CHAPTER 3

The Environment of Marketing Channels

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Macro environment

The five environments that affect the market operations

1. Economic environment
2. Competitive environment
3. Sociocultural environment
4. Technological environment
5. Legal environment
The Environment

Consists of all external uncontrollable factors within which marketing channels exist

Affects channel members and nonmembers, such as facilitating agencies

= All channel participants
• Channel managers must take into account how the environment affects their nonmember participants.

• Channel managers must analyze the impact of environment not only on their own firms and ultimate target markets but also on all of the participants in the marketing channel.
The Environment

Environment
1. Economic
2. Sociocultural
3. Competitive
4. Technological
5. Legal

Member participants
Producers & Manufacturers
Intermediaries
Target Markets

Nonmember participants
Facilitating agencies

Locus of channel management
The Economic Environment

- The economy is the most obvious and persuasive category of environmental variable because it affects every business and individual.
- In the channel management context, economic factors are critical determinants of channel member behavior and performance.
The Economic Environment

Major Economic Forces

Recession

Inflation

Deflation
a) Recession

• This occurs when there are two consecutive quarters of a decline in the Gross Domestic Product (GDP).

• All members of the marketing channel may feel the effects of recession in the form of substantial reductions in sales volume and profitability.
b) **Inflation**

The reaction of channel members to inflation is often a determination of the reaction of consumers or other final users to inflation. Unfortunately, these reactions are not easy to predict.
• From the perspective of the channel manager, such changes in consumer buying behavior should be viewed in the context of how they might affect channel member behavior and what the implications might be for channel strategy.
• Reducing the inventory burden on channel members through streamlined product offerings, faster order processing times and deliveries, higher inventory turnover strategy or stronger promotional support may have to be incorporated into channel strategy in times of high inflation rates.
c) Deflation

- Deflation, static prices, or even a very low rate of price increase can create serious channel management difficulties.

- It becomes anything but easy to increase prices when inflation is low and virtually impossible in times of falling prices.

- Each channel member is highly sensitive to price increases during these times and manufacturers may have a hard time passing on cost increases to other channel members.
Challenge:
Pass cost-induced price increases through channel when built-in cost pressures from labor contracts were negotiated several years earlier.
d) Other Economic Issues

The National Budget Deficit, National Debt, Trade Deficit and the relationship of the N$ to foreign currencies affects all channel members.
Recession

Channel strategy: Manufacturers provide channel member support by financing high inventory costs

Reduced sales volume
Reduced profitability
Firms caught with large inventories

Consumer and/or Corporate spending =

Reduced sales volume
Reduced profitability
Firms caught with large inventories
- When the Namibian dollar is strong against foreign currencies, Namibian products can become *less competitive* in the market thus making it more difficult for Namibian firms to sell their products to foreign consumers.

- High interest rates can be a problem even when the inflation rate is moderate and the economy is not in a recession.

- This is particularly true of the *real interest rate*, which is the nominal rate of interest minus the inflation rate.
a) Types of Competition

There are four types of competition, namely:

1. Horizontal competition
2. Intertype competition
3. Vertical competition
4. Channel system competition
Types of Competition

- Horizontal
- Vertical
- Intertype
- Channel System
1. **Horizontal competition** is defined as competition between firms of the same type. Examples include automobile manufacturer versus another automobile manufacturer. This is the most common form of competition and is generally referred to as simply “competition”.
2. **Intertype competition** is competition between different types of firms at the same channel level. Examples include off-price retailers versus department store retailers.
3. **Vertical Competition** refers to competition between channel members at different levels in the channel such as retailer versus wholesaler or wholesaler versus manufacturer.

This vertical competition can escalate to vertical conflict as one channel member attempts to directly impede another channel member’s attempt to achieve their objectives.
4. **Channel system** competition refers to complete channels competing with other complete channels.

In order for channels to compete as complete units, they must be organized as cohesive organizations.

Such channels have been referred to as *vertical marketing systems* and are classified into three types:
Three types of vertical marketing systems:
I. Corporate
II. Contractual
III. Administered
• In corporate system competition, production and marketing facilities are owned by the same company.
• Examples include Firestone Tire & Rubber Company and Sherwin-Williams Company
I. In contractual channel competition, independent channel members – producers or manufacturers, wholesalers, and retailers are linked by contractual agreements.
I. Administered channel systems result from strong domination by one of the channel members (usually a manufacturer) over others.

This dominant position is a function of the leverage that the dominant channel member can achieve based on a monopoly of supply, special expertise, strong consumer acceptance of its products or other factors.
As these vertical marketing systems take a larger and larger share of the total distribution system, the extent of channel system competition is expected to grow.

Not only do they have to think in terms of broad global perspective of competition, they also need to worry about horizontal, vertical, and channel systems competition.
Competitive Structure and Channel Management

• In designing the marketing channel, the channel manager needs to determine which kinds of distributors and/or dealers can provide the most efficient and effective distribution of the firm’s products.
A new term has emerged, called *scrambled merchandising*, to describe the selling of products through nontraditional outlets and has drastically changed the competitive landscape.

For example, the selling of automobile products in supermarkets or over the Internet is an example of scrambled merchandising.
• This changing competitive environment also means that producers and manufacturers face a far more complex management task because they are dealing with more and different types of channel members.
The Sociocultural Environment

• Marketing patterns are influenced by the sociocultural environment within which they exist.

• Indeed, some channel analysts argue that this is a major force affecting channel structure.

• In essence, then, the channel manager must be sensitive to the sociocultural environment of the marketing channel when the channel extends into foreign cultures.
Objective 6:

The Sociocultural Environment

Pervades all aspects of a society

Influences both national and international marketing channels

Influences wide variations among channel structures worldwide
b) Changing Ethnic Mix

• The emergence of these ethnic groups has been reflected in more economic and political power for both minority consumers and entrepreneurs.

• It is projected that minority businesses will grow dramatically in the twenty-first century.
• The manufacturer that wants to reach minority group target markets is therefore likely to find that an increasing number of the channel members needed to distribute products to these markets will also be members of minority groups.

• Thus, a manufacturer’s ability to sell products to minority markets will be dependent on developing strong relationships with minority group channel members.
c) Educational Trends

- In their role as consumers, people are sharper and more demanding of those who make and sell products they buy.
- Specifically, consumers are and will increasingly demand more information and more services from all channel members.
- In short, to meet the demands of an increasingly educated and sophisticated consumer market, all channel members will have to become more effective and efficient in their performance of the distribution tasks.
• **Family or Household Structure**
  
  There were about 105 million households in the United States by 2000; 69% contained families; married couples accounted for 53% and single women as head of the household accounted for 12%. Roughly, half of the nation’s 72 million families contain children.

• Some significant changes to the American family occurred in recent years:
  
  - **Families have become smaller**
  
    - The period of child rearing has been shortened by about three years; the period after the last child leaves home has been increased an average of 11 years; thus married couples can expect to be child free for 14 more years than couples of a generation ago.
  
    - The number of people living with nonrelatives grew by 31% from 1990 to 2000.

• These changing patterns in the life cycle of American families will significantly influence patterns of consumer shopping behavior which, in turn, have implications for channel management strategy.
• **e) Changing Role of Women**
  
  By 2000, 77.3% of all women between the ages of 35 and 44 were working compared to only 65% in 1980. Women now have far more choices available to them. The increase in career-oriented women may lessen the role of women as the primary buyer for the family unit. Hence, retailers will be called upon to make it much easier and quicker for women to shop.

• Channel members must rethink their channel strategies for reaching the career and working woman market segments.
The Technological Environment

• Technology is the most continuously and rapidly changing aspect of the environment.
• The channel manager has to sort out those developments that are relevant to his or her own firm and then determine how these changes are likely to affect the channel participants.
The Technological Environment

Scanners
Computerized inventory management
& Portable computers

Help retailers & wholesalers closely monitor success or failure of products they handle
• The Internet and Electronic Marketing Channels

• The Internet provides a highly efficient means for gaining access to, organizing, and sharing virtually unlimited amounts of information.

• Although the Internet was conceived primarily as an information exchange mechanism, it has now become an established “electronic marketing channel”.
The Technological Environment

EDI - Electronic Data Interchange

- Links together channel information systems
- Provides real-time responses
- Enhanced by Internet

= Enhanced Distribution Efficiency
a) Scanners, Computerized Inventory Management and Portable Computers

Electronic scanners can be used to replenish inventory electronically without having to rely on manually produced purchase orders.

A computer generated order can list items falling below minimum inventory levels and transmit the replenishment order directly to the producers and/or manufacturer.

Computerized inventory systems based on data received from point-of-sale terminals created a revolution in inventory management and control at the retail level and provided timely and valuable information for making better merchandising decisions.

Thus, the new technology is something of a mixed blessing for manufacturers. Quicker response by retailers and wholesalers to fast-selling products can allow the manufacturer more time to plan ahead to increase production. On the other hand, faster responses by channel members to slow sellers can mean a sudden halt in orders.
b) Electronic Data Interchange

- Electronic data interchange (EDI): Refers to the linking together of channel member information systems to provide real-time responses to communications between channel members.
- EDI technology enhances distribution efficiency resulting in substantial benefits to all channel members and consumers through more accurate and timely production schedules, order processing, and inventory carrying costs.
The Technological Environment

Accelerating technology

“Computer sales People”

Mobile robots

3-D modeling

Ultra-wideband technology
The Legal Environment

What should be kept in our minds as we proceed through the discussion of legal issues is the potential for conflict that exists between the objectives of an individual firm’s channel management strategies and the interests of society.
The Legal Environment

The set of laws that impact marketing channels

- Continually evolving
- Affected by changing values, norms, politics, & precedents
- Knowledge of basics helps channel manager avoid serious & costly legal problems
1. Dual Distribution

Dual distribution: Refers to the practice whereby a producer or manufacturer uses two or more different channel structures for distributing the same product to his target market. The selling of the same or similar products under different brand names for distribution through two or more channels is also a form of dual distribution.

• Dual distribution, which in recent years is increasingly being referred to as multi-channel distribution, is not illegal per se under federal antitrust laws.
Antitrust controversies have emerged when a firm distributes through its own vertically integrated channel in competition with independent channel members at the wholesale or retail levels.

Such distribution practices are common in the marketing of petroleum products, tires, shoes, paints, and drugs.
1. Exclusive Dealing

- Exclusive dealing: Occurs when a supplier requires its channel members to sell only its products or at least to refrain from selling products from directly competitive suppliers.

- With an exclusive dealing arrangement, the supplier gains a substantial degree of market protection from competitive products in the market areas covered by its channel members.
• Exclusive dealing arrangements are in violation of the antitrust provisions of the Clayton Act if their effect is to substantially lessen competition or foster monopolies.

• **The substantiability test is based upon three conditions:**
  a. Whether the exclusive arrangement excludes competitive products from a substantial share of the market
  b. Whether the dollar amount involved is substantial
  c. Whether the dispute is between large suppliers and a smaller distributor or deal where the supplier’s disparate economic power can be inherently coercive.
3. Full-Line Forcing

Full-line forcing: Occurs when a supplier requires channel members to carry a broad group of its products (the full line) in order to sell any particular products in the supplier’s line.

• It does represent, up to a point, a legitimate effort by the manufacturer to see that a broad range of its products is carried by channel members and to discourage “cherry picking” by channel members of only the “hottest” items in the manufacturer’s product line.

• Antitrust issues emerge when full-line forcing occurs to such an extent that it prevents other suppliers from selling competitive lines through channel members who are “loaded up” with the products of the supplier practicing full-line forcing.
3. Price Discrimination

- Price discrimination: Refers to the practice whereby a supplier, either directly or indirectly, sells at different prices to the same class of channel members to the extent that such price differentials tend to lessen competition.

- Accurate generalizations about whether specific channel pricing policies and practices constitute discrimination are difficult to make.
3. Price Maintenance

- Price maintenance: Refers to a supplier’s attempt to control the prices charged by its channel members for the supplier’s products.

- Thus, the supplier dictates the prices charged by channel members to the consumer.
• Manufacturers still try to influence prices charged by channel members for a variety of reasons:

To protect the image of their products, reduce the likelihood of price wars and to provide channel members with sufficient margins to enable the channel members to provide adequate pre- and post- sale service.
3. Refusal to Deal

Refusal to deal: Suppliers may select whomever they want as channel members and refuse to deal with whomever they want. Thus, there are no legal barriers to sellers using their own criteria and judgment in the selection of channel members.

• Refusal to deal cannot be used to coercively cut off channel members who will not conform to policies stipulated by the seller that may be illegal or in restraint of trade.
3. Resale Restriction

Resale restrictions: Refer to a manufacturer’s attempt to stipulate to whom channel members may resell the manufacturer’s products and in what specific geographical market areas (or territories) they may be sold.

• Such restrictions can be very advantageous to both the manufacturer and the channel members. The capacity to stipulate to whom products may be resold enables the manufacturer to retain and reserve certain house accounts (customers to whom the manufacturer sells directly) by prohibiting channel members from selling to these customers.

• Moreover, it enables the manufacturer to control the kinds of outlets from which final customers for its products will buy. In addition, the manufacturer can maintain a high degree of control over the distribution of its products.
• From the channel members’ standpoint, the territorial restrictions minimize *intrabrand competition* (competition between distributors selling the same branded product of a particular manufacturer) because each channel member is in effect given a “protected” geographical market area in which to sell.

• The Supreme Court has ruled that restrictions can have “redeeming virtues” by promoting intrabrand competition. The court also ruled that such resale restrictions are not necessarily anti-competitive if competition is viewed in a broader perspective.

• The legality of resale restrictions is still up in the air.
3. Tying Agreements

- *Tying agreements:* Agreements whereby a supplier sells a product to a channel member on condition that the channel member also purchase another product, or at least agrees not to purchase that product from any other supplier.
3. Vertical Integration

- Vertical integration: Occurs when a firm owns and operates organizations at other levels of the distribution channel (for example, a manufacturer owning and operating its own wholesaling facilities and retail stores).

Vertical integration can occur as a result of growth and evolution of the firm.

The firm desires to gain scales of economies and a high degree of control over its products.
END OF CHAPTER