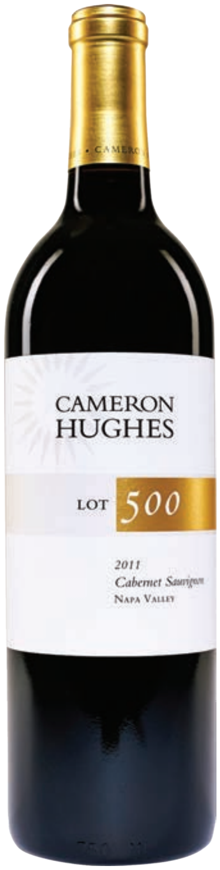
Order-processing costs must be compared with *inventory-carrying costs,* which include storage charges, cost of capital, taxes and insurance, and depreciation and obsolescence. Carrying costs might run as high as 30 percent of inventory value and are higher the larger the average stock carried. This means marketing managers who want to carry larger inventories need to show that incremental gross profits will exceed incremental carrying costs.

We can determine the optimal order quantity by observing how order-processing costs and inventory-carrying costs add up at different order levels. Figure 18.1 shows that the order-processing cost per unit decreases as the number of units ordered increases because the order costs are spread over more units. Inventory-carrying charges per unit increase with the number of units ordered because each unit remains longer in inventory. We sum the two cost curves vertically into a total-cost curve and project the lowest point of the total-cost curve on the horizontal axis to find the optimal order quantity Q^*.[74]

Companies are reducing their inventory costs by treating inventory items differently, keeping slow-moving items in a central location and carrying fast-moving items in warehouses closer to customers. Managers are also considering inventory strategies that give them flexibility should anything go wrong, as it often does, whether a dock strike in California, an earthquake in Japan, or political turmoil in North Africa and the Middle East. In an interconnected world, one weak link, if not properly managed, can bring down the entire supply chain.[75]

The ultimate answer to carrying *near-zero inventory* is to build for order, not for stock. Sony calls it SOMO, "Sell one, make one." Dell's inventory strategy for years has been to get the customer to order a computer and pay for it in advance. Then Dell uses the customer's money to pay suppliers to ship the necessary components. As long as customers do not need the item immediately, everyone can save money. Some retailers are unloading excess inventory on eBay where, by cutting out the liquidator middleman, they can make 60 to 80 cents on the dollar as opposed to 10 cents.[76] And some suppliers are snapping up excess inventory to create opportunity.[77]

CAMERON HUGHES "If a winery has an eight-barrel lot, it may only use five barrels for its customers," says Cameron Hughes, a wine *négociant* who buys excess juice from high-end wineries and wine brokers in France, Italy, Spain, Argentina, South Africa, and California and combines it to make limited-edition, premium blends that taste much more expensive than their price tags. A $100 California Cabernet may sell for $25 a bottle or less under his Lot 500 Napa Valley Cabernet Savignon label. *Négociants* have been around a long time, first as intermediaries who sold or shipped wine as wholesalers, but the profession has expanded as opportunists such as Hughes began making their own wines. Hughes doesn't own any grapes, bottling machines, or trucks. He outsources the bottling, and he sells directly to retailers such as Costco, Sam's Club, and Safeway, eliminating intermediaries and multiple markups. Hughes never knows which lots of wine he will have or how many, but he's turned uncertainty to his advantage—he creates a new product with every batch. Rapid turnover is part of Costco's appeal for him. The discount store's customers love the idea of finding a rare bargain, and Hughes promotes his wines through in-store wine tastings and insider e-mails about his upcoming numbered lots, which sell out quickly. One thing customers won't find out is exactly where the wine comes from. In signing deals Hughes typically has to accept non-disclosure agreements prohibiting him from naming his sources, though the Cameron Confidential flyer that accompanies each wine may hint at it.



Source: Cameron Hughes Wine

Cameron Hughes buys excess juice to make and sell affordable, high quality wines to select merchants.

TRANSPORTATION Transportation choices affect product pricing, on-time delivery performance, and the condition of the goods when they arrive, all of which affect customer satisfaction.

In shipping goods to its warehouses, dealers, and customers, a company can choose rail, air, truck, waterway, or pipeline. Shippers consider such criteria as speed, frequency, dependability, capability, availability, traceability, and cost. For speed, the prime contenders are air, rail, and truck. If the goal is low cost, then the choice is water or pipeline.

Shippers are increasingly combining two or more transportation modes, thanks to containerization. **Containerization** consists of putting the goods in boxes or trailers that are easy to transfer between two transportation modes. *Piggyback* describes the use of rail and trucks; *fishyback,* water and trucks; *trainship,* water and rail; and *airtruck,* air and trucks. Each coordinated mode offers specific advantages. For example, piggyback is cheaper than trucking alone yet provides flexibility and convenience.

Shippers can choose private, contract, or common carriers. If the shipper owns its own truck or air fleet, it becomes a *private carrier.* A *contract carrier* is an independent organization selling transportation services to others on a contract basis. A *common carrier* provides services between predetermined points on a scheduled basis and is available to all shippers at standard rates. Some contract carriers are investing and innovating to create strong value propositions.[78]

CONTRACT CARRIERS With so many transportation options available, firms in those industries are constantly competing to cut costs, improve services, and offer even more value to their shipping customers. After 10 years and billions of dollars in investment, including $2.5 billion in 2010 alone, Union Pacific saw on-time delivery on its railroads increase from 30 percent to roughly 90 percent. Improving reliability is also important in ocean shipping. Copenhagen-based Maersk Group is the world's largest global shipper, with around 550 container ships and 225 tankers. To improve efficiency, the firm in 2014 commissioned 20 of the largest ships ever built. Costing $185 million each, these giant ships can cost-effectively carry 18,000 containers, also emitting 50 percent less CO_2 in the process. Schneider, one of the country's largest full-truckload freight haulers with more than $3 billion in revenue, developed a fleet-wide "tactical simulator" that has saved the company tens of millions of dollars. Besides helping in the crucial day-to-day route scheduling for drivers, the simulator has also helped with specific decisions ranging from when to raise prices for certain customers to how many drivers to hire (and where). Little changes can make big differences for shippers. Global logistics leader UPS calculated that by having its drivers use a fob instead of a key to operate its trucks, it is cutting out on average 1.7 seconds per stop, or 6.5 minutes per day, saving an estimated $70 million a year in the process.

Union Pacific has invested billions to improve its on-time delivery.

Source: © Stephen Jonas/Alamy

Source: A.P. Møller-Mærsk A/S

Global shipping leader Maersk commissioned 20 of the largest, efficient ships ever built.

To reduce costly handing at arrival, some firms are putting items into shelf-ready packaging so they don't have to unpack them from a box and place them individually on a shelf. In Europe, P&G has used a three-tier logistic system to schedule deliveries of fast- and slow-moving goods, bulky items, and small items in the most efficient way.[79] To reduce damage in shipping, the size, weight, and fragility of the item must be reflected in the crating technique used and the density of foam cushioning.[80] With logistics, every little detail must be reviewed to see how it might be changed to improve productivity and profitability.

Summary

1. Retailing includes all the activities in selling goods or services directly to final consumers for personal, non-business use. Retailers can be store retailers, nonstore retailers, and retail organizations.
2. Retailers pass through stages of growth and decline. As existing stores offer more services to remain competitive, costs and prices go up, which opens the door to new retail forms that offer merchandise and services at lower prices. The major types of retail stores are specialty stores, department stores, supermarkets, convenience stores, discount stores, extreme value or hard-discount store, off-price retailers, superstores, and catalog showrooms.
3. Nonstore retailing is growing and includes direct selling (one-to-one selling, one-to-many party selling, and multilevel network marketing), direct marketing (which includes e-commerce and Internet retailing), automatic vending, and buying services.
4. Retail organizations achieve many economies of scale, greater purchasing power, wider brand recognition, and better-trained employees. The major types of corporate retailing are corporate chain stores, voluntary chains, retailer cooperatives, consumer cooperatives, franchise organizations, and merchandising conglomerates.
5. As new retail forms have emerged, competition between them has increased, the rise of giant retailers has been matched by the decline of middle-market retailers, investment in technology has grown, and shopper marketing inside stores has become a priority.
6. Like all marketers, retailers must prepare marketing plans that include decisions about target markets, channels, product assortment and procurement, prices, services, store atmosphere, store activities and experiences, communications, and location.
7. Wholesaling includes all the activities in selling goods or services to those who buy for resale or business use. Wholesalers can perform functions better and more cost-effectively than the manufacturer can. These functions include selling and promoting, buying and assortment building, bulk breaking, warehousing, transportation, financing, risk bearing, dissemination of market information, and provision of management services and consulting.
8. There are four types of wholesalers: merchant wholesalers; brokers and agents; manufacturers' and retailers' sales branches, sales offices, and purchasing offices; and miscellaneous wholesalers such as agricultural assemblers and auction companies.

9. Like retailers, wholesalers must decide on target markets, product assortment and services, price, promotion, and place. The most successful are those that adapt their services to meet suppliers' and target customers' needs.
10. Producers of physical products and services must decide on market logistics—the best way to store and move goods and services to market destinations and to coordinate the activities of suppliers, purchasing agents, manufacturers, marketers, channel members, and customers. Major gains in logistical efficiency have come from advances in information technology.

Applications

Marketing Debate

Should National-Brand Manufacturers Also Supply Private-Label Brands?

Ralston-Purina, Borden, ConAgra, and Heinz have all admitted at some point to supplying products—sometimes lower in quality—to be used for private labels. Other marketers, however, criticize this "if you can't beat them, join them" strategy, maintaining that these actions, if revealed, may create confusion or even reinforce a perception by consumers that all brands in a category are essentially the same.

Take a position: Manufacturers should feel free to sell private labels as a source of revenue *versus* National manufacturers should never supply private labels.

Marketing Discussion

Retail Customer Loyalty

✪ Think of your favorite stores. What do they do that encourages your loyalty? What do you like about the in-store experience? What further improvements could these stores make?

Marketing Excellence

>> Zara

Zara, the Spanish-based company, is Europe's leading apparel retailer, providing consumers with current, high-fashion styles at reasonable prices. With more than $14.5 billion in sales and more than 2,000 stores, the company has succeeded by breaking virtually every traditional rule in the retailing industry.

The first Zara store opened in 1975. By the 1980s, founder Amancio Ortega was working with computer programmers on a new distribution model to reduce the time from design to distribution to just two weeks—a groundbreaking difference from the industry average of six to nine months. As a result, the company now makes between 10,000 and 20,000 different items a year, approximately triple the number made by Gap or H&M. With this revolutionary step, Zara was able to introduce "fast fashion" at affordable prices.

Zara's business model is keenly focused on four strategic elements:

Design and Production. Zara employs hundreds of designers at its headquarters in Spain. Thus, new styles are constantly being created and put into production while others are tweaked with various colors or patterns. The firm enforces the speed at which it puts these designs into production by locating half its production facilities nearby in Spain, Portugal, and Morocco. It produces only a small quantity of each collection and is willing to experience occasional shortages to preserve an image of exclusivity. Clothes with a longer shelf life, like T-shirts, are outsourced to lower-cost suppliers in Asia and Turkey. With tight control on its manufacturing process, Zara can move more rapidly than any of its competitors and continues to deliver fresh styles to its stores every week.

Logistics. Zara distributes all its merchandise, regardless of origin, from Spain. Its distribution process is designed so that the time from receipt of an order to delivery in the store averages 24 hours in Europe and 48 hours in the United States and Asia. Having 50 percent of its production facilities nearby is key to the success of this model. All Zara stores receive new shipments twice a week, and the small quantities of each collection entice consumers not only to return frequently but also to make purchase decisions more quickly. Because of its logistics and inventory policy, while an average shopper in Spain visits a main street store three times a year, shoppers to a Zara store average 17 trips. Some fans know exactly what day new shipments arrive and show up early to be the first in line, keeping the company's sales strong throughout the year and even during slow economic times. The company also sells more products at full price—85 percent of its merchandise versus the industry average of 60 percent.

Customers. Everything revolves around Zara's customers. The retailer monitors customers' changing needs, trends, and tastes through daily reports from shop managers about which products and styles have sold and which haven't. Managers earn as much as 70 percent of their salaries from commission, so they have a strong incentive to stay on top of things. Zara's designers don't have to predict what fashion trends will be in the future. They react to customer feedback—good and bad—and if an idea fails, the line is withdrawn immediately. Zara cuts its losses and the impact is minimal due to the small quantities of each style produced.

Stores. Zara does not run advertising campaigns. The retailer's stores, in prestigious high-traffic locations around the world, are its key advertising element, featuring stylish and constantly changing window displays. Other retailers spend 3 percent to 4 percent of revenues on big brand-building campaigns, while Zara spends just 0.3 percent. The company has said it would rather use a percentage of revenue to open new stores than to advertise.

Zara's success comes from having complete control over all the parts of its business—design, production, and distribution. Louis Vuitton's fashion director, Daniel Piette, described the company as "possibly the most innovative and devastating retailer in the world." It has expanded aggressively throughout Europe as well as into emerging markets such as Asia, the Americas, and the Middle East, making sure it honors local tastes in each region. Zara was a latecomer to the Internet and launched its first online store only in 2011. However, the company now uses its Web site to test the waters before entering potential markets like China, Russia, and Canada with retail storefronts.

While Zara has experience record sales as of late, it faces unique challenges ahead, including what to do in the United States, where obesity rates are much higher than in the rest of the world and roomy clothes are preferred to the slim fits and high fashion the company offers. It also needs to decide how to maintain its tight control on manufacturing as it expands throughout the world.

Questions

1. Would Zara's model work for other retailers? Why or why not?
2. What can Zara do to ensure successful growth around the world while maintaining the same level of speed and instant fashion?

Sources: Rachel Tiplady, "Zara: Taking the Lead in Fast-Fashion," *BusinessWeek,* April 4, 2006; enotes.com, Inditex overview; "Zara: A Spanish Success Story," *CNN*, June 15, 2001; "Fashion Conquistador," *BusinessWeek,* September 4, 2006; Caroline Raux, "The Reign of Spain," *The Guardian,* October 28, 2002; Kerry Capell, "Zara Thrives by Breaking All the Rules," *BusinessWeek*, October 20, 2008, p. 66; Christopher Bjork, "Zara Is to Get Big Online Push," *Wall Street Journal*, September 17, 2009, p. B8; "Best Global Brands 2013," *Interbrand;* Walter Loeb, "Zara's Secret to Success: The New Science of Retailing," *Forbes,* October 14, 2013; Jessica Sheft-Ason, "Zara to Launch Online Shopping in September," *Forbes,* August 3, 2011; Zara.com; Inditex 2012 Annual Report.

Marketing Excellence

>> Best Buy

Best Buy is the world's largest multichannel consumer electronics retailer, with $45 billion in sales in fiscal 2013. Sales boomed in the 1980s as the company expanded nationally and made some risky business decisions, like putting its sales staff on salary instead of commission. This decision created a more consumer-friendly, low-pressure shopping atmosphere and resulted in an instant spike in overall revenues. In the 1990s, Best Buy ramped up its computer product offerings, and by 1995 it was the biggest seller of home PCs, a powerful market position during the Internet boom.

At the turn of the 21st century, Best Buy faced new retail competitors, including Costco, Walmart, and Target, which boosted their electronics divisions and product offerings and often priced lower than Best Buy. The company believed the best way to differentiate itself from the competition was to emphasize customer service by selling product warranties and offering personal services like home delivery and installation. Its purchase of Geek Squad, a 24-hour computer service company, proved profitable and strategically wise as home and small-office networks became more complex and the need for personal computing attention increased. By 2004, Best Buy had placed a Geek Squad station in each of its stores, providing consumers with personal computing services in multiple channels: in the stores, online, on the phone, and at home.

Best Buy also segmented its broad customer base into a handful of specific targets such as the affluent tech geek, the busy suburban mom, the young gadget enthusiast, and the price-conscious dad. It used extensive research to determine which segments were the most abundant and lucrative in each market and configured its stores and trained its employees to target those shoppers. For example, stores targeting affluent tech geeks offered a separate home theatre department with knowledgeable salespeople on location. Stores with a high volume of suburban mom shoppers offered personal shopping assistants to help Mom get in and out as quickly as possible with the exact items she needed.

Sometimes a store experienced a new type of lucrative customer. For example, in the coastal town of Baytown, Texas, the local Best Buy observed frequent visits from Eastern European workers coming off cargo ships and oil tankers. These men and women used their precious free time to race over to the store and search the aisles for Apple's iPods and laptops, which were cheaper in the United States than in Europe. To cater to this unique consumer, the store rearranged its layout, moving iPods, MacBooks, and their accessories from the back to the front, and added signage in simple English. The result: Sales from these European workers increased 67 percent.

Best Buy is hailed for growing into a $50 billion company virtually through one channel. However, in recent years, the company has struggled to maintain its retailing dominance. One reason is that consumers no longer have the same interest in large television sets, computers, or entertainment centers that took up so much retail space in years past. In addition, "showrooming" has become a problem, in which consumers visit stores to look, touch, and test out the products but leave empty-handed and purchase online instead. In fact, online retailers like Amazon.com have become Best Buy's biggest competitors in recent years. The company's overall market share in electronics and appliances is 16 percent, but it has only a 7 percent market share online. In comparison, Amazon's overall market share in electronics/appliances is 4 percent, but it is the market leader online, with a 21 percent market share.

Best Buy has acknowledged that it was slow to respond to category and channel shifts and was too focused on a single channel strategy when consumers' behaviors were changing. As a result, sales slipped, customer satisfaction declined, and stock value went with it. To turn things around, the company hired a new CEO who implemented a strategic initiative in 2013. "Renew Blue" was developed to reinvigorate and rejuvenate the customer experience. Online, Best Buy put a huge emphasis on improving the consumer's experience with faster and easier navigation tools, more competitive pricing, and relevant product offerings. The company also started shipping many of its online orders directly from nearby store locations, which improved delivery time and inventory turns.

Within its 1,477 domestic retail stores, Best Buy integrated a new optimization layout, which allocated additional space to growing and more profitable products like smart phones and reduced space for declining categories like entertainment. The company also plans to decrease the number of large stores it operates and increase the number of smaller, mobile stores.

As Best Buy evolves from a single-channel to a multichannel retailer, it faces many opportunities to grow its business even further. The U.S. consumer electronics and appliance market is a $228 billion industry, and the company is making changes to compete better and capture more market share. With so many storefronts across the nation, Best Buy has a competitive advantage and can leverage these assets as it expands into more channels.

Questions

1. What were the keys to Best Buy's success? What are the challenges it faces in today's retail environment?
2. How else can Best Buy compete against retail competitors like Walmart and Costco as well as online competitors like Amazon.com?

Sources: Jena McGregor, "At Best Buy, Marketing Goes Micro," *Businessweek,* May 15, 2008; Matt Richtel, "Last Man Standing," *The New York Times,* July 17, 2009; Matthew Boyle, "Best Buy's Giant Gamble," *Fortune*, March 29, 2006; Millstein, "Best Buy's Quest to Master Customer Centricity," *Chain Store Age,* December 2007; Ann Zimmerman, "Best Buy Plays Web Hardball," *Wall Street Journal*, October 12, 2012; Walter Loeb, "Best Buy in Turmoil, Will It Survive?," *Forbes,* August 22, 2012; Paula Rosenblum, "Can Best Buy Survive and Are Its Problems Really All about Amazon?," *Forbes,* August 12, 2013; Margaret Bogenrief, "Best Buy Is Pulling Off an Incredible Turnaround," *BusinessInsider,* July 30, 2013; NPD, Nielsen, Stevenson Traqline, Best Buy internal analysis, "Renew Blue," Best Buy Analyst and Investor Day presentation, November 12, 2012; BestBuy.com, 2012 Annual Report.