

# Lecture

# **Channel Management**

Summer Term 2011

# Exercise

Date/Time: Wednesdays, 10-12 *c.t.* (**start: 20.4.**)

Location: H-D 3206

Contact: Dipl.-Kfm. Gerhard **Wagner**  
Room H-C 8306  
[wagner@marketing.uni-siegen.de](mailto:wagner@marketing.uni-siegen.de)

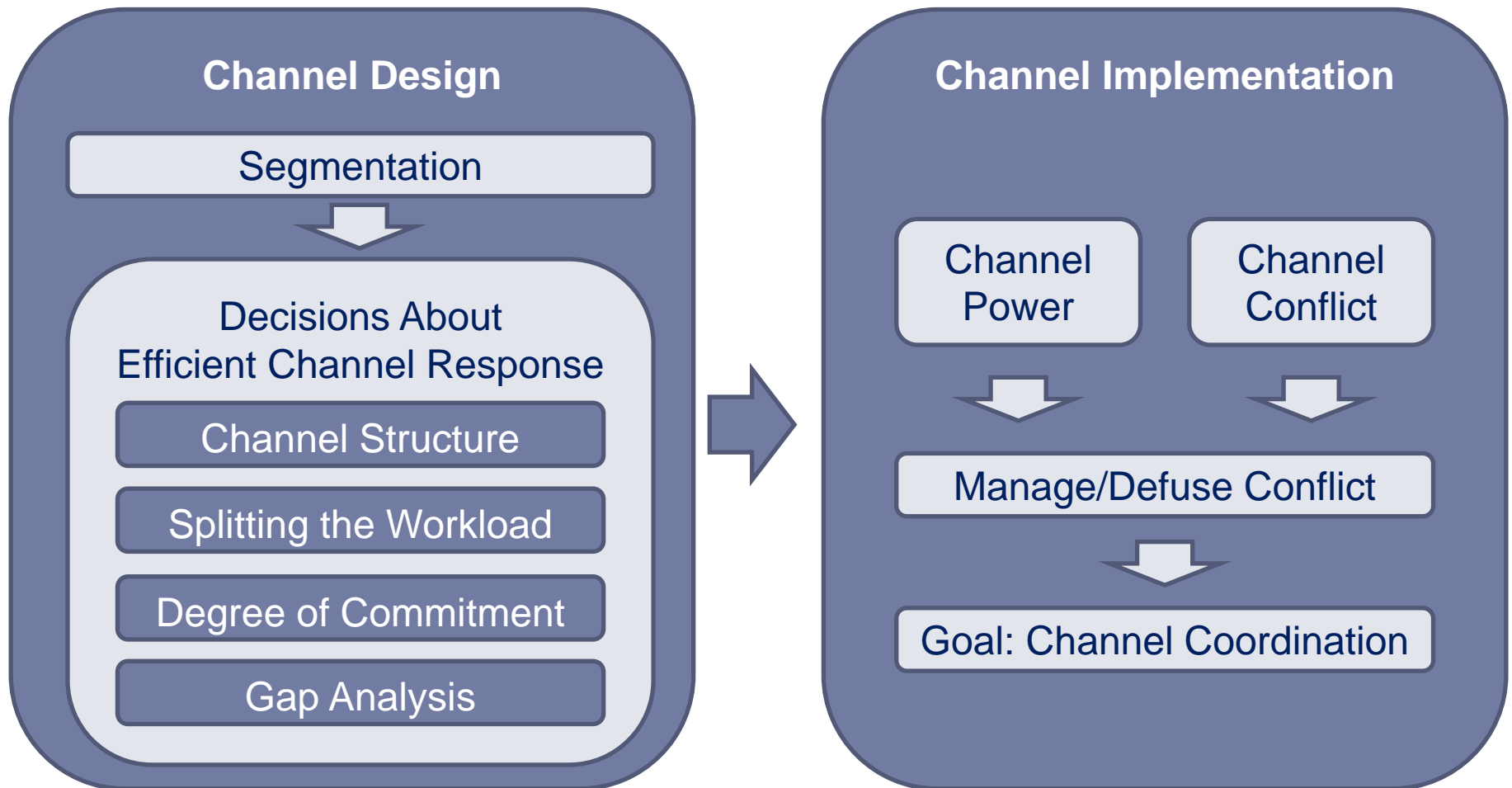
# Structure

04.04.2011	Introduction: Channel Structure and Channel Functions
11.04.2011	Channel Design and Service Outputs
18.04.2011	<b>Channel Flows and Efficiency Analysis</b>
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04.07.2011	Electronic and Mobile Commerce
11.07.2011	Logistics and Supply Chain Management

# Channel Design and Service Outputs

- Learning objectives:
  - Understanding the **central role played by end-users** and their demands in the design of marketing channels
  - Know what **service outputs** are and how to identify and analyze them
  - Be able to **divide a market into channel segments** for the purpose of designing or modifying a market channel
  - Be able to evaluate **when and whether to try to meet all expressed service output demands** in the short run in a particular market

# Channel Design and Implementation



**Insights for Specific Channel Institutions**

# Channel Flows and Efficiency Analysis

- Learning objectives:
  - Be able to define the **eight generic channel flows** that characterize costly and value-added channel activities
  - Understand how the efficiency template helps **codify channel flow performance** by channel and by channel participants
  - Understand the **role of channel flow allocation** in designing a zero-based channel
  - Understand how channel flow performance leads to appropriate **allocation of channel profits** among channel members using the Equity Principle

# Channel Analysis

Channel members produce service outputs

Channel flows are the activities that produce service outputs

Need to know:

- What flows are being performed
- By which channel members
- At what levels

Enables channel manager to:

- Diagnose and remedy shortcomings
- Design a new channel or revise an existing channel
  - Minimize costs
- Allocate profits equitably
  - Avoid channel conflict

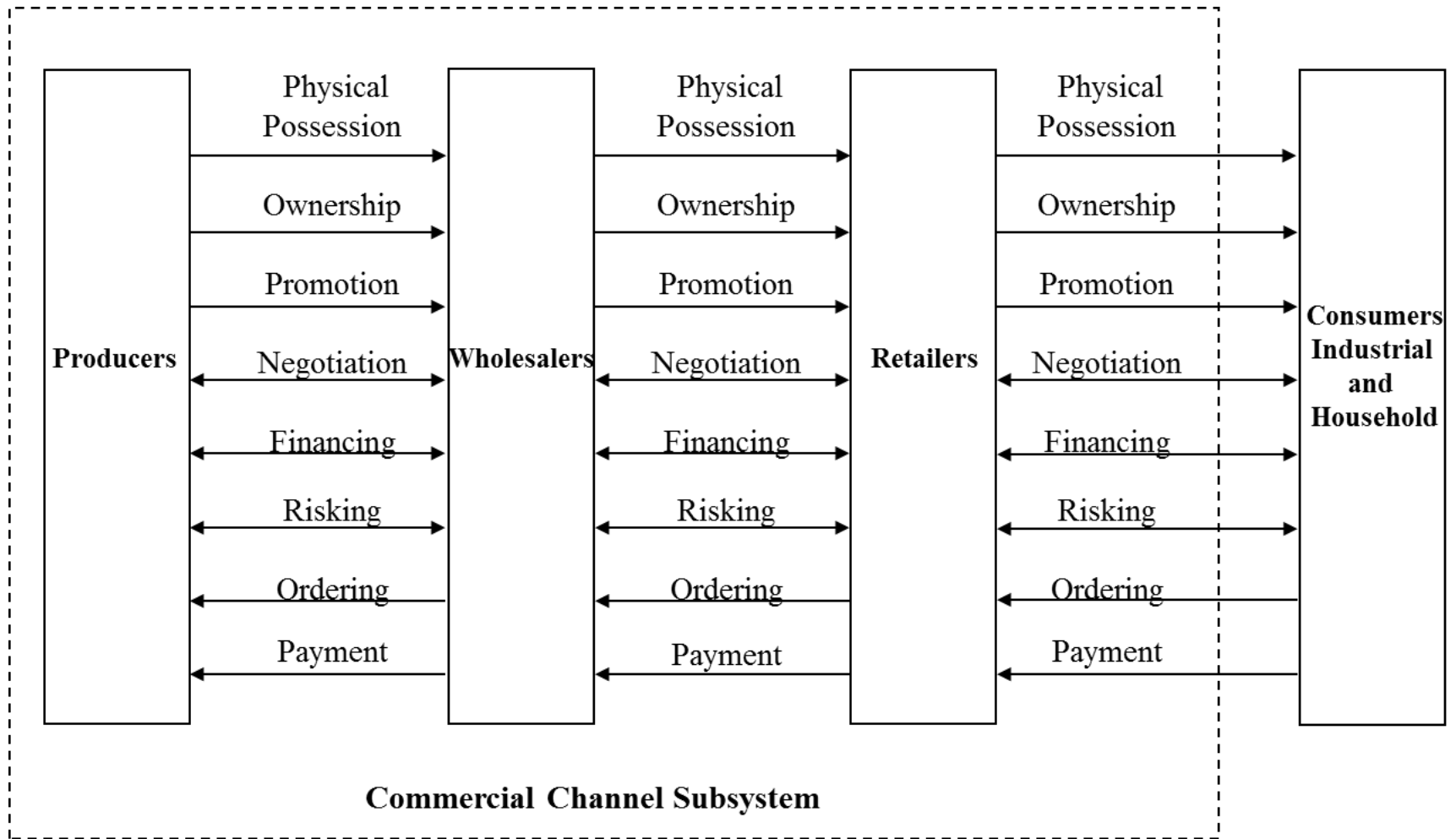
# Channel Flows

## The Eight Generic Channel Flows

1. Physical possession
2. Ownership
3. Promotion
4. Negotiation
5. Financing
6. Risking
7. Ordering
8. Payment



# Channel Flows



# Ownership and Possession

## Physical possession

- Has physical custody
- Carries holding costs
- Probably responsible for damage or loss

## Ownership

- Holds title
- Has not yet been paid but may collect finance charge
- May or may not have to accept returns

# Promotion and Negotiation

## Promotion

- Advertising for product
  - Through media
  - Point-of-Purchase (POP)
- Demonstrations
- Display/shelf space
- Personal selling

## Negotiation

- Settling terms of deal
  - Price
  - Responsibilities of each side
    - Promotion
    - Quantities sold and offered
    - Delivery schedule
    - Miscellaneous (e.g., replacement of spoilage)

# Financing and Risk Taking

## Inventory financed by

- Seller (manufacturer)
- Buyer (e.g., wholesaler or retailer)
- Third party (e.g., bank holds title to cars on dealer lot)

Terms (e.g., discount for prompt payment)

Ability to raise capital and cost of capital

## Risk taking

- Damage, spoilage
- Obsolescence
- Over-estimated demand

# Ordering and Payment

## Ordering

- Automatic
- Routine—review of whether to do straight reorder
- Re-evaluated

## Payment

- Timeliness
- Method
  - Cash/certified check
  - Check/electronic transfer
  - Credit cards (small retailers)
  - Payment by third party
    - Financier
    - Customer
- Flow through channel

# Implications of marketing/channel flows

- The **progress in information technology** provides great opportunity in capturing the vital **information flow**.
- The flows performed may be **managed in different ways for different parts of the company's business**.
- **Not every channel need participate in every flow.**  
Specialization in the performance of channel flows is the hallmark of an efficiently operating channel.

# Implications of marketing/channel flows

- **Flows should be shared only** among those channel members who can **add value** or **reduce cost** by bearing them. But one also needs to bear in mind that too much specialization also breeds interdependency.
  - The performance of certain flows is also **co related** with that of other flows. The opportunity cost tied up in the form of inventory should also be considered.
- ‡
- One can eliminate or substitute members in a channel **but not the channel flows**

# Channel Analysis

- **Every channel flow** not only contributes to the production of valued service outputs but also **carries an associated cost**.
- Channel manager **needs an accurate accounting** of the channel's activities **in order to evaluate the efficiency and effectiveness of flow performance**
  - Create a list of channel flows that **fits the particular channel's nature and functions**
  - It is crucially important that the description of channel flows **measure all the costs** incurred in running the channel.



Channel Flow	Costs
Physical possession	Storage and delivery costs
Ownership	Inventory carrying costs
Promotion	Personal selling, advertising, sales promotion, public relations costs
Negotiation	Time and legal costs

# Inventory

## Reasons to have inventory

- Demand surges
- Economies of scale
- Availability for quick delivery
  - Pipeline stock
- Uncertain supply and demand
  - Lead time
  - Safety stock

Channel Flow	Costs
Physical possession	Storage and delivery costs
Ownership	Inventory carrying costs
Promotion	Personal selling, advertising, sales promotion, public relations costs
Negotiation	Time and legal costs

Channel Flow	Costs
Financing	Credit terms, terms and conditions of sale
Risking	Price guarantees, warranties, insurance, repair, and after-sales service costs
Ordering	Order-processing costs
Payment	Collections, bad debt costs

# Customize for a Particular Channel

- Avoid unnecessarily high levels of flows
- Combining flows
  - Example: Consider the costs of physical possession and ownership jointly if they are always incurred by the same channel members at the same time
- Further categorize flows
  - add to the list of flows
  - expand one of the flows  
(promotion flow could be considered to be several different flows, each with its own cost: cost of creating and running advertising, cost of creating and running an PR program...)

# Customize for a Particular Channel

- Use names that channel members can recognize
- Match the ways in which channel costs are incurred and measured by channel members
- Account for all the relevant costly flow activities of the channel

# Efficiency Template

For analyzing existing channel or designing new channel includes:

- Importance of each channel flow
- Involvement of each channel member with each channel flow
- Fair allocation of profits among channel members

**Functions** of the Efficiency Template:

- describe type and work done by each channel member
- measure the costs borne by each channel member
- highlights the importance of each flow for service outputs
- shows the profit that each channel member should collect

	Weights for Flows:						
Flows:	Costs	Potential Benefit	Final Weight				
Physical Pos	31	High	35				
Ownership	12	Medium	15				
Promotion	10	Low	8				
Negotiation	5	Low/Med	4				
Financing	25	Medium	29				
Risking	5	Low	2				
Ordering	6	Low	3				
Payment	7	Low	4				
<b>Total</b>	<b>100</b>	-	<b>100</b>				
Normative Profit Share	-	-	-				



	Weights for Flows:			% of Flow Performance			
Flows:	Costs	Potential Benefit	Final Weight	Mfr.	Retailer	End-User	Total
Physical Pos	31	High	35	30	30	40	<b>100</b>
Ownership	12	Medium	15				
Promotion	10	Low	8				
Negotiation	5	Low/Med	4				
Financing	25	Medium	29				
Risking	5	Low	2				
Ordering	6	Low	3				
Payment	7	Low	4				
Total	<b>100</b>	-	<b>100</b>				
Normative Profit Share	-	-	-				

	Weights for Flows:			% of Flow Performance			
Flows:	Costs	Potential Benefit	Final Weight	Mfr.	Retailer	End-User	Total
Physical Pos	31	High	35	30	30	40	<b>100</b>
Ownership	12	Medium	15	30	40	30	<b>100</b>
Promotion	10	Low	8	20	80	0	<b>100</b>
Negotiation	5	Low/Med	4	20	60	20	<b>100</b>
Financing	25	Medium	29	30	30	40	<b>100</b>
Risking	5	Low	2	30	50	20	<b>100</b>
Ordering	6	Low	3	20	60	20	<b>100</b>
Payment	7	Low	4	20	60	20	<b>100</b>
Total	<b>100</b>	-	<b>100</b>	-	-	-	-
Normative Profit Share	-	-	-	<b>28%</b>	<b>39%</b>	<b>33%</b>	<b>100</b>

# Do Normative Profit Shares = Actual?

## Equity principle

- Reward each channel member according to the value they create in the channel
- Motivates channel members to continue to generate value

## When actual profit shares do not match normative profit shares

- Competition for channel member's position
- Powerful channel captain

	Weights for Flows:			% of Flow Performance			
Flows:	Costs	Potential Benefit	Final Weight	Mfr.	Retailer	End-User	Total
Physical Pos	31	High	35	2	2	2	<b>100</b>
Ownership	12	Medium	15	2	2	2	<b>100</b>
Promotion	10	Low	8	1	3	0	<b>100</b>
Negotiation	5	Low/Med	4	1	2	1	<b>100</b>
Financing	25	Medium	29	2	2	2	<b>100</b>
Risking	5	Low	2	2	2	1	<b>100</b>
Ordering	6	Low	3	1	2	1	<b>100</b>
Payment	7	Low	4	1	2	1	<b>100</b>
Total	<b>100</b>	-	<b>100</b>	-	-	-	-
Normative Profit Share	-	-	-				<b>100</b>

	Weights for Flows:			% of Flow Performance			
Flows:	Costs	Potential Benefit	Final Weight	Mfr.	Retailer	End-User	Total
Physical Pos	31	High	35	33	33	33	<b>100</b>
Ownership	12	Medium	15	33	33	33	<b>100</b>
Promotion	10	Low	8	25	75	0	<b>100</b>
Negotiation	5	Low/Med	4	25	50	25	<b>100</b>
Financing	25	Medium	29	33	33	33	<b>100</b>
Risking	5	Low	2	40	40	20	<b>100</b>
Ordering	6	Low	3	25	50	25	<b>100</b>
Payment	7	Low	4	25	50	25	<b>100</b>
Total	<b>100</b>	-	<b>100</b>	-	-	-	-
Normative Profit Share	-	-	-	<b>32%</b>	<b>38%</b>	<b>29%</b>	<b>100</b>

# Designing Zero-Based Channel

## Zero-based channel

- Meets service output demands of target market
- At minimal cost
- Zero based channel is one that
  - a) meets the target market's service outputs &
  - b) at a minimum cost of performing these channel flows that produce those service outputs.

## Use efficiency template

- Put in ideal instead of existing
- Optimal levels of service outputs
  - Too low—lose business to competitors
  - Too high—costs too high, reduces profits.

# Example: Inventory Holding Costs

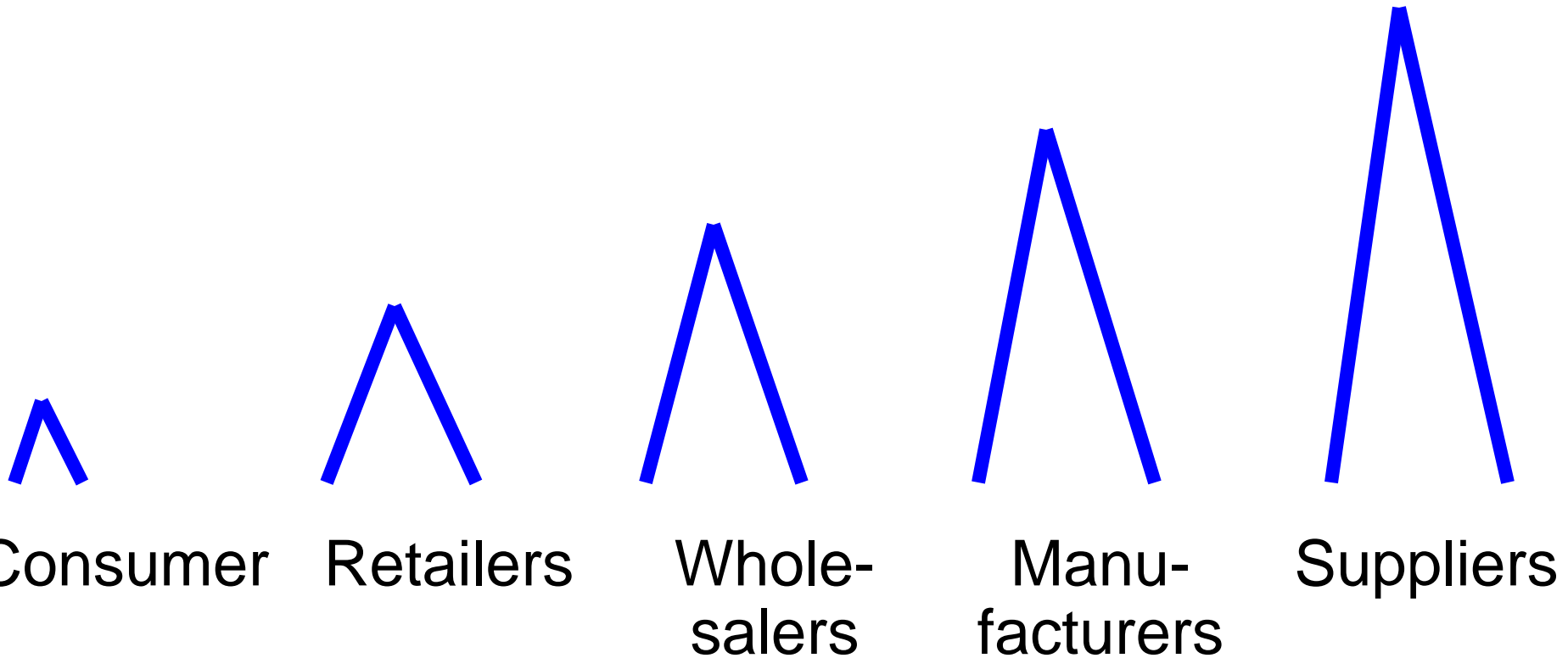
## Reduce inventory

- Avoid slow-turning items
- Forecast demand better
- Attain economies of scale at lower quantities
- Reduce variety
- Modular design for delaying final point of differentiation

## Avoid bullwhip effect

# Bullwhip Effect

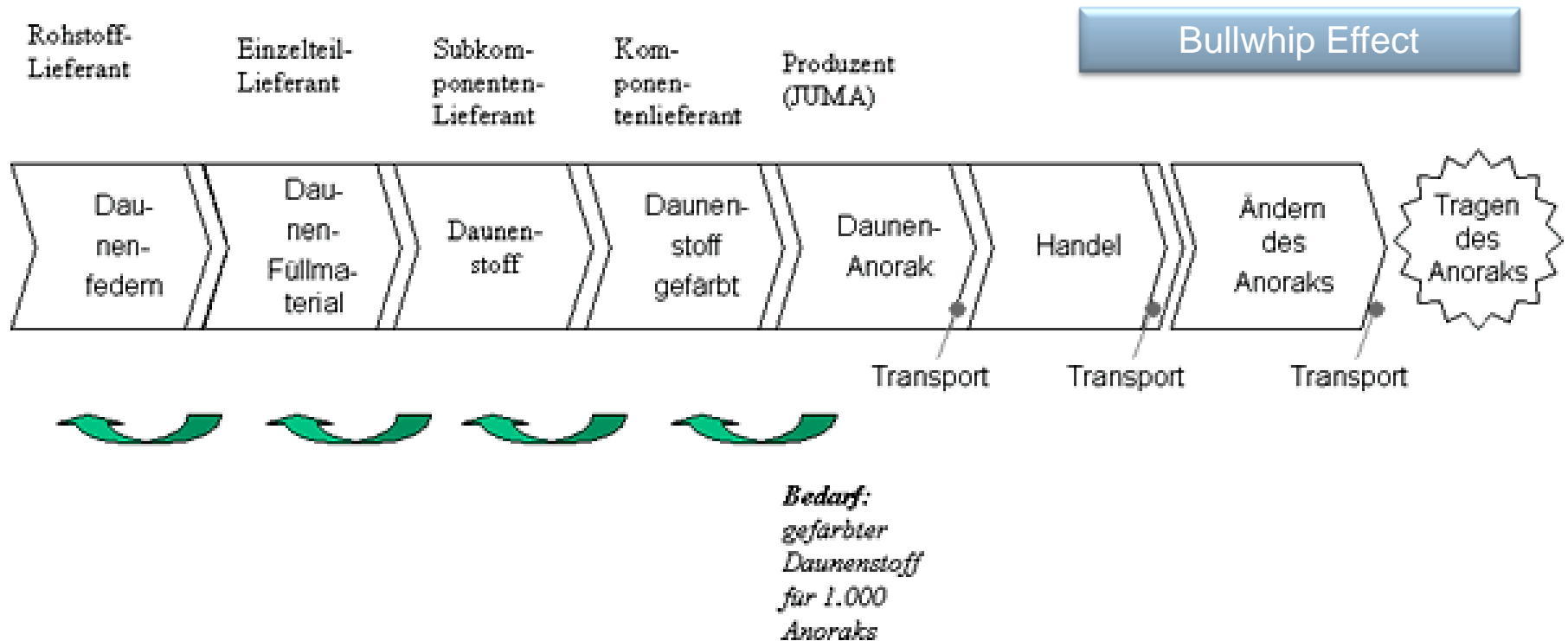
Not doing effective supply chain management  
Each channel member sees only its own link in the chain  
Over-react to changes in demand (up or down)



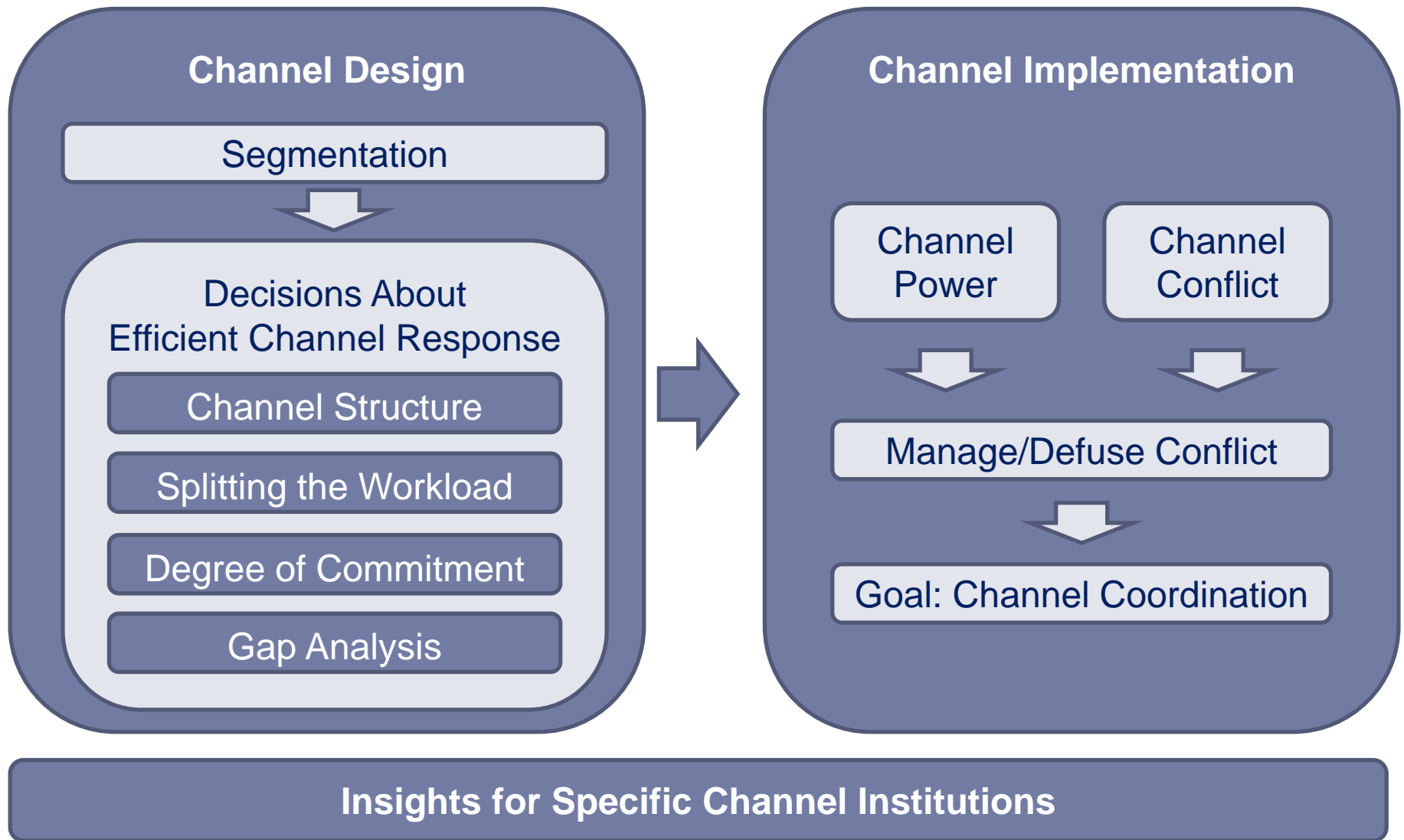


# Bullwhip Effect

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# Channel Design and Implementation



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