



UNIVERSITY OF NIŠ
FACULTY OF ECONOMICS
"ECONOMIC THEMES"

Year XLVI, N° 4, 2008, p. 51-62

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MARKETING CHANNEL DESIGN

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***Abstract:** The purpose of marketing channel design is to deliver value to final consumers. Similar to differences in the ways economic theoreticians have approached the study of value in different historic periods, marketing also displays noticeable differences in creating and delivering value. The 21st century marketing theory has been enriched by a new approach – the concept of holistic marketing, which regards the creation and delivery of value from the aspect of value network. According to the holistic marketing concept, marketing channel design starts from the first suppliers, distributors and consumers, but such a starting point is extended to the entire supply and delivery chain, placing the company into the centre of the value network. Building a system of partnerships and alliances facilitates the creation and delivery of supply on the highly competitive contemporary market.*

***Key words:** design, marketing channels, value delivery, value network.*

1. Introduction

Designing marketing channels is one of the most sensitive areas of decision making in marketing management, having in mind that it implies delivering value and the company's presence on the final consumer market. In contemporary business practice, companies in most cases do not deliver their goods to final users directly, but rather build a network of intermediaries, partners and institutions whose function is to connect producers and final consumers, in accordance with defined marketing goals.

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UDC 658.8

Received: November 10, 2008

Marketing channels are a part of the marketing mix concept, whereby a company aims to respond rationally to the impact of dynamic marketing environment factors. Together with product, price and promotion, marketing channels participate in combining, designing and connecting marketing elements, leading to the best accomplishment of business goals in particular market conditions in given time.

Linguistically, the word “channel” is of French origin, and in marketing it refers to the pathway a product follows from the place of production to the place of final consumption. As most producers in modern marketing are not involved in the direct sale of their supplies to final consumers or users, efficiency in spanning the space and time gap between production and final consumption is accomplished by appropriate marketing channel design.

2. Marketing Channels In Marketing Mix Concept

The term ‘marketing mix’ was first used in 1953 by Professor Nill Borden in his American Marketing Association (AMA) presidential address, although the idea of the concept is credited to Professor James Culliton, who elaborated on it analysing marketing costs, concluding that marketing managers are ‘mixers of elements’ aimed at creating a profitable market supply. The marketing mix concept rapidly gained universal acceptance in marketing theory, with some differences in classifying instruments included in this concept.

Although not the only one, the most frequently used classification of marketing mix instruments in contemporary marketing is that of McCarthy, defining instruments as product, price, place and promotion. This classification is based on clear criteria, stemming from the basic marketing functions. Combining these marketing mix instruments, companies perform the basic marketing functions, where each of the marketing mix instruments most contributes to the realisation of marketing function. Marketing mix concept facilitates it for companies to overcome barriers in the process of exchange and accomplish the defined marketing and business goals.

The development of marketing mix concept implied a declining significance of pricing as the basic instrument whereby a company influences the demand for its offer. Marketing mix concept highlights the importance of the so-called non-pricing instruments influencing the demand for a particular company’s supply, but without price modification. Pricing competition is, in fact, a movement along the demand curve of a certain

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commodity, while non-price competition refers to moving the demand curve in favour of a certain commodity.

Marketing channels are thus the non-pricing instruments of the marketing mix, and their function is to draw benefits from 'place', or, in other words, marketing channels enable the disposal of the product to the other side in the process of exchange.¹ The expert public regards marketing channels as perhaps the least researched marketing mix instrument, which also appears in practice as substantial opportunity cost.

In business practice, marketing channels feature various agents i.e. intermediaries, which can be consumer-dependent and independent organisations. Intermediaries buying products and selling them to final customers are merchants or retailers, while those who act as intermediaries between producers and final consumers are referred to as agents, brokers, dealers etc., as they do take title of the products they distribute. Finally, marketing channels may also include intermediaries providing various types of assistance in distributing products from producers to consumers, so that they can be referred to as facilitators (banks, insurance companies, marketing agencies, transporters etc.).

A set of marketing channels used by a particular company is called marketing channel system.² Decisions related to the set of marketing channels reflect on all other marketing management decisions, starting from decisions on price, hiring sales force, establishing partnerships with other companies, down to joint conduct of promotional activities. In addition, managing marketing channels implies the company's decision to use push or pull strategy.

Marketing channels as an element of marketing mix concept increasingly take on the characteristics of essential association, linking producers and final consumers, where this interdependence is manifested in intra-company as well as extra-company merger of a larger number of functions.³ Marketing channels are an important instrument in marketing

¹ A. Grubor, *Marketing istraživanja – integralni deo međunarodnog marketing programa* [Marketing research as an integral part of the international marketing programme (monograph)], Ekonomski fakultet Subotica, Subotica, 2008, p. 63.

² Ph. Kotler and K. L. Keller, *Marketing menadžment* (Serbian translation of *Marketing Management*) 12th ed., Data Status, Belgrade, 2006, p. 468.

³ A. Grubor, Informacije međunarodnih marketing istraživanja u funkciji kanala distribucije [International marketing research information in the function of distribution channels], in *Anali Ekonomskog fakulteta u Subotici* [Annals of the Faculty of Economics in Subotica], vol. 14, 2005, p. 14. i 15.

programme implementation, and should be designed in a way that will enable flexibility and adaptability to specific market conditions.

3. Marketing Channels And Value Networks

Analysing value networks in marketing channel design serves the purpose of creating optimized marketing mix, bearing in mind that decisions on distribution channels reflect significantly on the marketing programme's efficiency and effectiveness. Designing an advanced and serviceable system of marketing channels is a problem frequently burdened by the achievement of competitive advantages, which undermines the coordination of marketing and production.⁴ It is therefore necessary to extend the concept of supply chain, so as to overcome the limitations of partial approach to planning demand chain.

Extending this concept implies placing the company in the centre of the value network⁵, referring to a system of partnerships and alliances built so that a company can create, augment and deliver its supply. Value network includes both the company's suppliers and its suppliers' suppliers, immediate and final customers, i.e. consumers of products supplied. In a wider sense, a value network also encompasses other marketing environment factors affecting the delivery of a given company's supply to final consumers, which points to the significance of developing and enhancing relationships within marketing channels.

Value network concept stands in the function of delivering superior value to target market segment, as an enhancement in demand chain planning. Developing value network concept may lead to alternative solutions to generally accepted marketing mix instruments, known as SIVA, referring to the role of solutions, information, value and access in accomplishing defined marketing goals.⁶

Implementing value network concept implies companies' increased investment in developing information technologies and software packages. It is about the necessity of enhancing the management of cash flows, production processes, human resources, purchasing and other contemporary business system functions. Separating and enhancing business functions

⁴ A. Grubor, Kreiranje optimalnog međunarodnog marketing miksa [Creating optimum international marketing mix], in *Marketing*, Vol. 36, No 3, 2005, p. 139.

⁵ Ph. Kotler and K. L. Keller, *op. cit.*, p. 471.

⁶ M. Troy, From Supply Chain to Demand Chain, a New View of the Marketplace, *DSN Retailig Today*, 13 October 2003, pp. 8-9.

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should result in simplified realisation of individual processes in business operations.

Moreover, enhancing supply chain planning enables reviewing earned revenues at the beginning and the end of business process, which facilitates decision-making on backward and forward integration. Furthermore, it facilitates reviews of sudden diversions in any section of the supply chain, thereby reducing pressures to change costs, prices and supply chains. In addition, companies can liaise with their business partners in developing marketing communication and integrate transactions, thereby reducing costs and increasing business efficiency.

In business practices, marketing managers still pay the most attention to the part of value network focussed on final consumers of products. Such an approach may result in a more active role of final consumers in planning companies' marketing activities, especially in marketing channel design. With the growing role of value network in marketing channel design, contemporary marketing managers are increasingly likely to become value network managers, unlike previous product or account managers.

4. The Functions, Flows And Dynamics Of Marketing Channels

Marketing theory devotes most attention to building marketing channel structure, while the study of functions and flows is secondary to institutions, i.e. subjects in marketing channels. Regardless of approach to marketing channel design, they must perform all marketing functions characteristic of product distribution. Marketing channel functions include relevant tasks and operations such as negotiating, ordering, purchasing, classifying, transporting, warehousing, labelling, promoting, risk-taking, selling etc.

These functions are almost always performed in business practice, even in situations when a company sells its products directly to final consumers. When designing marketing channels, functions are transferred to other participants, as they cannot be eliminated. There are known examples when, in certain situations, final consumers take over some marketing channel functions.

In most cases, marketing channel design involves multiple intermediaries, who carry out various activities. In system approach, a

channel is viewed as a single institution, run and coordinated by someone cast in the role of marketing channel leader.⁷

Marketing channel design should result in a developed distribution system, capable of surviving in competition with differently designed marketing channels. If not, individual participants in a particular marketing channel could define strategies contrary to interests of other members of the marketing channel, which would, in the long run, undoubtedly lead to business failure both of the marketing channel system as a whole, and the less viable members of the marketing channel.

Marketing channels can, therefore, include a larger or smaller number of members, who perform marketing channel functions and are linked by different types of flows, the most significant of which are:⁸

- physical flow, i.e. physical movement of product from raw material to the end user, i.e. consumer;
- right of disposal flow, regulating the transfer of title from one legal entity to another within a designed marketing channel; and
- information flow, to be understood as deliberate channelling of effects through various forms of promotion and publicity from one member of the designed marketing channel to the others.

These flows should include payment flow as well as marketing channels also include various payments which accompany physical flow and right of disposal flow and are effected through commercial banks and other financial institutions.

Marketing channel functions and flows refer to their principal role, i.e. facilitating exchange or removing the gap between the quantity and structure of supply and demand for a particular product. This gap in most cases stems from producers' narrow specialisation in producing large quantities of a smaller range of products on the one hand, and consumers' demand for smaller quantities of a wide range of products on the other.

Marketing channel dynamics refer to decisions on whether to design conventional, vertical or horizontal marketing channels. Conventional marketing channels are recognisable by isolated and autonomous participants, performing a smaller number of traditional distribution

⁷ S. Vasiljev, *Marketing principi* [Marketing principles], 4th ed., Prometej, Novi Sad, 2005, p. 301.

⁸ G. Lancaster and L. Massingham, *Marketing management* (Serbian translation), Grmeč, Belgrade, 1997, str. 248.

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activities. Coordination within marketing channels is performed by individual negotiations between individual participants.

Vertical marketing channels are integrated distribution systems, which are the most common in developed market economies. They function as a single distribution system where the behaviour of individual members is controlled, with the aim of overcoming possible conflicts arising from individual members' aspirations to accomplish partial goals. Principal members of vertical marketing channels accept mutual dependence, justified by the accomplishment of long-term business interests. Contemporary business practice recognises various types of vertical marketing channels, the most common of which are corporate vertical systems and franchising.

Horizontal marketing channels refer to linking companies of the same level, or industry. Such marketing channel design points to the willingness of two or more independent companies to pool resources and marketing programmes, so as to exploit favourable market situations. Horizontal linking in most cases result in joint ventures, used in joint targeting of particular market segments.

5. Marketing Channel Strategy And Management

Marketing channel design implies making very important strategic decisions in marketing management, which should be in accordance with other decision-making related to creating marketing programmes. As marketing channels comprised in the marketing programmes are managed while moving products from producers to final consumers, it is necessary to develop appropriate strategies and management of marketing channels. Developing marketing channel strategy implies:⁹

- choosing the most effective marketing channel;
- deciding on the intensity of distribution;
- deciding on the degree of marketing channels integration .

When selecting the most effective marketing channel, a company should appreciate the impact of relevant factors, most notably market factors, producer factors, product factors, and competition factors. Reviewing the impact of these factors, a company can most effectively meet the demands of the increasingly diversified contemporary market for the

⁹ D. Jobber & J. Fahy, *Osnovi marketinga* (Serbian translation of *Foundations of Marketing*), 2nd ed., Data Status, Belgrade, 2006. p. 311.

delivery of required, desired or - perhaps most aptly - requested products and services.¹⁰

Deciding on the intensity of distribution refers to choosing between three basic options, i.e. inclusive, selective and exclusive distribution. Intensive distribution prevails in products targeted at mass market; selective distribution achieves good market coverage by using a smaller number of retail outlets, while exclusive distribution is an extreme form of selective distribution, where only one distributor is engaged on the target market segment.

Deciding on the degree of marketing channels integration includes the choice between conventional marketing channels, building a franchising system, all the way to taking title of the channel by the producer. In conventional marketing channels, the producer has little or virtually no control of agents, in view of their independence. One exception refers to commercially strong producers with developed strong brands, resulting in vertical marketing systems in business practice.

Developing a franchising system implies the existence of a legal relationship between the producer and the agents, stipulating all the rights and obligations of all system members. Franchising systems are examples of vertical marketing systems, as they rely on formal coordination and integration of total marketing and distribution activities.

Taking the title of the channel by the producer leads to total control of activities of the employed intermediary, serving as a basis for developing a corporate vertical marketing system. On this way, by acquiring retail outlets, the producers achieve a full control of production, purchasing and other marketing activities in their own retail outlets. The advantages of this marketing channel strategy are based on balancing the control with the acquisition price of retail outlets, i.e. the risk of excessive extension of managing activities.

After developing marketing channel strategy, the next stage is its effective implementation, i.e. continuous management of marketing channel strategy. In other words, the follow-up activities in marketing channel design are related to decisions on marketing channel management. Marketing channel management decisions include choice, motivation, training and

¹⁰ R. Kovač Žnideršić and D. Marić: *Društvene determinante ponašanja potrošača* [Social determinants of consumer behaviour], Ekonomski fakultet Subotica, 2007, p. 205.

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assessment of channel members, as well as resolving conflicts within marketing channels.¹¹

Selecting marketing channel members implies the identification of potential members and definitions of selection criteria. After choosing marketing channel members, the next stage is motivating them, so that distributors devote sufficient attention and resources to particular company's products. Training marketing channel members is determined by their internal abilities, especially in the areas of management, marketing, finance and human resources management. Assessment of marketing channel members affects decisions on retaining, training and motivating selected distributors. Assessment produces information on which the distributors should be retained, and which should be substituted. Finally, marketing channel management includes conflict management, especially in a situation when the producer and chosen distributors are independent. Conflicts may arise from different objectives, introduction of additional product lines, or the use of multiple marketing channels.

Conflict management is facilitated by developing partnerships between producers and chosen distributors, i.e. marketing channel members, and is achieved by reaching consensus on sales targets, staff training in conflict resolution, market segmentation, enhancing marketing performances, as well as acquisition, i.e. commitment of the other side.

6. Contemporary Practices In Marketing Channel Design

The changing business conditions on the contemporary market also require adjustments in the application of marketing concepts, implying a different approach to marketing functions, especially marketing channel design. Contemporary practices in marketing channel design increasingly point to the unity of functional areas related to the transfer of products, services, capital, knowledge, ideas, skills and other relevant elements of contemporary business effort.¹²

The development of information and telecommunication technologies has also resulted in changes in marketing channel design. The emergence of e-business, e-trading and e-marketing has set new demands on

¹¹ D. Jobber and J. Fahy: *Osnovi marketinga marketinga* (Serbian translation of *Foundations of Marketing*), 2nd ed., Data Status, Belgrade, 2006, p. 314.

¹² A. Grubor: Marketing i globalizacija – međunarodni marketing program [Marketing and globalisation – international marketing programme], in *Montenegrin Journal of Economics*, Vol. 1, No. 2, December 2005, p. 125.

marketing channel design. Moreover, contemporary business practices know examples of internet-based (pure-click) companies, i.e. organisations that first set up web sites and were only subsequently incorporated.¹³ Still, the majority of contemporary companies are both brick-and-mortar and internet-bases (brick-and-click), having created online sites featuring the necessary infrastructure of e-business, i.e. e-marketing.

Marketing channel design is justified in situations when consumers expect substantial benefits when ordering products, i.e. expect low distribution costs. E-marketing channels also enable information exchange on all the significant elements of supply. Pure-click companies only build e-marketing channels. The effects of such business practices are best illustrated by the data on the high capitalisation levels of pure-click companies in the final years of the twentieth century.

In addition to traditional ones, brick-and-mortar companies increasingly design e-marketing channels, thereby converting to brick-and-click. Initial consideration was that the development of e-distribution might lead to conflict between marketing channels, as it was supposed that there would be competition between online and offline distribution. The fear of withdrawal of traditional agents is partly justified, but companies can develop strategies for achieving coordination among intermediaries.

The contemporary practices offer three most frequent strategies for achieving coordination of intermediaries. Firstly, e-marketing can offer the consumers different brands, i.e. products. Next, offline partners can be stimulated by higher commissions so as to overcome the negative impact of online distribution. Finally, products can be ordered online, with delivery and collection done traditionally.

Contemporary marketing channel practices also refers to designing consumer-focussed marketing structures, aimed at highlighting the central role of consumers in achieving business performance.¹⁴ The emergence and development of relationship marketing is conducive to designing consumer-focussed structures, as relationship marketing is an intrinsically different approach to doing business than transaction marketing. Building and maintaining long-term consumer relations is becoming an essential determinant of market survival, especially in cases of companies with high overheads and high profit margins in doing business with particular

¹³ Ph. Kotler and K. L. Keller, *op. cit.*, p. 493

¹⁴ A. Grubor: Oblikovanje strukture međunarodnog marketinga usmerene na kupca program [Designing consumer-focussed international marketing structure], in *Strategijski menadžment* [Strategic Management], 3/2005, p. 37.

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customers or customer categories. Moreover, in consumer goods retailing, long-term relationship building and maintenance enables earning stable and predictable revenues throughout the business year.

7. Conclusion

Marketing channel design at the beginning of 21st century is increasingly focussed on their optimisation, which means that companies cooperate with marketing intermediaries in building new and frequently unified retail and distribution systems. Such focussing results in the integration of new forms of transport, new methods of stock control and handling materials, as well as information exchange systems, reducing distribution costs, and at the same time consumers receive high quality and service levels.

Modern retailing and product distribution is characterised by high quality and level of service supplied to consumers, starting from the smallest to highly specialised and exclusive retail facilities, and services rendered to consumers in e-marketing channels. On the other hand, marketing channels are still an underdeveloped area of marketing, which, if researched more thoroughly, could lead to significant cost reduction. High product distribution costs require adequate approach to managing relevant marketing channel design factors.

Contemporary marketing channel design serves the purpose of successful delivery of value to final consumers. From the aspect of holistic marketing, creating and delivering value to final consumers is viewed from the angle of value network, which means analysing the entire supply chain from raw materials and production components to the delivery of final products to final users. Accordingly, in designing marketing channels, contemporary companies focus on building and managing value networks under permanent development.

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DIZAJNIRANJE MARKETING KANALA

Rezime: Dizajniranje kanala marketinga jeste u funkciji isporučivanja vrednosti krajnjim potrošačima. Slično kao što su ekonomski teoretičari u određenim vremenskim periodima različito pristupali izučavanju vrednosti, tako su i u marketingu primetne promene u kreiranju i isporučivanju vrednosti. Teorija marketinga u XXI veku obogaćena je novim pristupom, odnosno konceptom holističkog marketinga, u okviru kojeg se kreiranje i isporučivanje vrednosti posmatra sa aspekta mreže vrednosti. Prema konceptu holističkog marketinga, u dizajniranju marketing kanala polazi se od prvih dobavljača, distributera i potrošača, ali se ovakva polazna osnova proširuje sa celokupnim lancem snabdevanja i isporučivanja, kojim se kompanija dovodi u centar mreže vrednosti. Izgrađivanjem sistema partnerstva i alijansi olakšava se kreiranje i isporučivanje ponude na visoko konkurentnom savremenom tržištu.

Ključne reči: dizajniranje, marketing kanal, isporučivanje vrednosti, mreža vrednosti.