



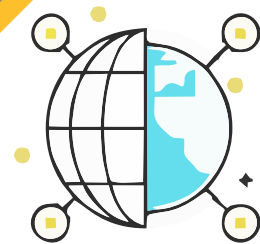
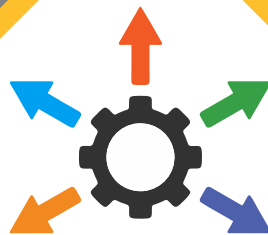
Information Booklet

Sales and  
Marketing

17

# DISTRIBUTION CHANNELS OF YOUR BUSINESS

for SMEs



National Business Development  
Program for SMEs

## Introduction

**Small and Medium Enterprises Development Authority (SMEDA)** works under the Ministry of Industries and Production, Government of Pakistan and was established in 1998 with the objective to propel economic growth through development of SMEs. SMEDA serves as an SME strategy-advisory body for the Government of Pakistan and facilitates partners in meeting their SME development agendas.

SMEDA envisions growth of a globally competitive SME sector (in Pakistan), through creating an enabling environment and support services for increase in the national economy. SMEDA strives to achieve this vision by providing assistance in employment generation and value addition to the national income, through development of the SME Sector, by helping increase the number, scale and competitiveness of SMEs.

National Business Development Program for SMEs (NBDP) is a project of SMEDA which intends to provide hands-on support services to SMEs. The aim of this business development support provided by NBDP is to advance new businesses and improve efficiencies in existing SME value chains to empower them to contend in global market. NBDP expects to facilitate around 314,000 SME beneficiaries over the period of five years.

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## Objectives

- To explain the concept and importance of having a good distribution channel.
- To elaborate complete chain of channels and ways of developing right distribution channels.

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## a Concept and Importance of Distribution Channel

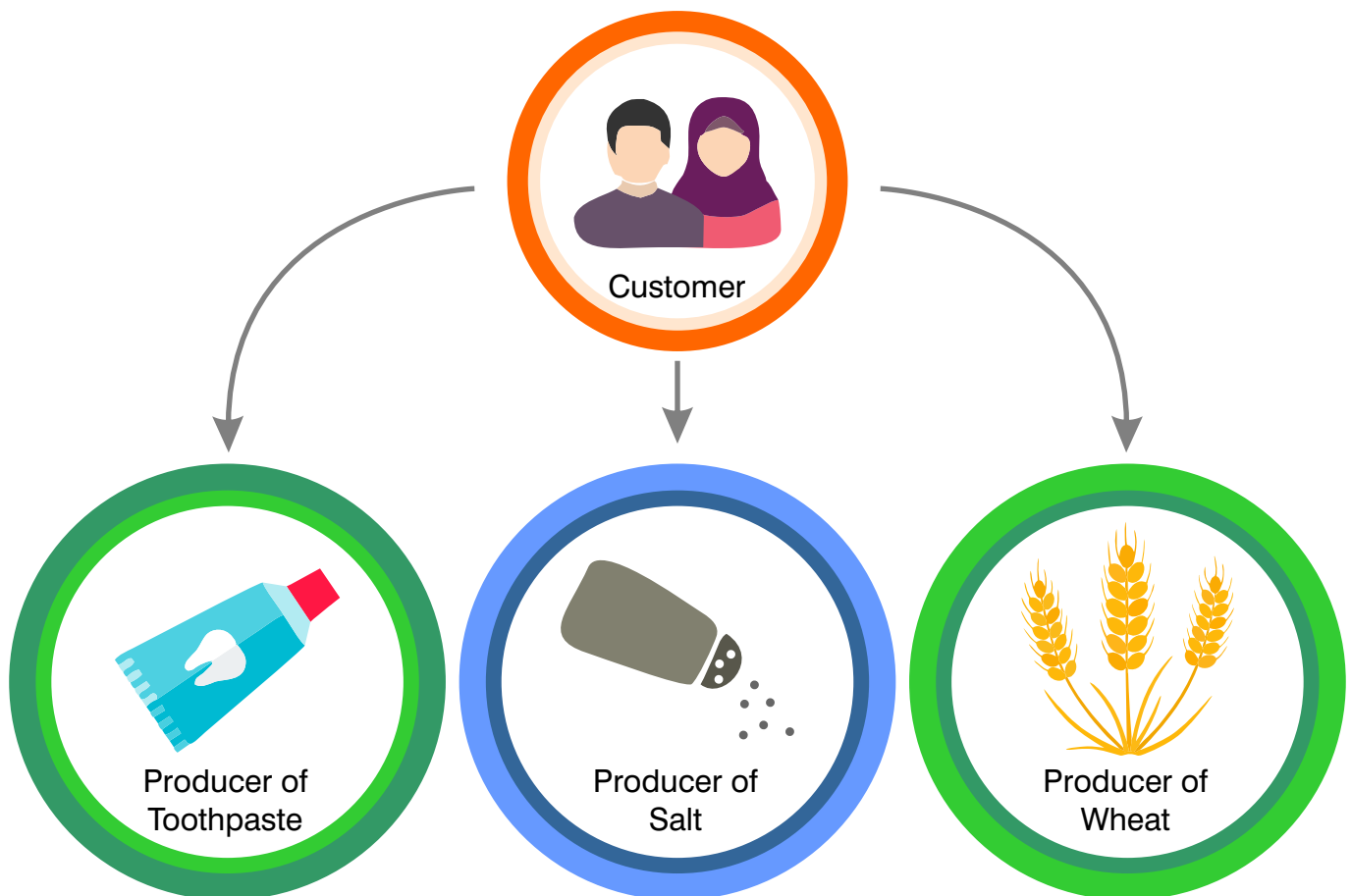
Distribution is the activity of both selling and delivering products and services from manufacturer to customer. As businesses become mature, they learn to improve distribution through different elements of the distribution channel. Distribution Channel refers to those people, institutions or merchants who help in the distribution of goods and services.

Usually, most of the goods are produced at one or relatively fewer places but their consumers and customers are scattered over a much wider geographical area. Therefore, businesses take the help of some intermediaries to distribute goods. For example, Gul Ahmad and Alkaram textile mills are located at Karachi but their products are available all over the country with the help of distribution channels and intermediaries.

- Channels of distribution bring economy of effort.
- They help to cover a vast geographical area and also bring efficiency in distribution including transportation and warehousing.
- Channels of distribution provide convenience to customer, like retailers where people can get various items at one store.

### Consider Following Two Diagrams

1. When there is no channel of distribution



2. When there is a channel of distribution e.g., retailer



**Channels of Distribution used for a Consumer Product**

## Importance of Distribution Channels

### Optimizing Sales Volume

If a business has limited opportunities to distribute the product on their own and has limited capacity to sell the product, it must look for distributors who will help to generate the maximum sales. However, maximum sales do not always mean optimum sales because some channels have higher associated costs.

### Appropriate channels for Specific Products

Another consideration is the impact of distribution channel on the product serviceability as customer expectations on how the business owner chooses to distribute the products plays an important part. If a business deals in the products that may require accessories or intermittent maintenance, choosing online distribution as primary method of distribution will not be feasible. Distributing through authorized retailers who are trained to perform maintenance helps to ensure that customers who purchase the given product will receive excellent customer service as well as will become repeat customers of accessories and add-on products.

### Distribution as Cost of Sales

Some distribution channels require more costs to sell/distribute the product. For example, direct sales require order processing and fulfillment, including staff time, shipping and credit card processing software and transaction fees. Other options might require promotional costs, such as signage, coupons, displays and sale calls. This is why distribution channels that offer the highest sales volumes do not always offer the highest profit margins.

Once one knows their expected sales from a potential distribution channel, cost of sales and price per unit, he/she can calculate the profit margin per item and gross profits. This helps to determine which distribution options are the best for a particular business, based on the ability to fund sales and produce goods.

## Branding and Distribution Model

Specifically branding the product to fit a specific niche or even distribution venue can also yield big results. Apple computer stores, for example, have a very minimalist design and high-tech feel geared toward creating a simple and customer-focused experience. Customers have the opportunity to try before buying, and can learn from in-store experts. Beware, however, crowded stores and long lines may be a turn-off to some and drive traffic elsewhere. Originally, people wanting an Apple product had to purchase from Apple, but now they can skip the "Apple experience" and purchase the same product elsewhere while comparison shopping for similar products the store may carry.

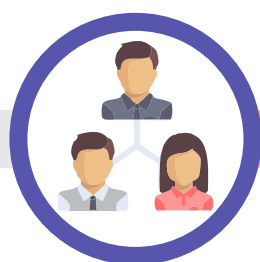
## Protecting The Brand (Reputation)

Selection of distribution channel also depends upon the brand image one wishes to carry. If an SME relies on a strong brand or want a prominent name in the marketplace, he/she must consider the effect that selling in a particular location or using a particular method has on the business. Selling a high-end product through a supermarket, where the product is being sold next to bargain brands, can damage the image. However, if one thinks that a supermarket is a good place in terms of customer foot-fall and visitations, then the enclave must be designed in a special manner. Similarly, if the image includes superior personal service, selling online can reduce reputation in this area.

## **b** Chain of Intermediaries or Businesses

Intermediaries, are used by businesses to expand their outreach to customers. These are also known as distribution intermediaries, marketing intermediaries, or middlemen and are an extremely crucial element of a company's product distribution channel. Without intermediaries, it would be very difficult for the business to function at all. This is because intermediaries are external groups, individuals, or businesses that make it possible for the company to deliver their products to the end user.

There are four generally recognized broad groups of intermediaries: agents, distributors, wholesalers and retailers.



### Agents/Brokers

Agents or brokers are individuals or companies that act as an extension of the manufacturing company or farmers. Their main job is to represent the producer to the retailer or final user in selling a product. Thus, while they do not own the product directly, they take possession of the product in the distribution process. They make their profits through fees or commissions. This category is particularly most important for the distribution of agricultural produce to the vegetable and fruit retailers and hawkers. They are normally found in and around the agriculture, fruit and vegetable wholesale markets and local 'Mandis'. They are referred to by the names of 'Commission agents' and 'Arrhities'. Similarly, there are commission agents for manufactured goods in the local markets, they are commonly found in the wholesale markets of Joria Bazar- Karachi, Shah Aalmi Market- Lahore and Qisa Khawani- Peshawar and Sutermandi Faisalabad.



## Wholesalers

Wholesalers are independent trading organizations. Unlike agents, wholesalers take title to the goods and services that they are intermediaries for. They are independently owned, and they own the products that they sell. Wholesalers do not work with small numbers of product: they buy in bulk, and store the products in their own warehouses and storage places until it is time to resell them. Wholesalers rarely sell to the final user; rather, they sell the products to other intermediaries such as retailers, for a higher price than they paid. Thus, they do not operate on a commission system, as agents do.



## Distributors

Distributors are similar to wholesalers as they also take ownership of the product, store it, and sell it off at a profit to retailers or other intermediaries. However, the key difference is that distributors ally themselves to complementary products. For example, distributors of Coca Cola will not distribute Pepsi products, and vice versa. In this way, they can maintain a closer relationship with their suppliers than wholesalers do. Major distributors of Pakistan include Alkhair distributors, International distributors, Allied distributors, M&P distributors, IBL distributors, Premier and UDL etc.



## Non-Traditional and Online Retailers

Whenever a consumer buys a product from anyone other than the company that makes it, the consumer is dealing with a retailer. This includes corner stores, shopping malls and e-commerce websites. Retailers may buy directly from the producers or from another intermediary. In some markets, they may stock items and pay for them only after they make a sale, which is common for most bookstores today.

Any e-commerce website that is not owned by the company that makes a product, which it then sells to a consumer, can also be called a retailer e.g., Daraz.pk. However, with companies such as Amazon, which make their own products and sell them directly to customers in addition to products made by other companies – the line between producers and retailers is becoming increasingly blurry. Shoplus, Boulton market and OLX.pk are some of the local online retailers.

## C Types of Distribution Channels

Broadly, channels of distribution are categorized into of two types;

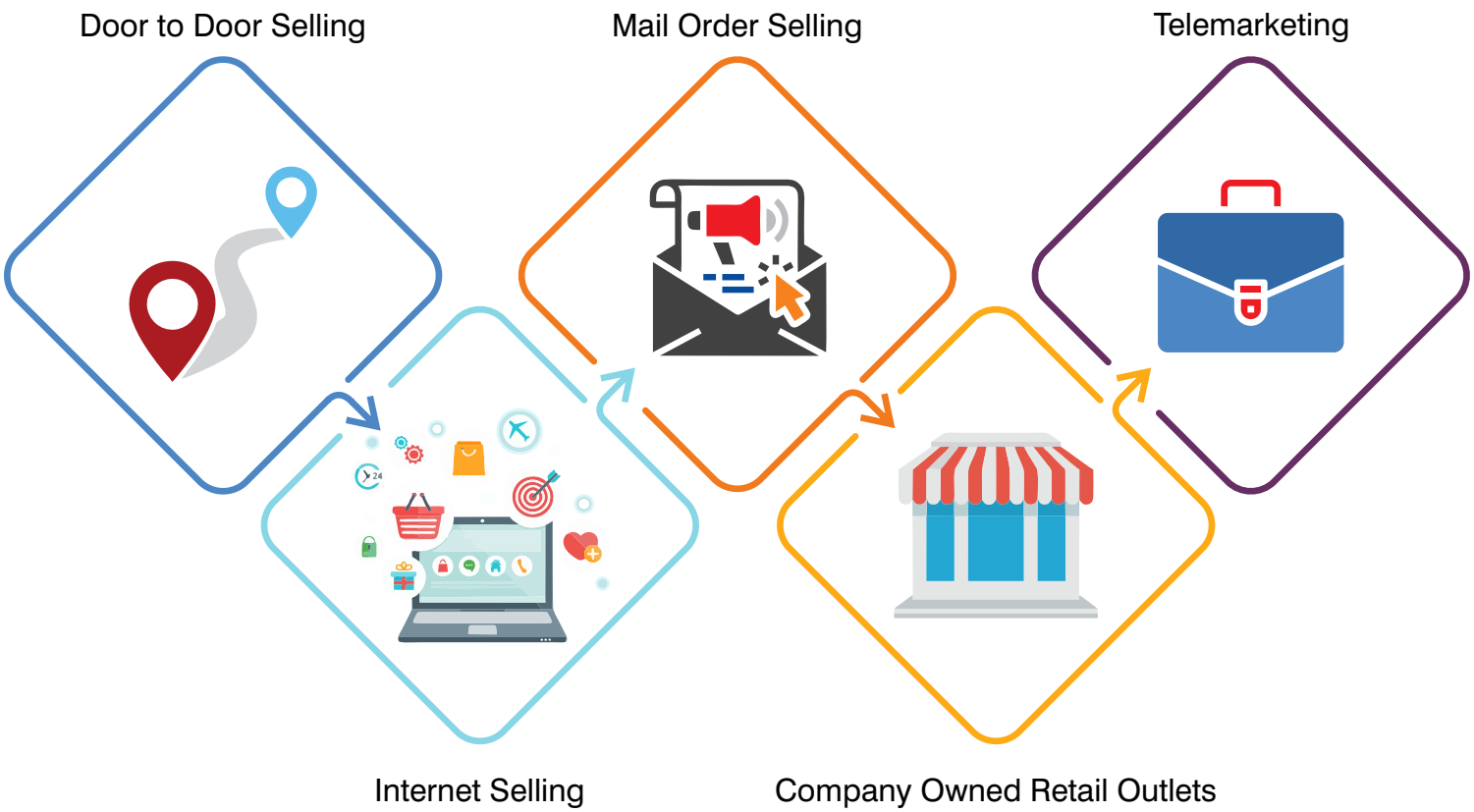
1 Direct Channel

2 Indirect Channel

### 1. Direct Channel or Zero Level Channel

When the producer or the manufacturer directly sells the goods to the customers without involving any middlemen, it is known as Direct Channel or Zero Level Channel. It is the simplest and the shortest mode of distribution. Selling through post, internet or door to door selling etc. are the examples of this channel. For example, Gourmet, Bata, Servis, Outfitters, Sana Safinaz and Khaadi etc.

Methods of Direct Channel are:



### 2. Indirect Channels

When a manufacturer or a producer employs one or more intermediaries to distribute goods, it is known as Indirect Channel.

Following are the main types of indirect channels:

### i. Manufacturer-Retailer-Consumer (One Level Channel)

This channel involves the use of one middleman i.e. retailer who in turn sells them to the ultimate customers. It is usually adopted for specialty goods. For example, Tata sells its cars through company approved retailers.



### ii. Manufacturer-Wholesaler-Retailer-Customer (Two Level Channels)

Under this channel, wholesaler and retailer act as a link between the manufacturer and the customer. This is the most commonly used channel for distributing goods like soap, rice, wheat, clothes etc.



### iii. Manufacturer-Distributor-Wholesaler-Retailer-Consumer (Three Level Channels)

This level comprises of three middlemen i.e. agent, wholesaler and the retailer. The manufacturers supply the goods to their agents who in turn supply them to wholesalers and retailers. This level is usually used when a manufacturer deals in limited products and yet wants to cover a wide market.



## d Different Functions of Distribution Channels

Some of the functions a distributor does create efficiencies and facilitate product movement like following:



### Packaging

Providing adequate packaging for a product so it can be transported safely.

### Inventory Management

Maintaining a good level of inventory is hugely important to distribution. Management of inventory is one of the main responsibilities for distribution management.



### Order Processing

Once an order comes in from a customer, distribution management needs to plan for the delivery. This involves collecting the stock, loading it and delivering it in a timely manner. Approval needs to be sent and invoicing done for this step to be valid.



### Logistics

Mode of transport is important to consider for all orders. If they require overseas shipping, there must be agreements in place for permits to be approved quickly. Loading and handling need to be decided so that all equipment that could be needed, is available onsite.



### Communication

Very clear and specific communication is needed both on and offsite at distribution centers and intervening points. This is to ensure that correct products are shipped and customers know when they will receive their products and services. If a shipment is delayed, distribution management needs to notify all interested parties immediately.



Examples of marketing activities carried out by distribution channels are as follows:

- In addition to marketing by the manufacturer, a distributor can be employed to reach out to suppliers or retailers to purchase their product.
- A supplier can make their stock available on a marketplace for merchants to find and sell.
- A retailer could stock a wide array of products strategically placed across their store to entice customers to buy, this is usually employed by the FMCG companies.
- A wholesaler can build a website so customers can order products straight from them.

### Streamlining Distribution

Streamlining distribution involves the planning and efficient use of intermediary resources, individuals and organizations and may involve working with a variety of them, simultaneously. Depending on the business and the products, these can include distributors, wholesalers, retailers, online marketplaces, or shipping companies that take those products directly to customers.

Choosing the right distribution channel is a pivotal decision for any business. What one chooses determines how the given products are handled, the speed in which they are delivered, and how successful a business is at getting the goods into the hands of consumers.

### How to Choose a Channel of Distribution?

Before choosing a distribution channel for the products, there are a variety of factors to consider including the type of product, market and middlemen.

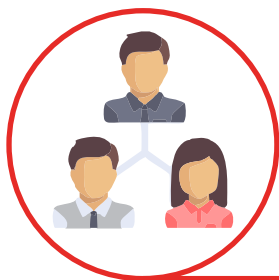


#### Type of Product

If the product is perishable, or is exceedingly delicate, it will be needed to arrive quickly and in controlled conditions. One may need to use a direct distribution method or some specialized distribution channels with highly dependable services, which may be on premium prices.

#### Market

Are products being sold directly to customers or other businesses? Are they more likely to purchase from retailers, websites like Amazon, or other online sellers? Can they be shipped directly, or one needs to work with retailers? Knowing the ideal customers will help to identify the most efficient way to get products to them.



#### Middlemen

A middleman can help distribute products quickly and efficiently. Whether or not a middleman makes sense will depend on the budget, market, and existing business relationships.

#### Cash Flow Requirements

How well are the business funds being managed and how much one can wait for the encashment of the inventories, also plays a role in the type of channel being selected. In some cases, where the funds are to be tied up with the retailers, it is better for the business to look for the distributors, at some margin.



Once the factors have been analyzed for type of distribution channel that will work best for the business and customers, select a specific option depending on the business and where the customers are located. To choose the right channels, consider the following factors which help in determining the channels of distribution:

### Examine Costs and Benefits



After deciding on a method of distribution, creating the support systems that go with it is time-consuming and expensive. Once the business is oriented around a specific distribution channel, it is difficult to reverse the decision. Carefully weigh the costs and benefits associated with each option before committing resources to it.

### Consider Competitors



What methods are the competitors using, and why? Does it provide a qualitative advantage over other channels, or is it simply the way the industry has always operated? If there is a distribution channel that the competitors have overlooked, one could gain an advantage by using it. For example, if competitors are mainly distributing products via big-box retailers, taking advantage of direct sales through the internet can give a unique angle, into the market.

### Rank the Options



After examining the different methods available, rank them by order of preference according to what will net the highest revenue at the end of the year, minus associated costs. Choose the option that allows to reach the most customers while remaining within budget.

### Have a Plan for Growth



One may find that pursuing one distribution channel does not preclude from adding additional channels as the business acquires more capital or as the business expands, it will need additional methods of connecting customers with products. Keeping up with market and competitors is necessary so that one can continue to make informed decisions about distribution as market grows.

The most important thing one can do when choosing a distribution channel is to carefully consider the options and not select a channel simply because it is the industry standard or most convenient option for business. Questioning the reason behind the decision at the onset helps to discover hidden advantages, or drawbacks and find new ways of reaching customers in a budget-friendly and innovative manner.

Considerations for a channel design are somewhat similar to selecting a channel. A firm can have any number of intermediaries in its channels. A "level zero" channel with no intermediaries at all is used by businesses like furniture manufacturers. Other businesses use "level one" channel, which has a single intermediary, usually from the manufacturer-to the retailer-to the consumer like the Marble Units. Where as, most mid-sized manufacturers have a "level two distribution. These include biscuit manufacturers and edible oil etc. The larger FMCG manufacturers have "three level" distribution with their distributors having their own network of wholesalers and retailers.

### 1. Product Related Factors

Following are the important product related considerations in designing the channels of distribution:



#### i. Nature of Product

In case of industrial goods like CT scan machines, short channels like zero level channel or first level channel should be preferred because they are usually technical, expensive, made to order and purchased by few buyers. Consumer goods like LCDs or refrigerators can be distributed through long channels as they are less expensive, not technical and frequently purchased.



#### ii. Perishable and Non-Perishable Products

Perishable products like fruits or vegetables are distributed through short channels while nonperishable products like soaps, oils, sugar, salt etc. require longer channels.



#### iii. Value of Product

In case of products having low unit value such as groceries, long channels are preferred while those with high unit value such as diamond jewelry short channels are used.



#### iv. Product Complexity

Short channels are preferred for technically complex goods including industrial or engineering products e.g., machinery or generators etc while non-complex or simple ones can be distributed through long channels.

## 2. Company Characteristics

Following are the main Company Characteristics offering choice of channel of distribution:

### i. Financial Strength

The businesses having huge funds at their disposal usually go for direct distribution. Those without such funds see advantage in going for indirect channels.



### ii. Control

Apart from financial strength, short channels are also preferred if management wants greater control over the channel members, otherwise, a can go in for longer channels.

## 3. Competitive Factors

Policies and channels selected by the competitors also affect the choice of channels. A business has to decide whether to adopt the same channel as that of its competitor or choose a different one. For example, if Nokia has selected a particular channel say Big Bazaars for sale of their hand sets, other firms like Samsung and LG have also selected similar channels.

## 4. Market Factors

Following are the important market factors affecting choice of channels of distribution:



i.

### Market Size

If the number of customers is small like in case of industrial goods, short channels are preferred while if the number of customers is high, as in case of convenience goods, long channels are used.



ii.

### Geographical Concentration

Generally, long channels are used if the consumers are widely spread while if they are concentrated in a small place, short channels can be used.



iii.

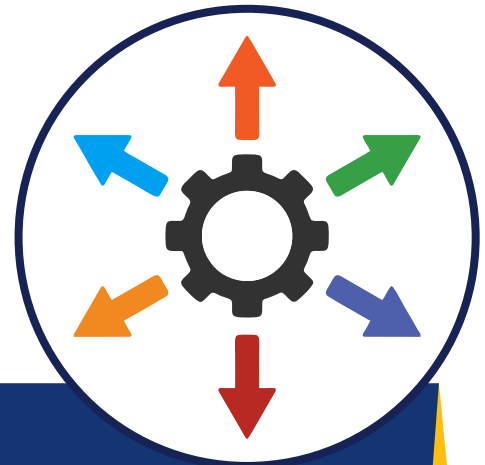
### Quantity Purchased

Long channels are used, in case the size of order is small, while in case of large orders, direct channels may be used.

## 5. Environmental Factors

Economic factors such as economic conditions and legal regulations also play a vital role in selecting channels of distribution. For example, in a depressed economy, generally shorter channels are selected for distribution.

## Conclusion



A distribution channel, a part of the 4P's of marketing mix, is a chain of businesses or intermediaries through which a good or service reaches the end consumer.

Distribution channels can include distributors, wholesalers, retailers and even the internet.

Channels are broken into two different forms-direct and indirect. A direct channel allows the consumer to make purchases from the manufacturer while an indirect channel allows the consumer to buy the goods from a wholesaler or retailer. Selecting a channel for distribution means considering factors like product, market, middlemen and cash flow. Additionally, competition and growth strategy are important factors to consider while selecting distribution channel.



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