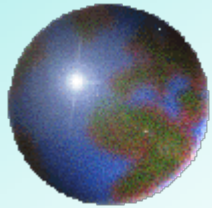


# *Lecture 8*

## *Relationship of Customer Service to Successful Marketing*

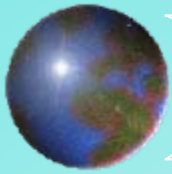


# Part 1



## Channel of Distribution

- ◆ Functions Performed by Distribution Channels
- ◆ Channel-Design Decisions
- ◆ Channel-Management Decisions
- ◆ Channel Dynamics

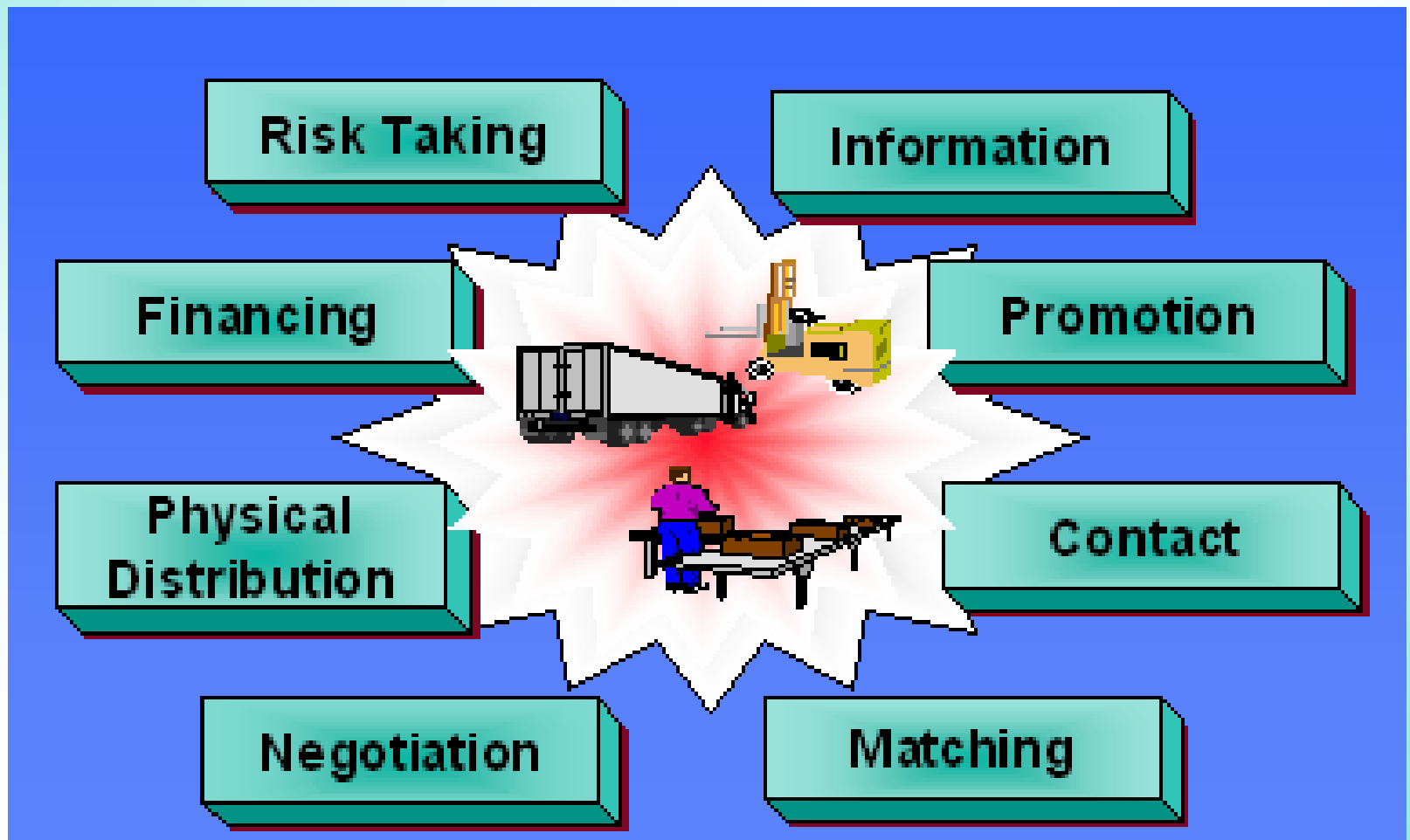


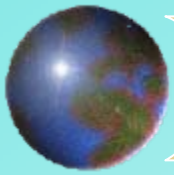
## *Definition of channel of distribution*

- **It is defined as the collection of organization units, either internal or external to the manufacturer, which performs the functions involved in product marketing.**
- **Any organizational unit that performs one or more of the marketing functions is a member of the channel of distribution.**



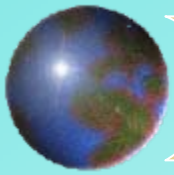
# *Distribution Channel Functions*





# *To successfully market its product , What should be done by a manufacturer?*

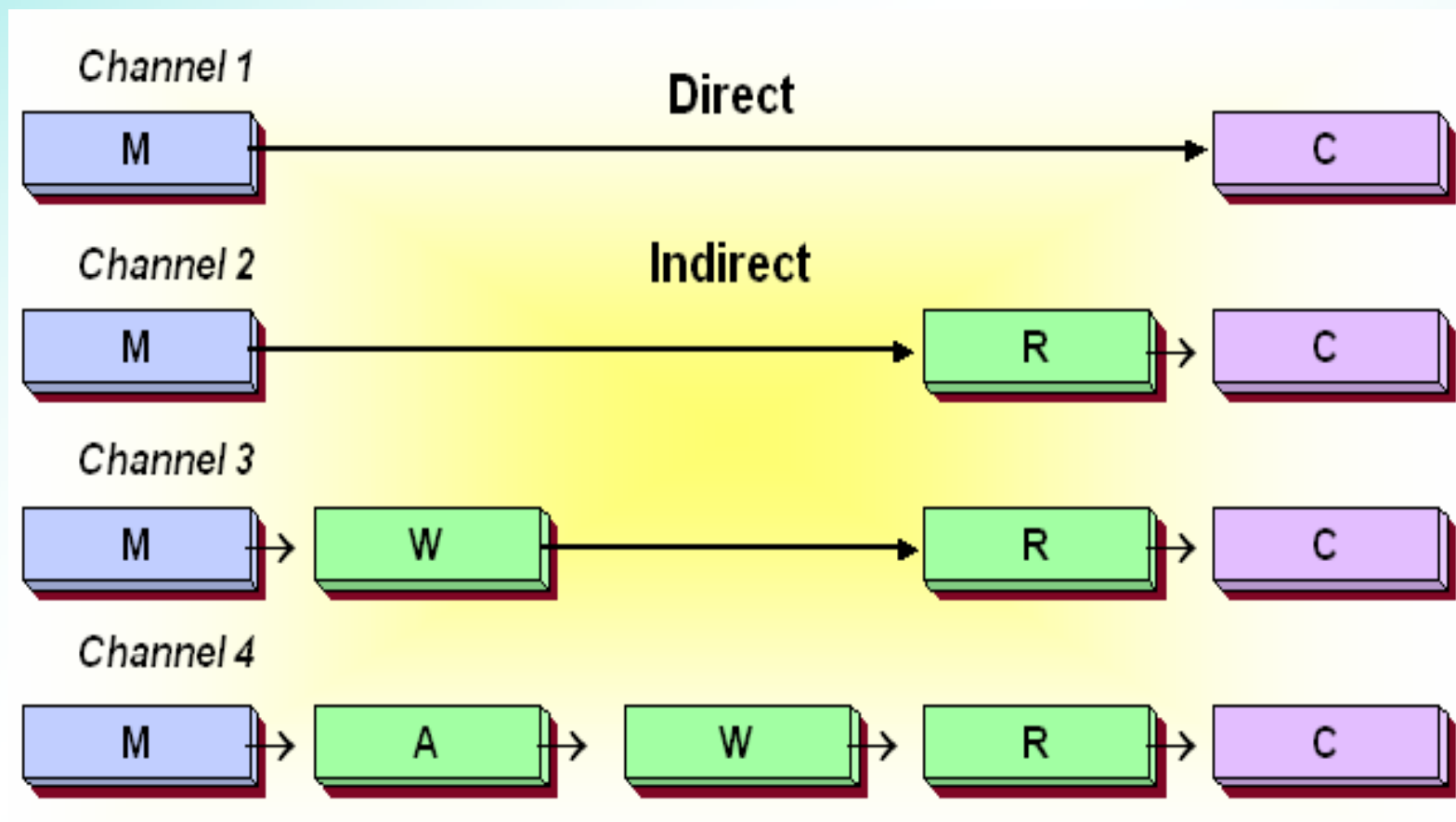
- select the appropriate channel structure
  - ❖ Control over the performance of functions
  - ❖ Speed of delivery and communication
  - ❖ The cost of operation
- choose the intermediaries to be used and establish policies regarding channel members
- devise information and control systems to ensure that performance objectives are met

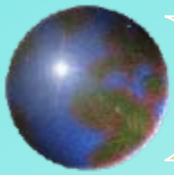


Most distribution channels are loosely structured networks of vertically aligned firms. The specific structure depends to a large extent on the nature of product and the firm's target market.

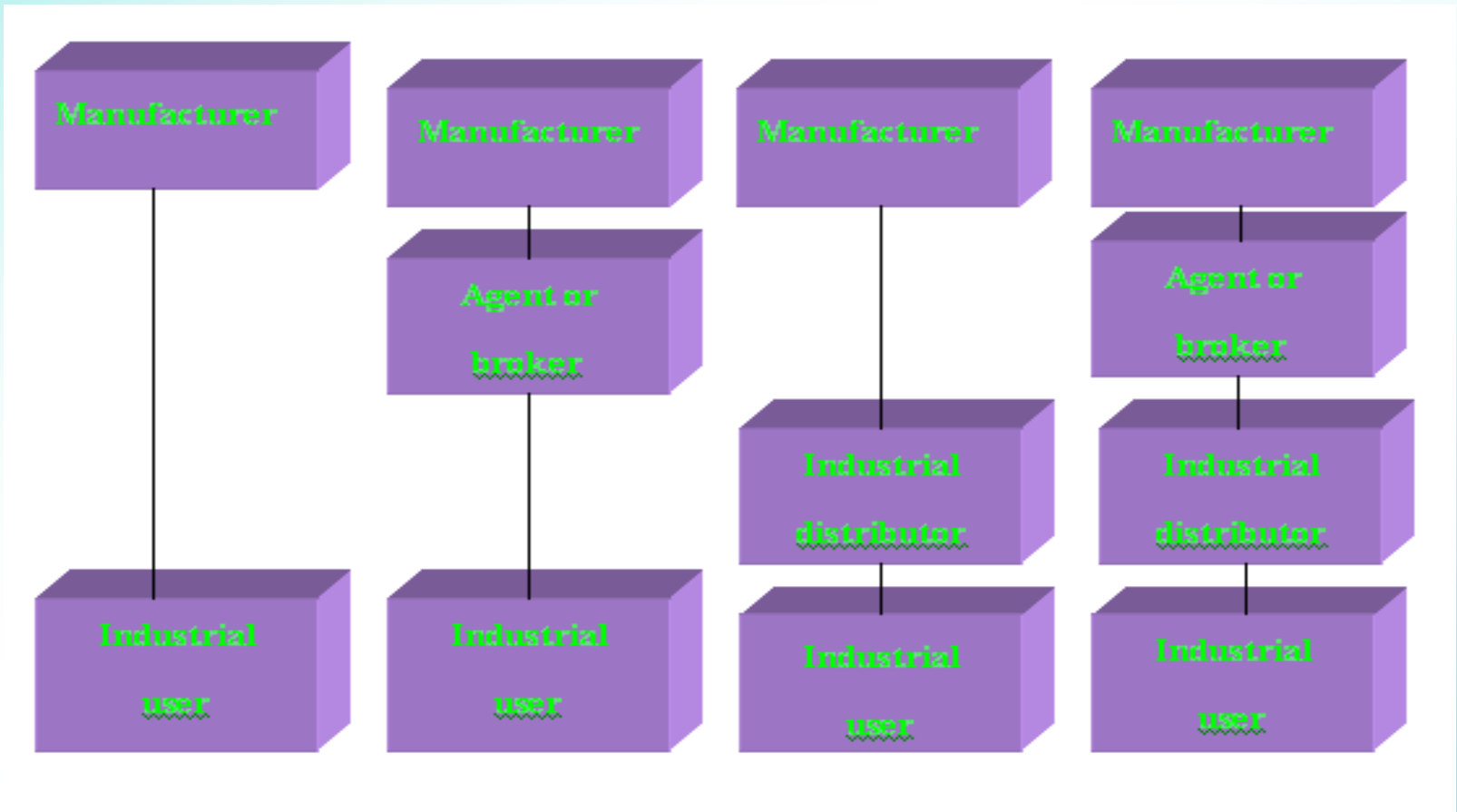


# Consumer Goods Channels & Levels





# *Industrial Goods Channels & Levels*





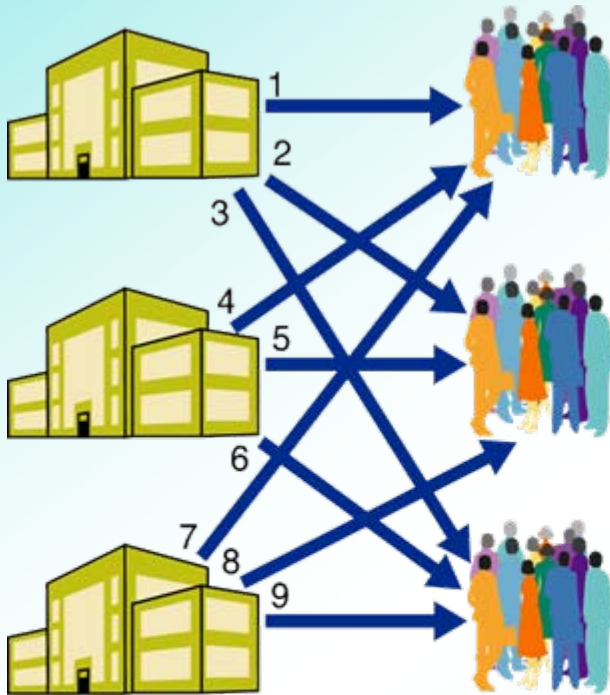


# *Why are Marketing Intermediaries Used?*

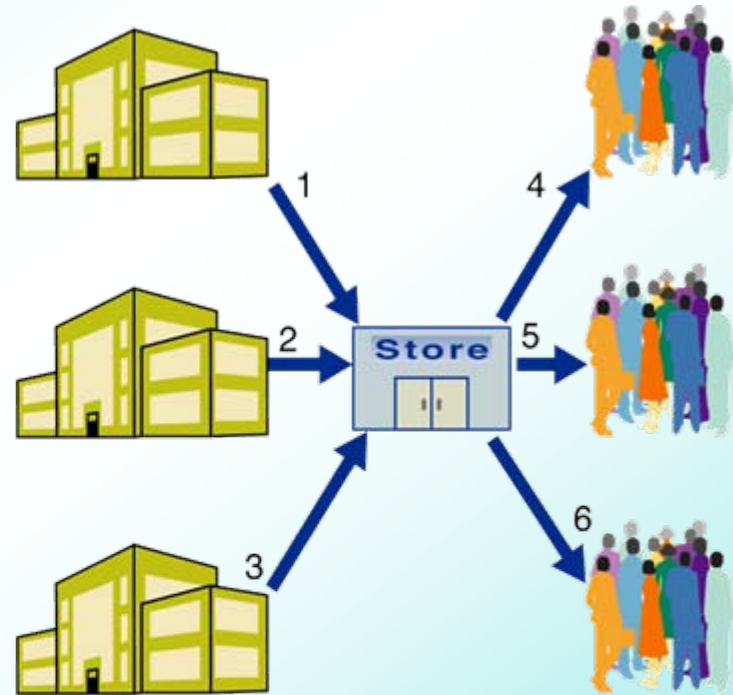
- Greater efficiency in making goods available to target markets.
- Offer the firm more than it can achieve on its own through the intermediaries:
  - ❑ Contacts
  - ❑ Experience
  - ❑ Specialization
  - ❑ Scale of operation
- Match supply and demand



# Intermediary Reduces the Number of Contacts



**A. Number of contacts without a distributor**  
 $M \times C = 3 \times 3 = 9$



**B. Number of contacts with a distributor**  
 $M + C = 3 + 3 = 6$



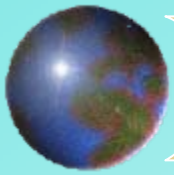
= Manufacturer



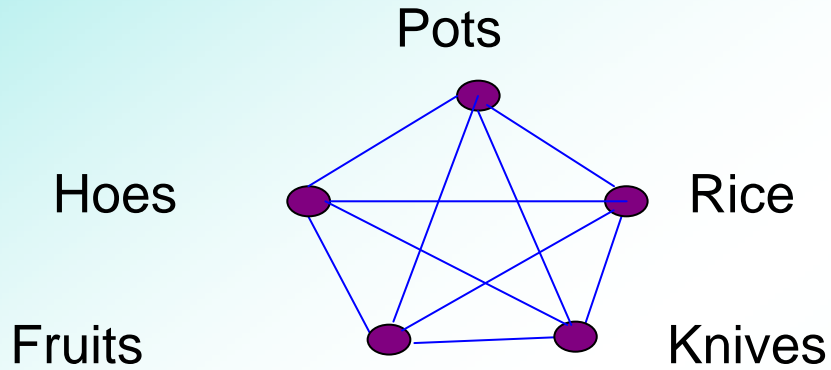
= Customer



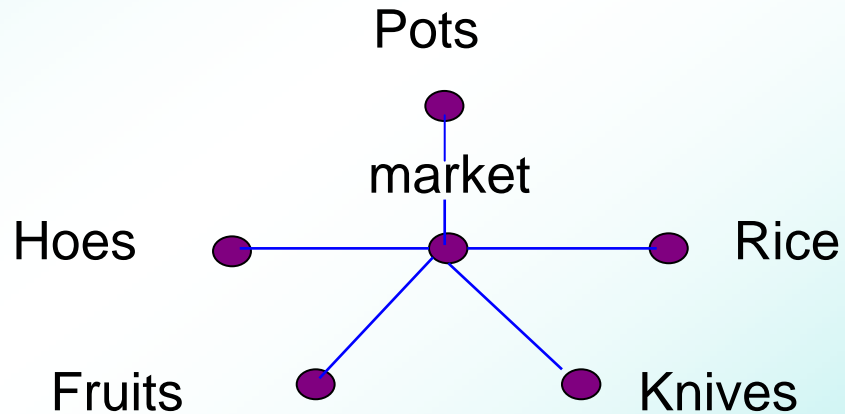
= Distributor



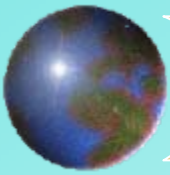
## Decentralized versus centralized exchange



10 transactions

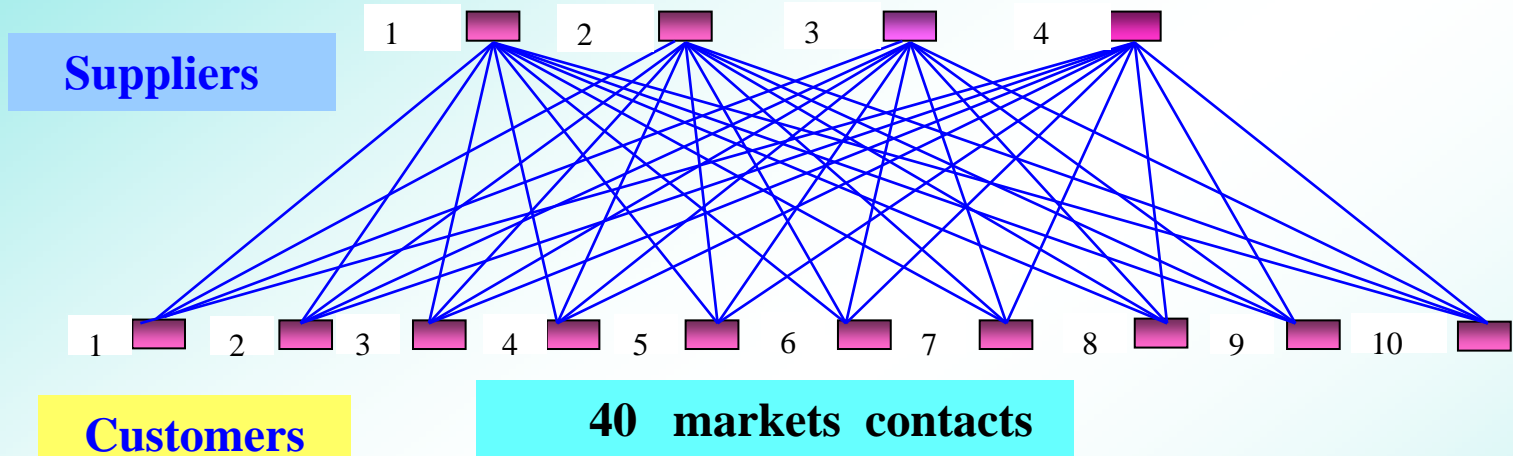


5 transactions

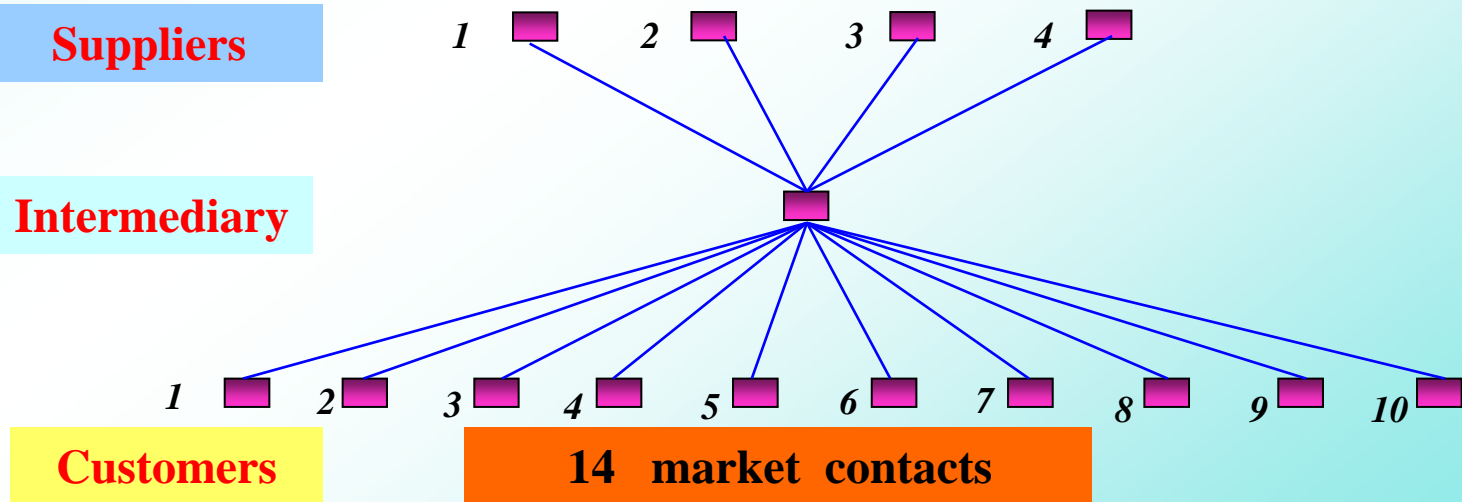


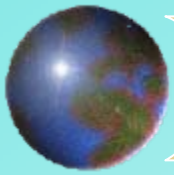
# Intermediary reduces the cost of market contact

## A Direct selling



## B selling through one intermediary



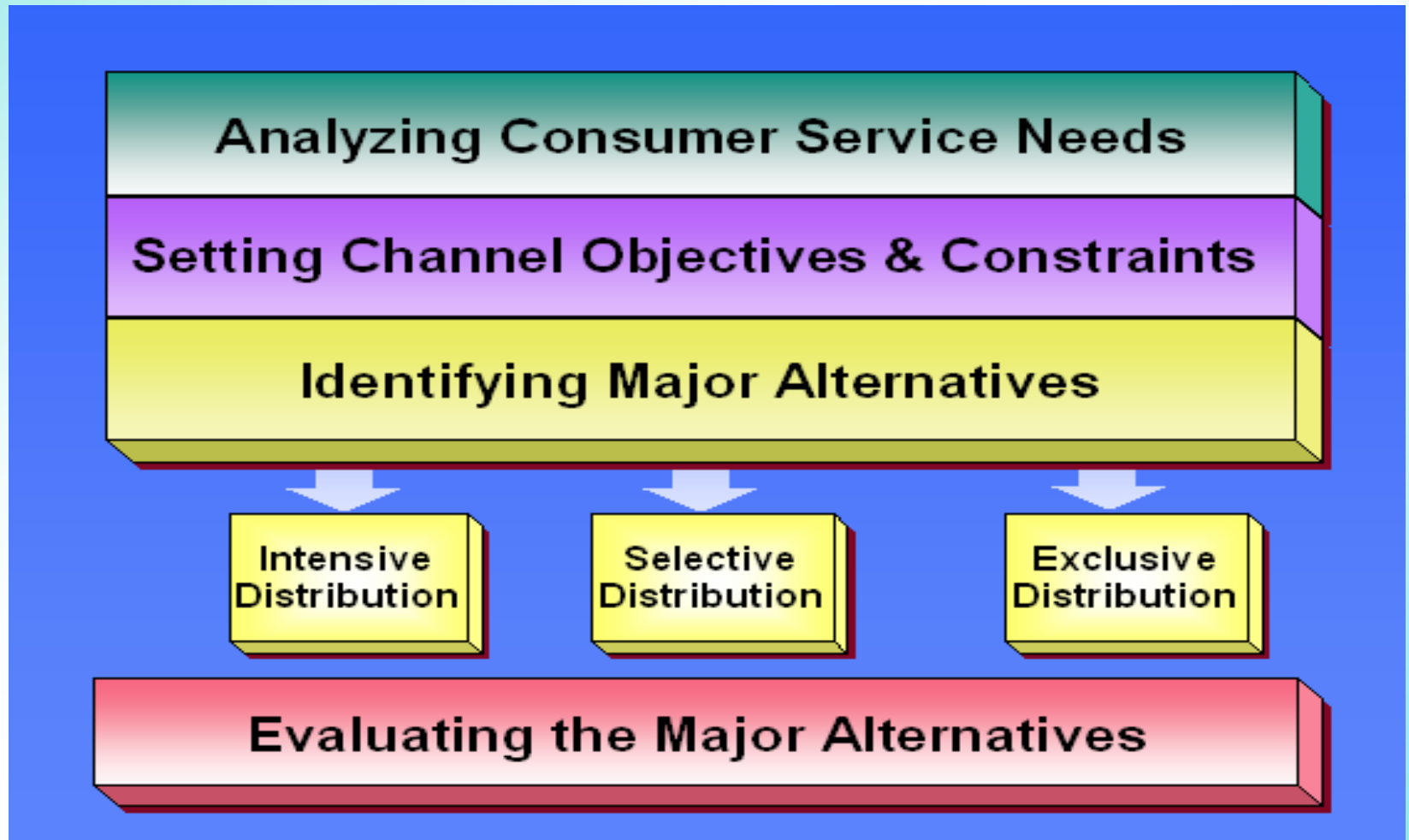


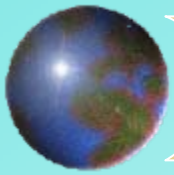
# *Channel Behavior & Conflict*

- The channel will be most effective when:
  - each member is assigned tasks it can do best.
  - all members cooperate to attain overall channel goals and satisfy the target market.
- When this doesn't happen, conflict occurs:
  - Horizontal Conflict occurs among firms at the same level of the channel.
  - Vertical Conflict occurs between different levels of the same channel.
- For the channel to perform well, conflict must be managed.

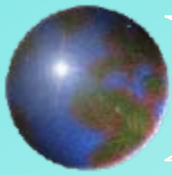


# *Channel Design Decisions*

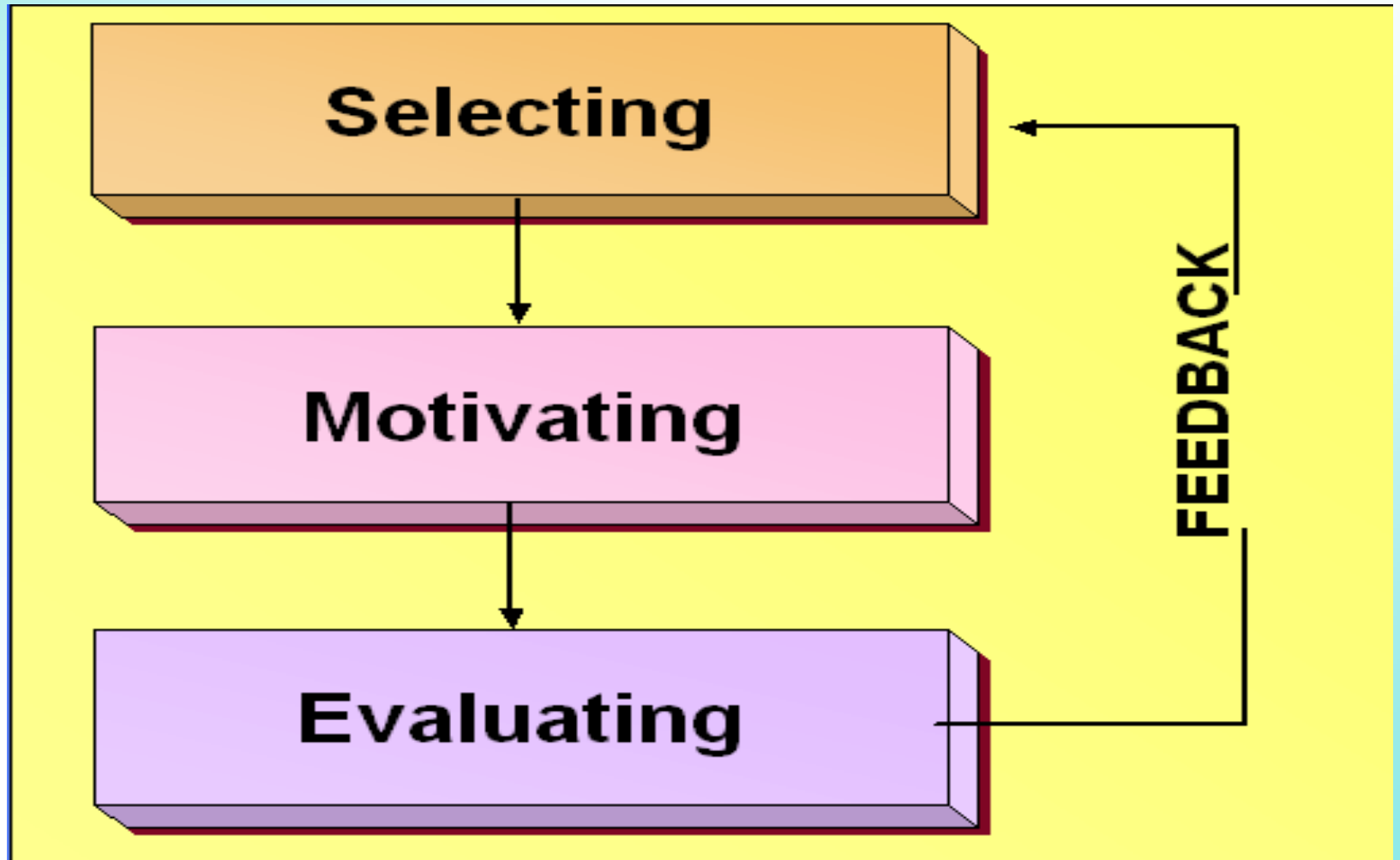




- **Intensive distribution:** channel policy in which a manufacturer of a convenience product attempts to saturate the market
- **Selective distribution:** channel policy in which a firm chooses only a limited number of retailers to handle its product line
- **Exclusive distribution:** channel policy in which a firm grants exclusive rights to a single wholesaler or retailer to sell its products and a particular geographic area



# *Channel Management Decisions*







# *Factors to Evaluate for Selecting a Distribution Channel*

## ● Customer Characteristics

- ❑ Number
- ❑ Geographic Dispersion
- ❑ Buying Behavior
- ❑ Use of Technology

## ● Product Characteristics

- ❑ Cost per Unit
- ❑ Perishability
- ❑ Bulkiness
- ❑ Standardization
- ❑ Need for Installation & Maintenance

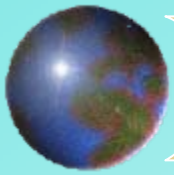


## ● Intermediary Characteristics

- Availability
- Willingness to Carry Product
- Market Serviced
- Distribution Functions Performed
- Potential for Conflict & Cooperation
- Other Product Offering
- Financial Condition

## ● Competitor Characteristics

- Number and Size
- Distribution Strategies
- Financial Conditions
- Sizes of Product Lines, Product Mix vs. Objective, Strategies, & Budget
- Strengths & Weaknesses

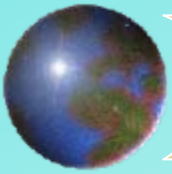


## ● Environmental Characteristics

- ❑ Economic Conditions
- ❑ Political Issues
- ❑ Laws, Regulations, and Ethics
- ❑ Cultural and Social Changes
- ❑ Technological Changes

## ● Organizational Characteristics

- ❑ Size and Market Share
- ❑ Financial Condition
- ❑ Size of Product Lines, Product Mix
- ❑ Ability to Perform Distribution Functions
- ❑ Objectives, Strategies, and Budget
- ❑ Channel Experience
- ❑ Strengths and Weaknesses

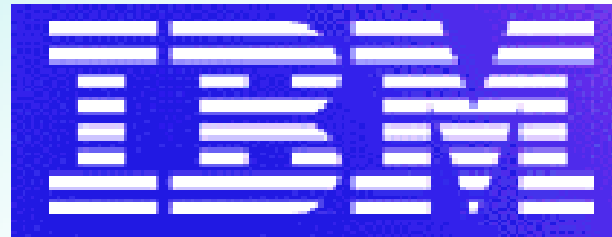


## *Channel Dynamics*

- There is no "best" channel structure for all firms producing similar products.
- Management must monitor and evaluate the performance of the channel of distribution channel regularly and frequently
- If the firm has targeted multiple market segments, management may have to develop multiple channels to service these markets efficiently. Whirlpool , IBM as examples



# IBM's Distribution Channels



IBM Direct

–By phone,  
web ,  
or mail

PC Stores

–Various  
retailers  
–Franchised  
stores

Agents

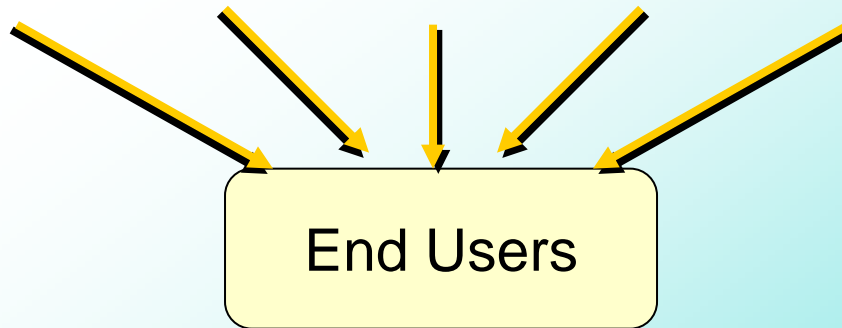
–*For middle men  
or business users  
with small demand*

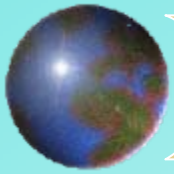
Dealers

–Some  
industrial users  
with  
large demand

IBM sales force

–For large  
or middle  
business  
users





# Part 2

## Customer Service

- ◆ **Basic Service**
- ◆ **Value**
- ◆ **Satisfaction**
- ◆ **Success**



# *Customer Service- Basic Elements*

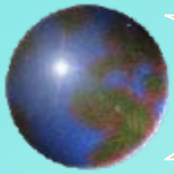
Customer service – competitive weapon

Continual rising of customer expectations

Need differentiation in “commodity” market

Personalized service attract customers

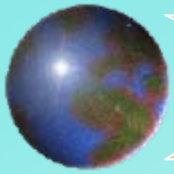
- Availability
- Operational Performance
- Service Reliability
- The Perfect Order



# *Availability*

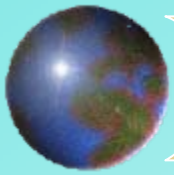
- ❑ Stockout Frequency
- ❑ Fill Rate
- ❑ Order Shipped Complete





## *Stockout Frequency*

Stockout frequency refers to the probability that a firm will not have inventory available to meet a customer order. For example, a study of retail supermarkets that at any point in time during a week, the average supermarket is out of stock of 8% of the items planned to be on the shelves.

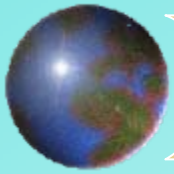


## *Fill rate*

Fill rate measures the magnitude or impact of stockouts over time. Being out of stock does not affect service performance until a customer demands. Then it is important to determine that the product is not available and how many units the customer wanted. For example, if a customer wants 100 units of an item and only 97 are available, the fill rate is 97%.

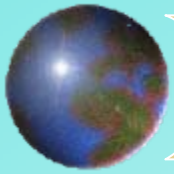
Survey of customer response on **Stock-out**:

- 9% do not buy; 26% buy different brand; 31% buy item at another store  
19% substitute same brand; 15% delay buy
- 2/3 customers buy on sight, only 1/3 will stay



## *Orders Shipped Complete*

It views having everything that a customer orders as the standard of acceptable performance. Failure to provide even one item on a customer's order results in that order being recorded as zero in terms of complete shipment

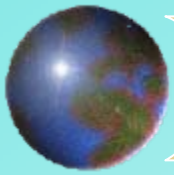


# *Operational Performance*

- Speed
- Consistency
- Flexibility
- Malfunction

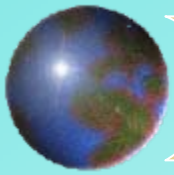
e.g., South-West airlines

- Speed – 25 min turn-around
- Consistency – shuttle-like
- Flexibility – seating policy (non-assignment)
- Recovery – correction, compensation, etc.



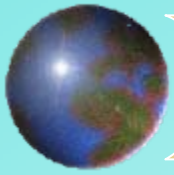
## *Performance cycle speed*

It is elapsed time from when a customer establishes a need to order until the product is delivered and is ready for customer use. The elapsed time required for total performance cycle completion depends on logistical system design.



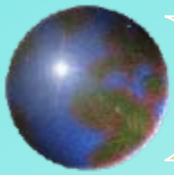
## *Order cycle consistency*

It is measured by the number of times that actual cycles meet the time planned for completion. While speed of service is important, most logistical managers place greater value on consistency because it directly impacts a customer's ability to plan and perform its own activities.



## *Flexibility*

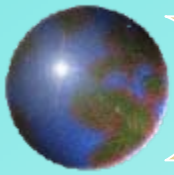
It involves a firm's ability to accommodate special situations and unusual or unexpected customer requests.



## *Malfunction recovery*

for example, if a stockout of an essential item occurs at a distribution facility that normally services a customer, the item may be obtained from an alternative facility utilizing some form of expected transportation.

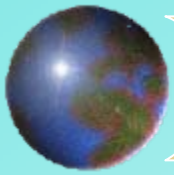




## *Service reliability*

It involves the combined attributes of logistics and concerns a firm ability to perform all order-related activities, as well as provide customers with critical information regarding logistical operations and status. Beyond availability and operational performance, attributes of reliability may mean that shipments arrive damage-free; invoices are correct and error-free; shipments are made to the correct locations; and the exact amount of product ordered is included in the shipment.

- Low Damage rate – shipping & handling - **fragile**
- Few Mis-shipments, etc.- **e.g. Kantola- videos**

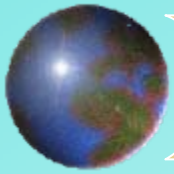


## *The Perfect Order*

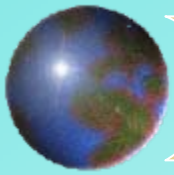
*(correct, on time, condition, etc.)*

The ultimate in logistics service is to do everything right and to do it the first time. It is not sufficient to deliver a complete order but to deliver it late. Nor is it sufficient to deliver a complete order on time but to have an incorrect invoice or product damage incurred during the handling and transportation process.

E.g., **beef package contract**



If orders shipped complete, average on-time delivery, average damage-free delivery, and average correct documentation are each 97%, the probability that any order will be delivered with no defects is approximately 88.5%.



# *Customer Service -Values*

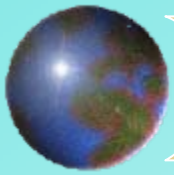
- Customer value – a relative index

- $CV = \text{Quality} \times \text{Service} / \text{Cost} \times \text{Time}$

- High Quality
- Spatial convenience (e.g., Mall)
- Product (service) variety/ specialty
- Lower Cost
- Time efficiency (e.g., Avis car rental; Caterpillar tractors – 48 hr parts/service globally )

- Customer's "Life Value"

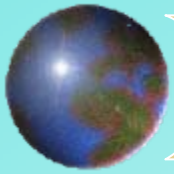
CLV = average transaction value x frequency  
x customer "life expectancy" - e.g., car dealer



# *Customer Service - Satisfaction*

– e.g., Cicoci

- Responsiveness – planning
- Access – assigned staff
- Courtesy
- Communication
- Credibility - trust
- Security
- Tangibles
- Personal touch



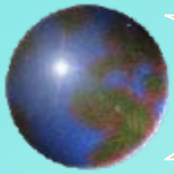
# *Customer Success*

- Understand customer's requirements
- Know customer's processes
- Use your capability to enhance your customer's performance; have lasting customer



# *Customer Success – e.g., TAL & Penney*

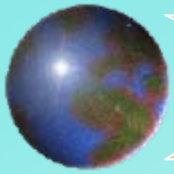
- **TAL – HK-based global shirts supplier, sells 1/8 shirts sold in US**
  - ❏ Plants in HK, Taiwan, Malaysia, Thailand
  - ❏ US clients: Penney, Crew, Klein, Banana Rep., Hilfiger, Claiborne, Lauren, Brooks, Land's Ends, etc.
- **Saw need – Penney held excessive inventory (9 Mon)**
  - ❏ proposed **direct shipping** for cost savings (28>>14c), skepticism, >> successful test in 1 store; later, deliver directly to > 1000 stores
  - ❏ **forecast demands** for Penney using advanced system and real data,; design, test-market 100,000 shirts in 50 stores, then produce and ship to all 100 stores, taking over **entire replenishment** function



## *Part3: Relationship of Customer Service to Successful Marketing*

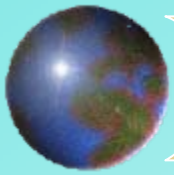
- ◆ Marketing mix (4Ps)
- ◆ How to determine a channel of distribution  
*(Benefits of wholesaler used)*
- ◆ Customer service---the output of logistics function
- ◆ On customer service level
- ◆ Cost/ revenue trade off





## *Marketing mix (4Ps)*

- Product
- Price
- Promotion
- Place



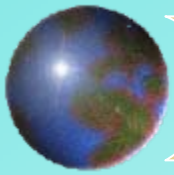
# *Product*

- Product is the bundle of attributes the customer receives from the purchase. Management may allocate resources to product development to bring new products to market or to improve the quality of existing products. The quality of the product influences demand in the marketplace and the price the company can charge. Reducing quality lowers manufacturing costs and increases short-term profits but may erode long-term profitability.
- In some industries, success depends on spending substantial sums on research and development to bring a continuous stream of new products to the marketplace. However, many new products are nothing more than product line extensions that do little to increase total market size but do increase the cost of doing business. In this situations, the market is simply carved up into smaller and less profitable pieces. Management must carefully consider the profit impact of changes in the product offering.



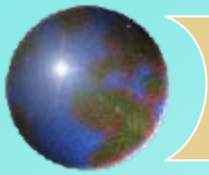
# *Price*

- Price is the amount of money the manufacturer receives for its product. Management must determine how changes in price will affect the purchase behavior of intermediaries and ultimate consumers. Price changes are not limited to changes in a product's list price. When a manufacturer demands faster payment of accounts receivable, provides a discount for early payment, or otherwise changes the financial terms of sale, it is changing the price of its products, and such changes may affect demand. The price that the manufacturer receives for its products differs depending on the channel of distribution used.
- Management may attempt to increase sales and profitability by reducing prices. However, in mature industries this is a questionable strategy. In order to break even and (maintain the prior profit), 1% price reduction will lead to substantial sales increase. Achieving the necessary sales increase in a mature market is very difficult.  $5\% / (20\% - 5\%) = 33\%$   
assume: 5% price reduction; 20% contribution margin then 33% of percentage increase to breakeven
- Please consider the affect from the viewpoint of the law of demand and supply



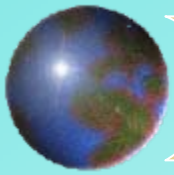
## *Promotion*

Promotion refers to both advertising and personal selling. Increasing expenditures for advertising will increase sales, but at some point additional advertising expenditures will not increase sales enough to justify the expenditure. The amount of sales support required depends on the channel of distribution used. Increased expenditures for promotion must lead to an equal or greater increase in contribution as a result of increase sales.



# *Place*

- Place represents the manufacturer's expenditure for customer service, which can be thought of as the output of logistics system. Customer service is the interface of logistics with marketing. While customer service is the output of the logistics system, customer satisfaction results when the company performs well on all components of the marketing mix. Product availability and order cycle time can be used to differentiate the product and may influence the market price if customers are willing to pay more for better costs, so logistics costs may affect the market price set by the company.
- For many firms customer service may be the best method of gaining a competitive advantage. The firm may be able to significantly improve its market share and profitability by spending more than competitors on customer service/logistics. By systematically adjusting the customer service package, however, the firm may improve service and reduce the total costs of logistics. When evaluating alternative customer service strategies, management's goal should be to maximize the firm's long-term profitability.
- Increases in expenditures require sales increases just to recover the additional costs. Most companies have limited resources and therefore must allocate these resources in a manner that will increase market share and profitability. Shifting marketing mix dollars to customer service from areas in which the money is not achieving sufficient sales may result in cost savings as well as improved customer service. The advantage of this method is that the contribution margin on resulting sales increases goes directly to the bottom line of the profit and loss statement. The impact on net profit is substantial because cost reductions in other components of the marketing mix offset the increased cost of customer service and it is not necessary to deduct the incremental service costs from the incremental contribution generated.

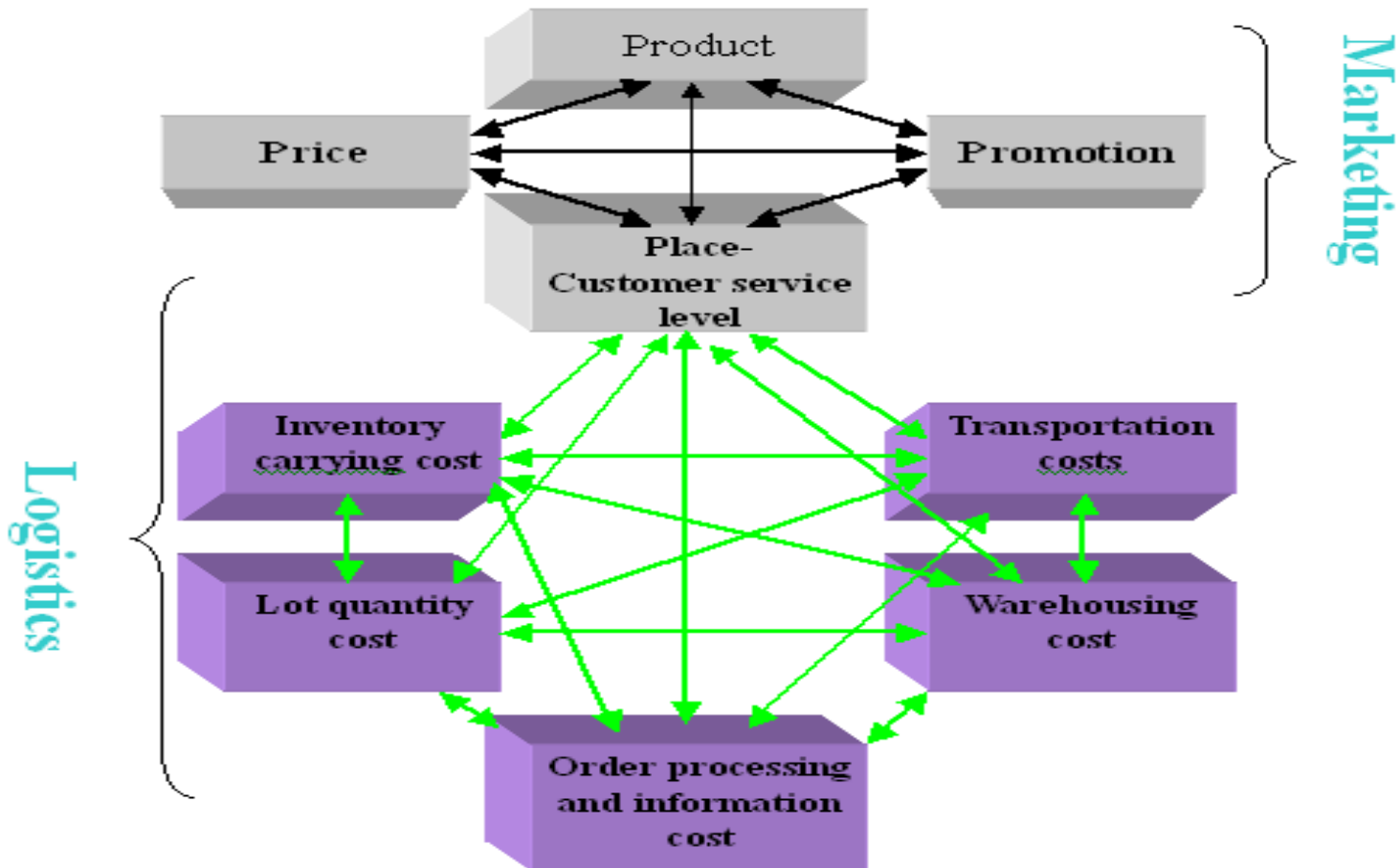


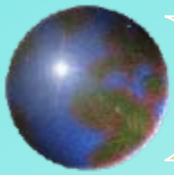
## *How to determine a channel of distribution (Benefits of wholesaler used)*

- lower transportation costs, because larger volumes will be shipped;
- lower inventory carrying costs;
- lower order processing and handling costs;
- reduced field warehousing costs;
- fewer bad debts



# *Customer service---the output of logistics function*

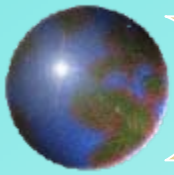




## *On customer service level*

- A reasonable level is enough
- Basis for making policy:
  - ▣ customer needs
  - ▣ overall marketing strategy
  - ▣ long-term profit objective





## *Cost/ revenue trade off*

- Whether is it justified to improve customer service level from 95% to 98%? (cues)
  - to evaluate the additional costs (\$ 2 million)
  - to calculate the sales amount that should be increased by break even method (here the amount equals to that contribution margin is divided by the additional costs--  $2 / 25\%$  )
  - to estimate the likelihood according to the percentage increased.
- Whether 94% of customer service level is enough?
  - To utilize unplanned decreases in service level
  - To measure the result

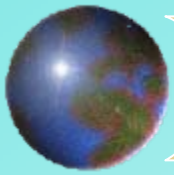


## Example 1

In planning its operation for 20xx based on a sales forecast of \$ 6,000,000, ABC co. prepared the following estimated data:

	Costs and expenses	
	Variable	Fixed
Direct materials	\$ 1,600,000	
Direct labor	1,400,000	
Factory overhead	600,000	\$900,000
Selling expenses	240,000	360,000
Administration expenses	60,000	140,000
	<hr/>	<hr/>
	3,900,000	1,400,000

What would be the breakeven point amount?



## *Cues:*

Contribution margin:  $2100000(6000000 - 3900000)$

Contribution margin ratio:  $7/20(2100000/6000000)$

Break even amount:  $4000000(1400000 * 20/7)$

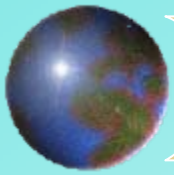


## *Example 2*

The following information pertains to Rica co.:

Sales(50,000 units)	\$ 1,000,000
Direct materials and direct labor	300,000
Factory overhead:	
Variable	40,000
Fixed	70,000
Selling and general expenses:	
Variable	10,000
Fixed	60,000

How much was the company's breakeven point in number of units?

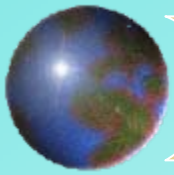


## *Cues:*

Contribution margin: \$650000

Unit CM: 13

Breakeven quantity: 10000units

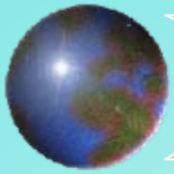


## *Homework:*

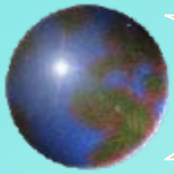
ABC co. makes 27,000 units of a certain component each year for use on its production line. The cost per unit for the component at this level of activity is as follows:

Direct materials:	\$ 4.20
Direct labor	12.00
Variable factory overhead	5.80
Fixed factory overhead	6.50

The co. has received an offer from an outside supplier who is willing to provide 27,000 units each year at a price of \$25 per component

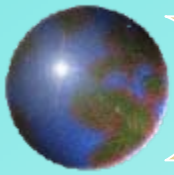


- 1. Assume that there is no other use for this facilities now being used to produce the component. If ABC co. continues to make the component, how much higher or lower will net income be than if the components are purchased from the outside supplier?*

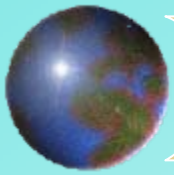


2. Assume that the facilities now being used could be rented for \$64,800 per year if the components were purchased from the outside supplier. Under this condition, if ABC co. continues to make the component, how much higher or lower will net income be than if the components are purchased from the outside supplier?





Suppose the conditions are the same as in question 2. At what price per unit charged by the outside supplier would the ABC co. be economically indifferent between making the component and buying from the outside supplier?



4. Assume that if the component is purchased from the outside supplier, \$35,100 of annual fixed factory overhead could be avoided and the facilities now being used could be rented for \$64,800 per year. If the co. chooses to buy the components from the outside supplier, then how about the change in annual net income due to accepting the offer?