



When Execution Matters

Distribution Channels

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In order to begin the discussion of direct and indirect distribution, let's review the business definition of distribution channels. Distribution channels are defined as the:

“Path or ‘pipeline’ through which goods and services flow in one direction (from vendor to the consumer), and the payments generated by them which flow in the opposite direction (from consumer to the vendor). A distribution channel can be as short as being direct from the vendor to the consumer or may include several inter-connected (usually independent but mutually dependent) intermediaries such as wholesalers, distributors, agents, resellers, retailers. Each intermediary receives the item at one pricing point and moves it to the next higher pricing point until it reaches the final buyer. Also called channel of distribution or marketing channel.” 1

To summarize, distribution channels are the process by which products and services are transferred or sold by a producer to an end customer.

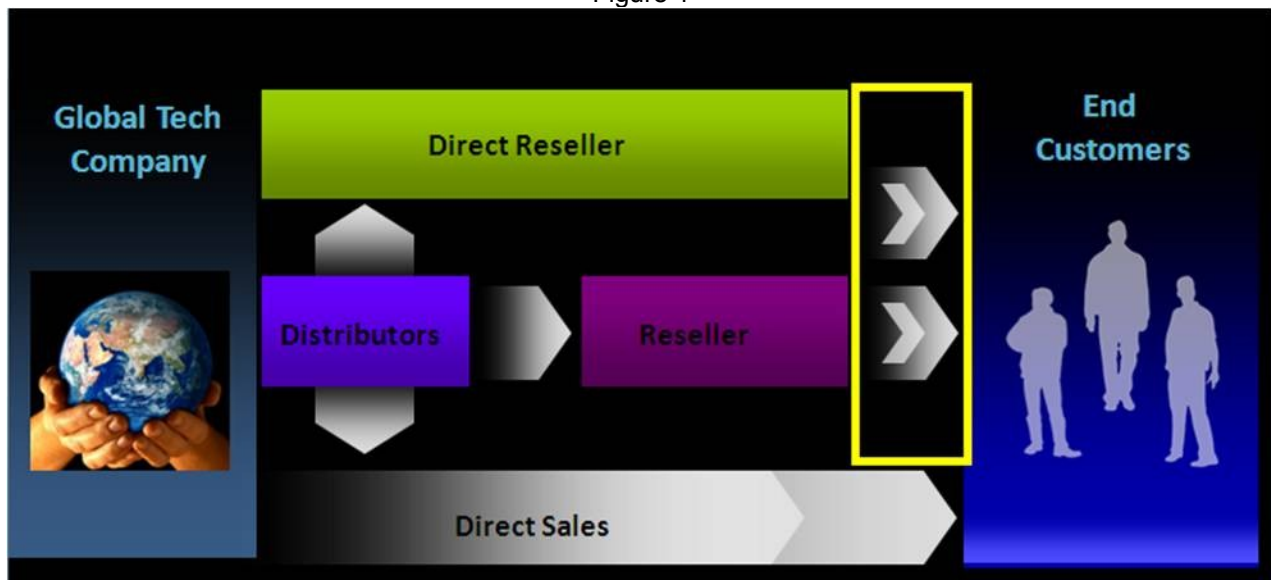
Forms of Distribution – Direct and Indirect

Direct distribution is as simple as it sounds. It is the direct selling of services or products to an end customer. The direct selling model is often perceived as optimal because of the lack of an intermediary or a broker (usually a reseller or distributor). It is an effective distribution method when the manufacturer has a range of services and products that entice the customer to engage them or their retail location (depending on industry). Direct distribution also takes the risk out of distributors or resellers learning details about the manufacturer's various products and trying to evaluate them against another manufacturer's line of similar products. Though direct distribution can be less complicated and risky than indirect distribution, it can make reaching the maximum number of end customers very difficult.

There are many versions of indirect distribution, but we will concentrate on 1-tier and 2-tier channels. In a 1-tier distribution channel, manufacturers engage a third party vendor to help sell and distribute their products and services. 1-tier channels usually flow from manufacturer to reseller to consumer or from manufacturer to wholesaler to consumer. In either case there is an intermediary that helps the distribution of products and services to reach the end customer base.

In a 2-tier distribution channel the manufacturer effectively engages two vendors to help sell and distribute their products and services. The 2-tier distribution channel primarily flows from manufacturer to distributor to reseller or wholesaler to consumer. The distributor receives the products at an adjusted price and then sells them (with a negotiated mark up) to the reseller. The adjusted price and mark up then drives the price that the product will be sold at to the end customer. The manufacturer usually stays out of negotiations between distributor and reseller.

Figure 1



Incentivizing Resellers

In order to motivate resellers it behooves the manufacturer to take into account the needs of the channel partners. To encourage the third party vendor to push the targeted products through the distribution channel, manufacturers take certain measures to incentivize resellers. The most important criteria for resellers is the profit margin (the difference between price sold to end customer and the price acquired from manufacturer) that is accumulated from each product sold. If the profit margin meets the resellers' financial objectives, they are naturally more inclined to push the manufacturer's product rather than their competitors.

Aside from profit margin, the manufacturer can offer other incentives in the form of additional market development funds to the reseller's teams within the third party that meets or exceeds sales expectations. These extra incentives entice the vendors' sales force to put extra efforts into selling the targeted product. Other incentives come in various forms ranging from performance-based commission, volume-based discounts, and a higher level of training and support to sell complex units of the products that have higher margins. These extra incentives motivate the reseller to push products.

Other ways that manufacturers take into account channel partner needs is by offering targeted training and making sure ordered products are delivered in perfect condition. When a reseller orders products, it is imperative to guarantee timely delivery and fully functioning products to build a good working relationship with the channel partners. As far as training is concerned, some products require deep subject matter expertise to display the product to potential clients that is not a part of the resellers' skill set. By offering training in these specific products, the manufacturer builds a partnership with resellers, as well as ensuring that their demonstrations to prospective clients are accurate and knowledgeable.

Conclusion

Whether utilizing direct or indirect distribution, an efficient and successful channels program should satisfy the needs of the company's maximum end customer base. Manufacturers that do not optimize their channels distribution strategy may struggle to get their product into the hands of their end customers. By incentivizing, motivating, and partnering with resellers, the manufacturer increases its chances of running a distribution channel at high efficiency and profitability.

Resources:

<http://www.businessdictionary.com/definition/distribution-channel.html>