

# UNIT VII TRADE

## CHAPTER

## 23

## CHANNELS OF DISTRIBUTION



திருக்குறள்

ஒண் பொருள் காழ்ப்ப இயற்றியார்க் கெண்பொருள்  
ஏனை இரண்டும் ஒருங்கு.

குறள்-760

### Couplet:

Who plenteous store of glorious wealth have gained, By them the other two are  
easily obtained

### Learning Objectives

To enable the students to

- state the meaning and types of channel of distribution
- explain the meaning of different types of middlemen
- understand the characteristics and services of whole
- explain the characteristics and services of retailers

### Introduction

The manufacturers producing goods on large scale select the channel through which their goods should reach the consumers. These goods are converted into cash only when the end user buys and uses them. To cut the cost, to reach maximum customers and to retain all customers the producers select one channel or combine many channels to distribute the goods. This chapter explains the channels of distribution in detail.

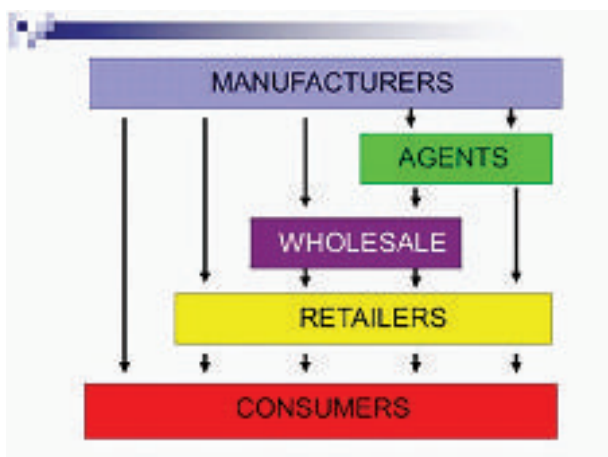
### 23.01 Channels of Distribution - Meaning

A channel is the route through which the goods are passed on to the ultimate consumer. There are direct channels or routes of distribution without middlemen. Indirect channel consists of one or more middlemen performing different functions. Middlemen help in the flow of goods towards the lakhs or crores of consumers. The products should reach all these consumers living inside the country and throughout the world. There are industrial and consumer goods, perishable and durable goods, pin to plane - different size of goods and so on. Not only the goods but also the services need distribution network.

### Definition

According to *Cundiff E.W* and *Still*, a channel of distribution may be defined as “a path traced in the direct or indirect transfer of title to a product as it moves from the producer to ultimate consumers”.

According to *American Marketing Association*, “A channel of distribution is the structure of intra company organization units and extra company agents and deals wholesale and retail through which a commodity or product or service is marketed”.



## 23.02 Types of Channel of Distribution

The types of channel of distribution are as follows;

- I. Channels based on the middlemen.
- II. Channels based on the type of goods and services
- III. Channels based on national and international markets

### I. Channels based on the middlemen

#### A. Direct Channel

##### i. No middlemen

The producer takes up the task of distributing the goods either through his own company showrooms or branches or through his sales team. Producer himself exercises direct control over the distribution. Some producers sell goods right from the doors of their factory directly to the consumers.



##### ii. Mail - Order Business or Phone Order Business

The manufacturer collects orders from the consumers through post or mail or phone and delivers the products themselves. Some producers send the catalog of their products directly to the consumers and receive orders over post or phone. Then they distribute goods to the demanding consumers.

##### iii. E-Commerce

This is also a direct channel where there is no middleman. A website is created by the producer and through internet the product order is received and delivery of goods is made from the nearest godown of the producer.

##### iv. Direct Marketing or Multi-Level Marketing

The manufacturer establishes branches all over the country or in other countries also. The producer first enrolls few consumers. These consumers are asked to bring in more consumers. Various commissions are paid to the senior and junior consumers according to their turnover. All consumers directly purchase from the producer's branches.



## **B. Indirect Channel or Distribution Through Middlemen**

### **i. Contract Distributors or Contract Logistics**

The large scale producer outsources the warehousing, transporting and distribution functions to a third party on contract. The contractor may process orders, collect payments and carry out customer service also. He is paid commission on the basis of turnover. Multi-National Companies outsource distribution function and concentrate on their core production function.

### **ii. Manufacturer - Value Added Reseller (VAR) or Distributor - Customers**

The VARs receive the products from the manufacturers, incorporate them as if their own products by adding value enhanced service and sell them to customers. VARs provide highly skilled technical support so that the customer can have world class satisfaction. Microsoft India has appointed Avnet and Redington as VARs in India. A solar panel producer may have builders as VARs and the builders offer solar panel as additional facility to the buyers of flats, etc.

### **iii. Manufacturer - Channel partner - Consumers**

An agreement is entered in between the producer and channel partner. The producer trains the technicians of the partner and provides certification that quality product and service is assured from the partner. Channel partner and producer work in cooperation to attain their respective goals. The USA computer Technology Company Dell has channel partners in India namely,

Ingram Iris, Redington, Neoteric, HCL, etc. System Integrators (SIs), VARs, Consultants, Managed Service Providers (MSPs), Independent Software vendors (ISVs) are also called channel partners.

### **iv. Manufacturer - Franchisor - Consumers**

Producers adopt this channel to distribute goods or services in the home country and foreign countries. (Read separate chapter on Franchising in another lesson)

### **v. Manufacturer- Retailer - Consumer**

The producer appoints a network of retailers. The storage, warehousing, transport and distribution functions are undertaken by the producer himself. Branded and well established products can be routed through this channel.



### **vi. Manufacturer -Wholesaler - Retailer - Consumer**

The manufacturer engages wholesalers to purchase products from them as soon as the production is over. The storage, warehousing, transport and distribution functions are carried out by the wholesalers. These wholesalers contact retailers and sell goods in small quantities to them. Wholesalers may deal in a variety of products from different producers. Finally retailers sell goods to individual end consumers.

### vii. Producers - Agent - Wholesaler - Retailer - Consumer

In addition to the above channels of distribution, the middlemen, agents play the role of producers and wholesalers. They gather the agricultural produces or fishes from boats operators. They collect orders from the wholesalers and bring the goods to the place of wholesaler. Agents perform their functions for a commission based on their turnover.



### viii. Manufacturer - Authorised Dealers - Consumers

To retain the control over the relationship with consumers, the manufacturer appoints authorized dealers. They receive all the goods produced by the manufacturer and sells them in smaller quantities to retailers. Authorised Dealers use the brand name of the manufacturer and deal with one producer only. Authorised Dealers provide the service of installation of machinery to the consumers. Sports Utility Vehicles (Cars) are sold through authorized dealers only.

#### B2B and B2C

All purchases and sales between the producers and wholesalers, and from the wholesalers to retailers, etc. are called Business to Business (B2B) transactions. All business transactions between the producers or wholesalers or retailers on the one side and consumers on the other side are called Business to Consumers (B2C).

## II. Channels Based on the Type of Goods and Services

### (i) Goods distribution channel

#### A. Consumer Goods Distribution Channels

Fast moving consumer goods (FMCG) like provision items, clothes, etc. every customer buys to utilise and exhaust them. Next day or week or month fresh purchases need to be made. There are durable goods used by consumers like refrigerator, television, LED bulbs, fan, laptop etc.

They are used continuously for years together. Next purchase is made after some years. Further they need to be installed, serviced and spare parts for replacement. The retail stores for FMCG goods are far more in number than durable goods retailers. But the distribution channels are the same for both of them.

#### B. Industrial Goods Distribution Channels

Industrial machinery and equipment need shorter channel of distribution. The industries that use the products are less in number. Technical support from producer or dealer is required for installation, operation and maintenance of the machinery. The producer sells the machinery through his salesmen or authorized dealers. MRI - Magnetic Resonance Imaging Scanner used in hospitals to produce images of body structures are sold through authorized dealers or wholesalers to customers.

### (ii) Services Distribution Channels

Services can never be stored. A banking transaction or a mobile connectivity is created for the particular customer at the specific



time. Mostly direct channel is operated by all producers through branches. Even in Information Technology (IT) companies, a software is created and modified to suit the customer's needs. Insurance companies have branches and employ agents to connect with policyholders. Producer's website is of greater use in connecting with the consumers in services marketing.

### **III. Channels Based on National and International Markets**

The national or country level middlemen are already dealt with in detail in the previous paragraphs. The international distribution of goods and services consists of two sub systems. They are domestic distribution system and foreign distribution system. There are export merchants, export trading houses, export agents, state trading organisations, joint ventures, licensees, franchisees etc. performing the functions of middlemen.

#### **23.03 Factors Influencing Channel of Distribution**

The factors determining the suitability of a channel for a product distribution are as follows:

##### **i. Product Characteristics**

Seasonal products are distributed through less layer of middlemen. Non standardized products that are made according to customer specifications may be delivered directly. But standardized products may be passed on through middlemen. Trucks which are heavily needed to be distributed with less layers of distribution. The life of perishable products is limited and should

reach the consumer at the earliest. e.g. Flowers and milk. Technical products which require pre-sale and post-sale advice from technicians should be directly distributed by producer or with middlemen. e.g: Air-conditioners, Washing machine.

##### **ii. Market Characteristics**

The size of the market for the goods is a major factor while selecting the route for distribution of products. Distribution in large geographical area requires more middlemen. Middlemen are not required to distribute products in a limited area.

##### **iii. Number of Consumers**

Large purchases made by few consumers require centralised distribution. Large number of consumers making purchases in small quantities requires more middlemen.

##### **iv. Middlemen factor**

Middlemen who are experienced and have produced more sales are wanted by all producers. Long channel naturally increases the cost and price of the product. The number of layers of middlemen should be kept to the minimum. The competitor who is efficient in reducing distribution cost will sell more as his price tends to be lower. More the middlemen are lesser will be the level of control and more problems on the part of the producers. Quality of distribution service can be ensured and loyal customer base can be created with less middlemen. In some areas there may be scarcity of right middlemen and in some other cases the policies of producers may be not acceptable to the middlemen.







#### **v. Capacity of the Manufacturer**

A financially strong producer may select a high technology oriented channel which will reduce cost in the long run. Manufacturers with large volume of production may open direct branches in cities and towns where there is more sales. They can also provide more services expected by consumers. Small and medium producers require the services of middlemen for selling their products. A producer offering wide range of products can have a long channel as he can defray the cost of distribution over more number of products.

#### **vi. Cost and Time Involved in the Channel of Distribution**

The channel cost should go along with the quality of service provided by middlemen. Ordinary goods are routed through economical channel even though the time taken by the channel for delivery is more.

#### **vii. Services Required along with the Product**

Machinery or equipment which need to be installed and demonstrated should be sold with shorter channel. Technical services can be provided by manufacturers or by their trained technicians. Therefore a shorter channel is preferred for sales.

#### **viii. Life Cycle of the Product**

An established product can select an ordinary channel. But a new product entering into the market should be carefully promoted by experienced middlemen.

### **23.04 Middlemen**

The term 'Middlemen' refers to all those who are in the link between the primary producer and the ultimate consumer in the exchange of goods or service. The various intermediaries can be broadly classified into two main categories.

- 1) Mercantile Agents
- 2) Merchant Middlemen

#### **(1) Mercantile Agents**

Mercantile Agents are also called functional middlemen. A businessman appoints a person to buy and sell goods on his behalf and gives him the right to borrow money on the security of goods. He is known as mercantile agent. He is not given ownership title of the goods. He is paid commission on his turnover.

### **23.05 Kinds of Mercantile Agents or Agent Middlemen**

- i. Brokers
- ii. Factors
- iii Commission Agents
- iv. Del-credere Agents
- v. Auctioneers
- vi. Warehouse keepers.

#### **(i) Brokers**

A Broker is one who bargains for another and receives commission for his service. He is paid 'brokerage' for his services. He brings buyer and the seller to the negotiating process and arranges for finalising contracts between them. The principal businessman does not pass on either possession of goods or the ownership of goods to the broker. The broker is not personally liable for the contracts concluded.



Clothing, furniture, food, and commodities such as timber and steel are often sold by brokers. They are assigned to different geographical territories by the producers with whom they work as they have excellent industry contacts. The most common form of agent and broker encountered by the consumers are functioning in real estate sector. A real estate agent acts for both the buyer and the seller.

#### **(ii) Factors**

A factor is a mercantile agent to whom goods are entrusted for sale by a principal. He takes physical possession of the goods, though he does not obtain ownership of the goods. A factor sells goods in his own name without revealing the name of his principal. He may even sell them on credit and other usual terms. He is entitled to receive payment for the goods sold and he gives valid receipts. He is liable for his action. He can sue or be sued for his contracts. He has a right of lien on goods in his possession for his unpaid charges.

#### **(iii) Commission Agent or Consignees**

A commission agent buys and sells goods on behalf of the principal for a fixed rate of commission for all his transactions. All risks connected with his transactions are borne by the principal. His functions are more varied than a broker and he takes decision over the prices and terms of the sale. He has expert knowledge of the goods and trends in the market. He takes possession of the goods without title over them and sells in his own name.

#### **(iv) Del-credere Agents**

The agent who guarantees to the principal the collection of cash from credit sales is called del-credere agent. If they do not pay, the agent would bear the loss himself. He is given an additional commission known as del-credere commission for bearing the risk. He carefully selects the buyers to whom credit can be extended based on their honesty and reliability.

#### **(v) Auctioneers**

Auctioneers are agents who sell goods by auction on behalf of their principals. Auction sale is made through a notification to the public. The notice clearly mentions the date, time, place and details of goods which will be widely published through newspapers, posters, leaflets and announcements etc., Auction sale may be "WITH RESERVE" and "WITHOUT RESERVE". In case of auction "WITH RESERVE" no sale can take place below the minimum price fixed by the seller, which is known as "Reserve Price". In case of auction "WITHOUT RESERVE" the auctioneer is bound to sell the product to the highest bidder. The price for which the bid is accepted is called "knocked down price". Striking a hammer on the desk indicates the acceptance of a bid by auctioneer. After the highest bid is accepted, the auctioneer becomes the agent for both the seller and the buyer. For his services, the auctioneer is entitled to receive a commission, which is a certain percentage of the sale proceeds.

#### **(vi) Warehouse-keeper**

A Warehouse keeper accepts goods for the purpose of storage in his warehouse. He should exercise reasonable care and diligence

in the storage of goods. He is entitled to payment for his services. He will have lien on the goods in case the payments for his services remain unpaid. The warehouse keeper delivers to the owner of the goods a receipt known as warehouse keeper's receipt or certificate. It is an acknowledgement issued by warehouse keeper for the receipt of goods by him for the purpose of storage. It is not a document of title to goods. He may issue a 'Warehouse warrant', which is a document of title to goods



## (2) Merchant Middlemen

Merchant Middlemen are the intermediaries who buy and sell the goods in their own name, and in return earn a profit out of it. They take ownership as well as possession of the goods they sell. They operate in their own name and bear all the risks. Merchant middleman can be further sub- divided into:

1. Wholesaler, 2. Retailer

1. **Merchant Wholesalers:** Merchant wholesalers are wholesalers who take title to the goods. They are also sometimes referred to as distributors, dealers, and jobbers. This category includes both full-service wholesalers and limited-service wholesalers. Full-service wholesalers perform a broad range of services for their customers, such as stocking inventories, operating warehouses, supplying credit to buyers, employing salespeople to

assist customers, and delivering goods to customers.

a. **Limited- Service Wholesalers** offer fewer services to their customers but lower prices. They might not offer delivery services, extend their customers' credit, or have sales forces that actively call sellers. Small retailers often buy from cash-and-carry wholesalers to keep their prices as low as big retailers that get large discounts because of the huge volumes of goods they buy.

b. **Drop Shippers** are another type of limited-service wholesaler. Although drop shippers take title to the goods, they don't actually take possession of them or handle them. They deal with goods that are large or bulky. Instead, they earn a commission by finding sellers and passing their orders over to the producers, who then ship them directly to the sellers. Mail-order wholesalers sell their products using catalogs instead of sales forces and then ship the products over to buyers.

**Truck jobbers** (or truck wholesalers) actually store products, which are often highly perishable (e.g., fresh fish), on their trucks. The trucks make the rounds to customers, who inspect and select the products they want straight off the trucks.

**Rack Jobbers** sell specialty products, such as books, hosiery, and magazines that they display on their own racks in stores. Rack jobbers retain the title to the goods while the merchandise remain physically in the stores for sale. Periodically, they take count of what's been sold off their racks and then bill the stores for those items.



## 23.06 Wholesaler

Wholesale Trade means buying and selling goods in relatively large quantities or in bulk. The traders who are engaged in wholesale trade are called wholesalers.



A wholesaler buys goods in bulk directly from manufacturers and sells them in small lots to customers or industrial users. A wholesaler is the first intermediary and serves as a link between producers and retailers. Wholesalers place large orders with producers and supply in small quantities to retailers. In this way wholesaler serve both manufacturers and retailers.

### Definition

According to Cundiff and still “*wholesaler buys from the producer and sell merchandise to the retailers and other merchants and not to the consumers*”.

According to Evelyn Thomas “*a true wholesaler is himself neither a manufacturer nor a retailer but act as a link between the two*”.

## 23.07 The Characteristics of Wholesalers

The following are the characteristics of wholesalers;

1. Wholesalers buy goods directly from producers or manufacturers,

2. Wholesalers buy goods in large quantities and sell in relatively smaller quantities,
3. Wholesalers sell different varieties of a particular variety of product,
4. They employ a number of agents or workers for distribution of products
5. They need large amount of capital to be invested in his business,
6. They generally provide credit facility to retailers,
7. They also provide financial assistance to the producers or manufacturers,
8. In a city or town, they are normally located in one particular area of the market.

### Types of Wholesalers

#### 1. Manufacturer wholesaler

Manufacturer wholesaler undertakes manufacturing of goods in addition to wholesale business. He sells not only the goods manufactured by him on wholesale business, but also goods manufactured by other producers.

#### 2. Retail Wholesaler

This type of wholesaler carries on both wholesale and retail trade. He purchases goods in bulk from manufacturers and sells them directly to consumers through his own retail outlets.

*Ex. Super Bazaar.*

#### 3. Merchant Wholesaler.

A merchant wholesaler neither manufactures goods nor sells them directly to consumers. He is the ‘wholesaler proper’ or ‘pure wholesaler’. He buys goods in bulk

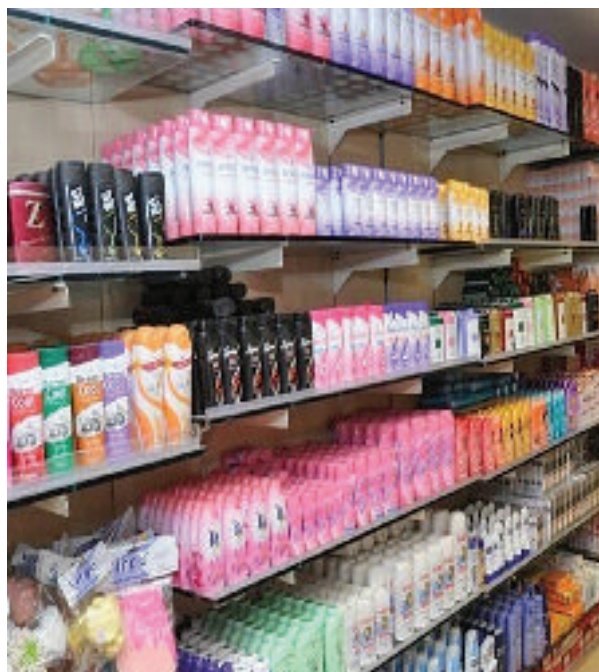
from manufacturers and sells them in small lots to retailers. Merchant wholesalers can be further classified into three categories on the basis of degree of specialisation.

- a) General merchandise wholesalers.
  - b) Single line wholesalers
  - c) Speciality wholesalers
- a. **General Merchandise Wholesalers:** This type of wholesaler deals in a wide range of goods such as groceries, electrical equipment, medicines, cloth etc. The importance of this type of wholesaler has heightened due to increasing specialisation in trade.
- b. **Single Line Wholesalers:** This type of wholesaler deals in only one line of goods and distributes different brands and variety of the particular line. For example, a wholesaler may deal in refrigerators produced by different manufacturer.
- c. **Speciality Wholesalers:** This wholesaler specialises in a single product. For example, a wholesaler may deal only in Tata tea and nothing else.

### 23.08 Retail trade - Meaning

Retail trade is a trade that deals with the distribution of goods in small quantities to the end consumers. The retails represent the final stage in the distribution where goods are transferred from the hands of manufacturers or wholesalers to the final consumers or users. If the sales are made directly to the end consumers it will be considered as retailing. Retail trade performs different functions in the distribution of goods and services, purchasing of variety of products, arranging

proper storages and selling the goods in small quantities and so on.



#### Definition

According to S. Evelyn Thomas “*the retailer is the last of the many links in the economic chain whereby the consumer’s wants are satisfied smoothly and efficiently by retailers*”.

According to Cundiff and Still “*a retailer is a merchant or occasionally an agent whose main business is selling directly to the ultimate consumers*”.

A retailer has been defined as “a trading intermediary engaged in the distribution of goods to the ultimate consumer”.

#### RETAIL TRADE



### 23.09 Characteristics of Retailers

Following are the characteristics of retail traders

1. Retailer generally involves dealing in a variety of items. A retailer makes purchases from producers or wholesalers in bulk for sale to the end consumers in small quantities.
2. Retail trade is normally carried on in or near the main market area.
3. Generally, retailers involve buying on credit from wholesalers and selling for cash to consumers.
4. A retailer has indirect relation with the manufacturer (through wholesalers) but a direct link with the consumers.



### 23.10 Distinction Between Wholesaler and Retailer

- 1 **Link:** A wholesaler serves as a link between producers and retailers. On the other hand, a retailer provides a link between wholesalers and consumers. Wholesaler is the first link, whereas retailer is the last link in the chain of distribution of goods.

- 2 **Scale of Operations:** A wholesaler carries on business on a large scale and requires huge capital. A retailer, on the other hand, deals generally on a small scale and capital invested in retail trade is relatively small.
- 3 **Range of Goods:** A wholesaler generally deals in one commodity. But a retailer deals in a large variety of goods and caters to the diverse needs of his end customers.
- 4 **Dealings:** A wholesaler generally sells goods to retailers on credit. But a retailer usually sells goods to end consumers on cash basis.
- 5 **Purpose of Selling:** A wholesaler sells goods for resale. On the other hand, a retailer sells goods for ultimate consumption or use.
- 6 **Source of Supply:** A wholesaler buys goods from manufacturers and their agents in large quantities. On the other hand, a retailer generally buys goods from wholesalers and their agents in small quantities.
- 7 **Location:** A wholesaler operates his business in big commercial cities and expands his business to different areas. A retailer operates in a smallest village and also big cities and locates his business in a particular place of area.

Concludingly, channels of distribution facilitate the transfer of goods and services. It enables the free flow of goods and services from the producer to consumers.

#### Key Terms

Channel of distribution,  
Auctioneers,  
Mercantile agent, Warehouse  
keepers,  
Merchant middlemen Wholesalers,  
Retailers Retail trade



## Success story



### Dr. Arokiaswamy Velumani

Landless farmer's son to owner of ₹2158 crores business empire. Velumani was so poor that he sought government subsidy to go through school and college. Today, he is the owner of the world's largest thyroid testing company, that boasts of 1,122 outlets across India, Bangladesh, Nepal and the Middle East!

He started his career as a shift chemist at Gemini Capsules, a small pharmaceutical company in Coimbatore, in 1979 and earned a measly sum of ₹150 every month. The curtains came down on the company three years later and Velumani found himself without a job.

After 14 years of servitude at BARC, Velumani resigned his job. He decided to channel his expertise in thyroid biochemistry to set up testing labs that detected thyroid disorders. With ₹1,00,000 from his provident fund, Velumani, at the age of 37, opened a shop in Byculla, South Mumbai.

Thyrocare is worth ₹3,377 crores ( on may 2016 ) and has made its debut on Indian bourses. Velumani owns a 64% stake in the company, which makes him worth ₹2,158 crore!

But it doesn't end there for Velumani and his team. Thyrocare is also working towards developing a subsidiary to focus on cancer screening through molecular imaging.



## Case Study

*A Rama industry was established to manufacture fashion shoes. Since they were new in the market, they decided to sell their product through wholesalers. They appointed one wholesaler in each district and promised them verbally that they will remain the exclusive wholesalers in the area. After three years during one of the review meetings the sales manager informed that if company sells directly to retailers, they will be able to offer competitive prices, which will increase sales volume and eventually profits. He was directly supporting elimination of wholesalers.*

- a. Should the company follow sales manager's suggestion and start direct business with retailers?

- b. What values would the company ignore if they by-pass wholesalers to earn extra profit?

### Answers:

- a) No, I don't think that company should follow sales manager's suggestion and start direct business with retailers. Because it is the wholesalers who have put in all the effort to establish sales network and prepared a market for new product. The company has though verbally promised wholesalers the exclusivity to sell, so it may not send good signals about the company in the market. The wholesalers may sell the competitors' product more aggressively, which may affect the company's sales adversely.
- b) Values ignored are
1. Mutual trust
  2. Integrity
  3. Importance to relationships





### For Own Thinking

1. Student should visit a nearby wholesale trade unit and watch the trading activities held there.
2. Student should visit a nearby two-wheeler showroom and watch which type of channel of distribution followed by them.



### For Future Learning

1. Student should know that there will be SOHO (small Office - Home Office) method that plays an important role.
2. Students should recognize the importance of on-line trading and develop them as per the future developments in this field.



### Exercise



#### I. Choose the Correct Answer

1. Trade middleman who acts as a link between wholesaler and customers refers to a -----.  
a. Producer      b. Broker  
c. Retailer      d. Customer
2. Who is the first middleman in the channel of distribution?  
a. Wholesaler      b. Producer  
c. Retailer      d. Customer

3. -----buy the goods from the producer and sell it to the retailers.  
a. Manufacturer  
b. Wholesaler  
c. Retailer  
d. consumers
4. ----- are agents who merely bring the buyer and the seller into contact.  
a. Broker  
b. Commission agent  
c. Selling agent  
d. stockiest
5. Merchant middlemen can be classified into ----- categories.  
a. Three      b. Two  
c. Five      d. Four

#### Answers

1. c    2. a    3. b    4. a    5. b

#### II. Very Short Answer Questions

1. Who is a middleman?
2. Define Retailer.
3. Who is a Broker?
4. What are the classification of the merchant middlemen?
5. Who are the mercantile agents?



### III. Short Answer Questions

1. Explain the types of mercantile agents.
2. Explain any three characteristics of wholesalers.

### IV. Long Answer Questions

1. What are the characteristics of retailers?

2. What are the functions of Wholesalers? (any 5)
3. What are the functions of Retailers? (any 5)

### Reference

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