Channel Basics – NOTES for 4.01 Channels of Distribution

**Recognizing the need for distribution channels**

Have you ever had to travel a considerable distance to purchase a product you wanted? Perhaps you found the perfect used car—it was the make and model you wanted, had low mileage, and was listed at an affordable price. The only trouble was that you had to drive 200 miles to pick it up. In this case, your time and effort were probably worth it since you only needed to deal with the hassle one time.

But, what if this circumstance applied to all your needs? You would soon find that the goods and services you consume would be limited to those produced in your own geographic area.

Fortunately, there are channels of distribution. Because of these channels and their participants, products from many different locations are available right where you live.

**Channels of distribution** are the paths, or routes, that goods and services take from the producer to the ultimate consumer or industrial user. These paths aren’t physical, however. Although goods do travel to their destinations along highways and railroads, the term “channels of distribution” doesn’t refer to those types of routes. Instead, it refers to businesses or people who perform a variety of functions to enable products to be in the right places at the right times.

A channel of distribution begins with a producer and ends with an ultimate consumer or industrial user. A **producer**makes or provides goods and services.

Examples of producers include Whirlpool, a manufacturer of household appliances, and Pfizer, a company that makes pharmaceuticals. Farmers are producers as well—they grow a variety of crops such as corn, wheat, and rice. Producers of services include actors and entertainers, teachers, and health-care professionals. (For a look at some of the top producers in the U.S., see [http://www.industryweek.com/resources/iw50best/2014 (Links to an external site.)](http://www.industryweek.com/resources/iw50best/2014).)

An **ultimate consumer** is anyone who personally uses a good or service to satisfy her/his own needs or wants. We are all ultimate consumers of many different goods and services.

* If you’ve used one of its dishwashers, you are one of Whirlpool’s ultimate consumers.
* If you’ve eaten corn on the cob, you are one of a farmer’s ultimate consumers.
* If you’ve gotten your teeth cleaned, you are one of a dentist’s ultimate consumers.

An **industrial user** is a business that buys materials, services, or goods that will be used to make other goods or used in the operation of the company.

* A construction company, for instance, must buy lumber, steel, and other materials needed to build homes and offices.
* An accounting firm will purchase computers, printers, and other office equipment necessary for its employees to perform their jobs.
* All good things must come to an end
* A channel of distribution ends, then, when the good or service has reached the ultimate consumer or industrial user.
* A channel also ends when changes are made to the form of the good. For example, the channels of distribution for the milk, flour, eggs, and sugar purchased by a bakery end when the items are combined to make doughnuts. However, a new channel of distribution for the doughnuts begins.

Intermediaries

Many products take paths that include channel members in addition to the producer and the ultimate consumer or industrial user. These channel members are known as **intermediaries** or **middlemen**. They operate between the producer and the consumer or user to help in the movement of goods and services. Different types of intermediaries are:

* **Retailers**
Businesses that buy consumer goods and sell them to ultimate consumers are **retailers**. Retailers perform functions such as buying, selling, promoting, storing, and pricing goods. They may also provide customer services such as credit, installation, and repair. McDonald’s, Macy’s, and your neighborhood gas station are all examples of retailers. Can you name a few more?
* **Wholesalers**
Businesses that buy goods from producers or agents and sell them to retailers are called **wholesalers**. Wholesalers buy a variety of goods from many producers and sell groups of related products to retailers.

For instance, a wholesaler might purchase baseball bats from one producer, mitts from another, and baseballs from still another. A retailer would then be able to purchase all the baseball equipment from one source, rather than having to contact each producer.

Important functions of wholesalers include packaging, transporting and storing, extending credit to retailers, and providing promotional and consulting services.
* **Agents**
Businesses or individuals that assist in the sale and/or promotion of goods and services but do not buy them from the producer are known as **agents**. They do not take title to the products; in other words, they never actually own them. Instead, their job is to sell and promote a producer’s goods and services. Agents usually handle a limited number of noncompeting products.

For more on intermediaries, check out this [short video (Links to an external site.)](http://www.investopedia.com/video/play/distribution-channel/) from Investopedia.com, "Distribution Channel."

**Importance of intermediaries**

The primary objective of producers in distributing goods and services is to get them to consumers in the most effective and efficient manner possible. To do that, they must have products in the right places, at the right times, and at the least cost.

In some cases, the most effective, efficient manner of distribution will be to sell directly to ultimate consumers or industrial users. In other cases, producers will use intermediaries to assist in getting products to consumers.

Regardless of the methods used to distribute products, the functions involved will remain the same. These include buying, selling, pricing, financing, etc.

When a producer chooses to sell goods and services directly to consumers, the producer must perform all the necessary functions and will incur all the costs of distribution. At the same time, however, the producer earns any and all income the products bring in.

When producers use intermediaries to assist in distributing goods and services, costs can be passed on to other channel members. Producers’ profits could decrease since income also has to be shared with intermediaries; however, producers’ income might be higher if the intermediaries are able to sell more than the producers can sell on their own.

It is frequently not realistic for producers and consumers or industrial users to deal with each other directly. Likewise, it would not be practical for retailers to deal directly with producers all the time. Through the use of agents and wholesalers, retailers are able to reduce the number of contacts that they must make with producers.

Through the use of intermediaries, producers are able to match their production to the needs and wants of consumers or industrial users. This is possible because intermediaries:

* **Buy big and sell small.**
Intermediaries buy large quantities of goods from producers and sell smaller quantities to other intermediaries or consumers. For example, an intermediary might purchase 10,000 two-liter bottles of soda from a producer and sell 100-200 at a time to a small retailer. By placing large orders with producers, intermediaries are able to reduce their per-unit cost for goods, allowing them to make a profit and/or pass some of the savings along to consumers.
* **Develop an assortment of goods.**
Since most producers are able to produce more than any consumer will purchase at one time, intermediaries collect goods from a variety of producers and divide them into quantities and assortments that consumers will want. Consumers are then conveniently able to obtain the desired amounts and types of goods and services. A makeup boutique, for instance, will develop an assortment of products for its customers—lipsticks, blush, mascaras, eyeshadows, etc.—in many different sizes and colors from several different producers.
* **Transport and store goods.**
Intermediaries transport and store goods so that they will be available to consumers or industrial users where and when they are wanted or needed. This enables goods to be on hand when consumers or industrial users are ready to buy them rather than only when they are produced.

Intermediaries can perform a variety of other functions as well. They can provide market information to producers. Since intermediaries have more contact with consumers, they may be able to provide up-to-date information about consumer buying habits, problems with products, etc. Intermediaries can also promote the sale of goods and services. Most often, they perform this function through sales staff. They may use other promotional techniques, such as advertising, as well. Extending credit, servicing sales, and providing management services are other ways that intermediaries make producers’ jobs easier. Management services may include planning inventories and store layouts and helping to train employees.

For more on the pros (and cons!) of using channel intermediaries, see David Stewart’s article “[The Advantages and Disadvantages of Intermediary Distribution (Links to an external site.)](http://www.ehow.com/info_8560892_advantages-disadvantages-intermediary-distribution.html.).”

# Summary (A)-10

Channels of distribution are the paths, or routes, that goods and services take from the producer to the ultimate consumer or industrial user. Intermediaries, or middlemen, operate between the producer and the consumer or user to help in the movement of goods and services. They include retailers, wholesalers, and agents. Intermediaries are important because they perform many helpful functions such as breaking down large quantities of goods, developing an assortment of goods, and transporting and storing goods.