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C.10 Direct versus Indirect Distribution

CHARACTERISTICS OF DISTRIBUTION LEVELS DECISIONS

Choosing between direct and indirect distribution is one of several channel design decisions made as part of marketing mix development.

The Direct versus Indirect Distribution Decision. In designing the channel of distribution for a product, the marketer must decide upon the **number of levels** of middlemen to be used. If the manufacturer of a product chooses to use the firm's own sales force to sell to retailers or to industrial firms with no intervening middlemen, it is termed **direct distribution.** If the manufacturer sells to one or more types of wholesalers who, in turn, sell to retailers or to industrial firms, it is said to be **indirect distribution.**

There are many variations and alternatives in deciding upon the number of levels of middlemen, some of which are explored in the next section. However, most often this issue surfaces as a choice between direct and indirect distribution. This decision occurs when the channel is first designed for a new product and recurs as the product matures or market conditions change. The criteria that are developed below for making the direct versus indirect decision are also useful in making other related decisions on the number of channel levels.

Alternative Levels in the Channel of Distribution. The number of levels of intermediaries found in a channel of distribution ranges from none to three. More than three levels are possible, but rarely found. Some of the more widely seen channel levels are illustrated in Figure C.10–1 for consumer products and in Figure C.10–2 for products sold to industry. They are discussed below.

- *Direct Marketing.* When a manufacturer sells a product direct to the end consumer, with no

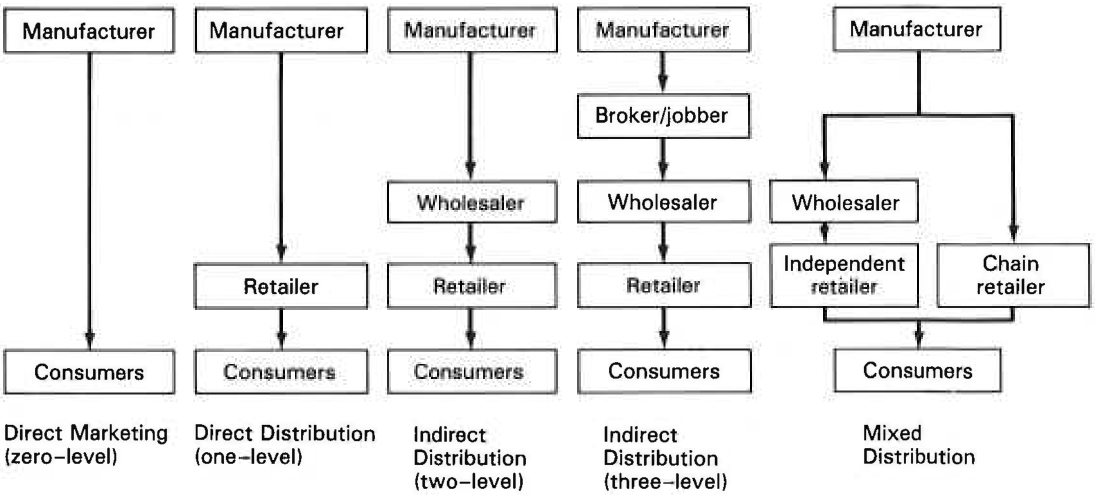

FIGURE C.10–1

Alternative Channel Levels—Consumer Products

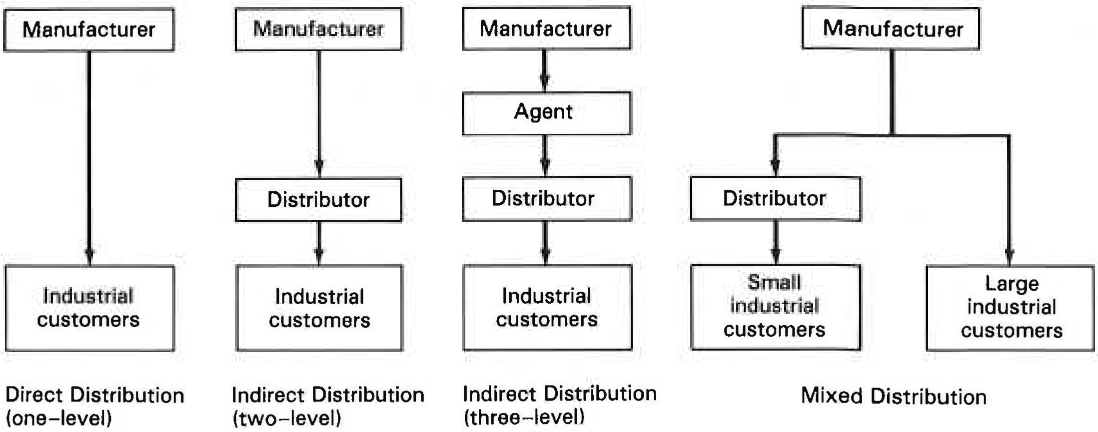

FIGURE C.10-2

Alternative Channel Levels—Industrial Products

middlemen intervening, it is termed **direct marketing.** It is also known as a **zero-level channel.** The terminology here can be confusing. Direct marketing is not the same as direct distribution which is a one-level channel. The decision to utilize direct marketing is more than a choice of distribution channel. It is a higher-level strategy decision that includes the selection of a highly refined target market, development of a data base of target consumers, and creation of a complete marketing mix to be offered directly to this segment. Promotion may utilize direct mail, telephone solicitation, or door-to-door solicitation. Product delivery may utilize mail or salesperson delivery. Well-known direct marketers include Avon, L. L. Bean, and Tupperware. Direct marketing can also be utilized in selling to businesses where it usually refers to direct solicitation of orders through nonpersonal selling, including use of direct mail, catalogs, and telephone.

- *Direct Distribution.* If a consumer products producer, using its own sales force, sells to retailers, with no other middlemen intervening, it is termed **direct distribution** or a **one-level channel.** A large, multiple-product food company might adopt this approach with its sales force soliciting orders direct from food stores. Note, however, that in this case, purchases by chain supermarkets might well be delivered through store-owned distribution centers that would perform some of the wholesaling functions (see GLOSSARY entry C.42).

  In the case of industrial products, direct distribution involves company salespersons soliciting orders directly from industrial buyers with the product **drop shipped** (shipped directly) to the purchaser. A mainframe computer manufacturer would probably use this form of direct distribution. Note, however, that in a case like this the manufacturer may use district sales offices to perform some of the functions of wholesalers.

- *Two-Level Indirect Distribution.* Distribution by a manufacturer through a wholesaler to a retailer or industrial customer would be **two-level, indirect distribution.** A producer of restaurant foods, for example, might sell to an institutional foods wholesaler who, in turn, sells to restaurants, which, in this case, are the retailers. Both product selling and product delivery would follow this channel. Two-level distribution is widely used for products sold to industrial buyers. A typewriter manufacturer, for example, might use an office supplies distributor who would, in turn, solicit orders from businesses in its territory. In both examples, although the wholsesalers take on the task of selling to their customers, the manufacturer must still have a small sales force to sell and service the wholesaler.

- *Three-Level Indirect Distribution.* **Three-level, indirect distribution** occurs when one type of wholesaler is used who, in turn, markets the product to a second type of wholesaler who distributes the product to the retailer or industrial customer. Usually these two different types of wholesalers perform different functions. In consumer food products, for example, a producer might use food brokers as the primary sales force for the product. The food brokers would then sell to grocery products wholesalers, who would stock product inventory and sell it to retail food stores.

A similar system in the industrial field would use agents to sell to distributors who would sell to industrial customers. In this case, the agents would serve as a selling arm of the manufacturer. The distributors would provide selling service to their customer base, but would also hold inventory of the product, process orders, and, perhaps, provide repair and parts services.

- *Mixed Direct/Indirect Distribution.* Marketers often use multiple distribution channels for the same product, sometimes mixing direct and indirect distribution. If a product is sold to multiple target markets, a separate channel for each market may be required. Major home appliance manufacturers, for example, use indirect distribution through home appliance distributors to retail dealers who sell to consumer home owners. At the same time, they distribute appliances direct to large home building contractors for installation in new homes and direct to kitchen remodeler firms for installation in remodeled kitchens.

  Another situation leading to mixed direct/indirect channels is the presence of a few large, important customers. Sometimes customers, who purchase in very large volume, demand that dealings be direct. They not only want special pricing that a middleman cannot offer, but they also want direct manufacturer involvement and servicing of their needs. The manufacturer may also be very reluctant to delegate dealings with this important customer to a middleman. Selling direct to high volume customers creates a conflict situation with middlemen. Often some means is found to compensate them for this loss.

MAKING THE DIRECT VERSUS INDIRECT DECISION

The choice between direct and indirect distribution is an important channel design decision. We shall use it as a prototype of channel level decisions.

Balancing Cost Against Control. The choice between direct and indirect distribution is, at the most fundamental level, a tradeoff between cost and control. By distributing indirectly, manufacturers gain cost efficiencies made available by middlemen, but they must relinquish some control over the marketing of their products.

Why is it cost efficient to use middlemen like wholesalers and agents? First, using a wholesaler is efficient because it relieves the manufacturer of providing the investment required to establish a new distribution system for its product. The wholesaler is a going business and has already invested in developing a customer base, a trained sales force, warehousing, and order processing facilities. An additional product can usually be handled by the wholesaler with little new investment.

Second, wholesalers offer cost efficiencies because they spread their costs across the products of many manufacturers. Wholesalers handle only products that meet the needs of their customer base. This means that all of the products can be sold, stored, delivered, financed, and serviced together. During a sales call, for example, the wholesaler sales representative presents the entire line of products. Thus the cost of the sales call is spread over all products and is far less per product than if one product were sold alone.

Finally, wholesalers gain cost efficiencies through specialization. They tend to be in one business only—distribution. This focus and the competitive pressures in the industry tend to create efficiencies that would be difficult for the manufacturer to duplicate.

However, there is a tradeoff in gaining the cost efficiencies of the wholesaler: Product marketing control is diminished. Wholesalers are independent businesses. They see themselves as purchasing agents for their customers, motivated to meet customer needs. In some cases the needs of the wholesalers and their customers conflict with those of the manufacturers of products handled by the wholesalers. Part of the design of distribution channels is concerned with developing middleman cooperation in marketing products (see GLOSSARY entry C.6). Manufacturers offer discounts, promotional allowances, sales force incentives, training programs, and the like in order to gain wholesaler cooperation. This can be partially successful, but does not result in the control that can be realized by selling direct with the firm's own sales force. It is very difficult to get wholesalers, especially those with extensive product lines, to give individual attention to any one product. This kind of control can be assured only by selling direct.

Criteria for Making the Direct versus Indirect Decision. How is the tradeoff between cost efficiency and marketing control reconciled in making the choice between direct and indirect distribution? Unfortunately, the need for control does not lend itself to quantification and the comparative costs of direct and indirect distribution may also be difficult to project accurately.

Despite this, there are a number of criteria that help the marketer decide how important distribution control is to a product and how great the cost disadvantage would be from distributing direct. These can be used to find a balance between cost and control and guide the decision between direct and indirect. The criteria are summarized below in five groups.[1]

- *Characteristics of the Customer.* Direct distribution will be more efficient if customers are concentrated than if they are widely dispersed. Personal selling costs, in particular, are lower if little travel is required between customers and still lower if concentrated in the vicinity of the manufacturer. On the other hand, if customers are scattered geographically, dispersed across several industries, and not in proximity to the manufacturer, then indirect distribution will be more efficient.

  Customer requirements may also affect the choice between direct and indirect distribution. Large, important customers that buy in volume may insist on dealing direct with the manufacturer to get service and price concessions. If the product is essential to the customer's operations and lack of product would cause an emergency, then the customer may wish the reassurance of direct contact with the manufacturer. In some fields a tradition of direct or indirect distribution is reinforced by long-standing competitive practice that would cause customer dissatisfaction if not followed. If the purchase decision is made high in the customer organization, by the CEO for example, there will be a tendency to respond by having the manufacturer deal directly with the customer.

- *Product Needs and Characteristics.* The choice between direct and indirect distribution is dependent upon the marketing and distribution requirements of the individual product. In designing the channel of distribution, the manufacturer should define the selling and service requirements to be performed in the channel and should specify what channel member is to do them (see GLOSSARY entry C.6). If there are selling and servicing requirements that can best be performed by wholesalers, this would point to indirect distribution. If wholesalers are unable or unwilling to perform the needed services, then direct distribution is favored.

  For example, products that are hard to handle because they are very bulky or perishable are better handled direct. If a product is highly technical or needs to be customized to individual buyers, then direct dealing between the manufacturer's technical representatives and the customer will be needed and will tend to lead to direct distribution. On the other hand, standardized, nontechnical products that are easily stocked in the field lend themselves to indirect distribution.

  Product value also affects the decision. High value products, high margined products, and products for which the unit sale is high tend to be sold direct because the higher selling expense is affordable. Low-margin, low-priced, low-unit sale products tend to require the efficiencies of indirect distribution.

- *Company Strengths and Resources.* In some instances, a company's situation will permit it to engage in direct distribution at a cost comparable to using wholesalers or will, at least, reduce the cost disadvantage. If a company has an existing direct distribution system for its line of products, other products could be distributed direct by adding them to this distribu-

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[1]Some of these criteria were suggested in James D. Hlavacek and Tommy J. McCuistion, "Industrial Distributors—When, Who, and How?" *Harvard Business Review* (March–April 1983), pp. 96–101; and in Donald J. Jackson, Robert F. Krampf, and Leonard J. Konopa, "Factors That Influence the Length of Industrial Channels," *Industrial Marketing Management* 11 (October 1982), pp. 263–68.

tion system. Little additional investment would be required. The products would, of course, have to have the same target market and have similar selling and service requirements.

The more products a company markets, and the more complementary those products, the more likely it will be able to use direct distribution efficiently. Early in their life, companies tend to have a single product that by economic necessity is distributed through wholesalers. As the business matures, the product line gradually grows, increasing the economic feasibility of direct distribution. The decision to switch from indirect to direct distribution frequently arises at this stage.

Developing a direct distribution system requires substantial investment by the manufacturer. Hiring and training a sales force, building warehouses and sales offices, establishing order processing and repair facilities, prospecting for customers, and extending credit to purchasers all require investment on the part of the manufacturer building a direct distribution system. This is clearly a barrier to smaller firms and to those short of capital.

- *Wholesaler Characteristics.* The choice between direct and indirect distribution should consider the characteristics of the wholesalers who would be used. Not infrequently the decision is made to use indirect distribution only to find that the desired wholesaler is not available (see GLOSSARY entry C.42). Wholesalers may refuse to handle a product for a variety of reasons. They may feel that it does not meet customer needs, they may have a duplicate product that they feel is superior, or they may not feel that the financial incentive is adequate. In such cases, the choice is to use a less desirable wholesaler or distribute direct.

A related problem occurs when marketers of new products are forced to distribute direct to establish a track record for the product so that middlemen will accept it. This can greatly slow new product introduction. Wholesaler reluctance to handle new products can sometimes be overcome by running introductory sales promotions that create strong initial product movement (see GLOSSARY entry C.36). When rapid initial product distribution is essential, use of the existing system of wholesalers will meet the need more quickly than building a new direct system.

SUGGESTIONS FOR FURTHER READING

HLAVACEK, JAMES D., and TOMMY J. MCCUISTION. "Industrial Distributors—When, Who, and How?" *Harvard Business Review* (March–April 1983), pp. 96–101.

JACKSON, DONALD J., ROBERT F. KRAMPF, and LEONARD J. KONOPA. "Factors That Influence the Length of Industrial Channels." *Industrial Marketing Management* 11 (October 1982), pp. 263–68.