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DAVID PAUL ADAMS

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A STUDY OF INSTITUTIONAL CHANGE PROCESSES
WITHIN THE APPLIANCE INDUSTRY

By

David Paul Adams

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ABSTRACT

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This research was undertaken to develop an understanding of decisions made during the development of the appliance industry. As a result of these decisions, several different and distinct channel arrangements are currently used by major appliance manufacturers. This research reconstructs the decision-making process which resulted in today's channel arrangements and compares this behavior to theories of channel evolution and change.

There were three objectives for this study. The first was the development of a chronology of the growth of the appliance industry and the development of the prevailing channel structures from inception to present. The second was to isolate the manner in which vertical channel decisions relative to structure were made by executives holding representative roles within major firms constituting the appliance industry. The third research objective was to interpret which if any behavioral and/or economic theories of channel formulation and change could have predicted or explained the structural development of the appliance industry.

The descriptive analysis of channel activities and the accumulation of observation is important to marketing. It is through such a process of specialized research and fact generation that channel theory can be established. Few of the theories relating to the distribution channel have been empirically examined. Without such examination of prevailing theories, the danger always exists that logically consistent and tightly reasoned models will fail to explain the way decisions are in fact made.

Consistent with the objectives of this research, the manufacturers of nationally branded appliances were selected for study. The appliance industry was selected because of the magnitude of channel decisions and because many of the executives that made channel decisions and/or their immediate replacements are available to help reconstruct the climate and pressure of the growth years. The enterprises selected for analysis included: Whirlpool, White-Westinghouse, Frigidaire Division of General Motors, General Electric, Kelvinator, and Gibson. To obtain the maximum amount of information, unstructured direct interviews were conducted with current and past key executives. Emphasis was placed on questioning which developed an understanding of the relative importance the respondents placed on: the cost of performing functions in the channel; the total cost of distribution; the profit and sales potential; the level and importance of conflict and power; and the importance of risk.

To accomplish the third objective of the research, the following conceptual framework was used in the analysis of structural change in

the channel: macroeconomic environment, microeconomic environment, power, and conflict. This framework provided a basis for organizing related channel change theories while still permitting examination of their interaction.

This research provided a chronology of the growth of the appliance industry and the development of appliance channels. In addition, it identified the way in which decisions affecting channel formulation and change were made by key executives of major companies in the industry. Although no single theory of channel formulation and change provided a basis for explaining all of the occurrences in the development of appliance industry channels, a number of theories provided useful insights. In each section of the conceptual framework, theories of channel formulation and change did provide a basis of explanation. This is significant in that these theories viewed in retrospect did provide a degree of predictive insight into channel decision making and thus provided a base for additional theoretical development. It was also concluded that existing channel theories fail to predict with any accuracy or regularity all interrelated occurrences in the appliance channel. While this conclusion is unfortunate, it is not inconsistent with the first conclusion.

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CHAPTER I

BACKGROUND OF THE PROBLEM

The relationships between manufacturing and distribution were not a subject of major managerial concern during the early periods of American commercial growth. As production expanded to support marketing following World War II, it became evident that increasing emphasis needed to be placed on the operational relationships between production and consumption. This emphasis in turn encouraged the investigation and analysis of the problems associated within distribution systems. Thus, channels of distribution or the thread which links producer to consumer became a subject of increasing concern.

The success of a business organization is largely dependent upon the effective utilization of channels through which products are legally and physically transferred to customers. The selection of a channel is an important policy decision which influences almost all functional areas within the enterprise and directly influences customer relations. This many faceted relationship was dramatized by Revzan who stated: "The channel is the managerial battlefield in which marketing strategy and marketing tactic activities of each business unit either succeed or fail."¹

¹David A. Revzan, Wholesaling in Marketing Organization (New York: John Wiley and Sons, Inc., 1961), p. 105.

Despite the recognized importance of the distribution channel, it is interesting to note that the channel "is one of the least managed areas in marketing."² McCammon and Little are of the opinion that the scholarly study of marketing channels has been relatively limited. They hypothesize that this neglect of channels results for three reasons. First, marketing scholars have been primarily interested in the theory of the firm. In some analyses, the firm is at least implicitly assumed to operate in a quasi-vacuum with little or no attention paid to its environment or to its relationships with other enterprises. This assumption precludes the analysis of a firm as a member of a channel system. Second, channels are one of the most complicated economic organizations in a developed economy. Channel organizations are elaborate economic, political, and social systems that typically include many decision makers, a diverse set of individual business goals, and often cover broad geographical areas. This structural complexity discourages systematic analysis of the channel. To fully understand a channel system requires the integration of concepts from sociology, economics, political science, cultural anthropology, regional science, marketing, and social psychology. Finally, the neglect of marketing channels is partially attributable to recent trends in marketing thought. Early scholars in marketing were institutionalists or functionalists and were, therefore, interested in exploring the relationships between channel members. However, current emphasis

²Reavis Cox and Thomas F. Schutte, "A Look at Channel Management," Marketing Involvement in Society and the Economy, ed. Philip McDonald (Chicago: American Marketing Association, 1969), p. 105.

is on a managerial point of view which concentrates on the internal management of the firm and places little emphasis on the channel system.³ In contrast, each firm is managerially viewed as formulating marketing strategies based primarily upon internal or individual firm goals.

In the same context, Louis Bucklin has noted that:

in the flesh and blood world of lumbering freight cars and chanting salesmen the array of channel configurations is both infinite and bewildering. Each institution--its physical characteristics, its history, the people who make it come alive--is different in meaningful ways. This diversity muddies the view and makes it difficult to distinguish between the significant and the trivial.⁴

To compound these analysis problems, channel systems are always changing with respect to participants and relationships. Such change forces channel managers to make tactical and often strategic decisions to ensure attainment of overall marketing goals.

A Perspective of Channel Change

Change in most channels of distribution is a constant. Middlemen are constantly entering and leaving channels of distribution creating new relationships and terminating others. These alterations in channel structure introduce potential conflict into channel

³Bert C. McCammon, Jr., and Robert W. Little, "Marketing Channels: Analytical Systems and Approaches," Science in Marketing, ed. George Schwartz (New York: John Wiley and Sons, Inc., 1965), pp. 321-322.

⁴Louis P. Bucklin, A Theory of Distribution Channel Structure (Berkeley, Calif.: Institute of Business and Economic Research, University of California, 1966), p. 5.

relationships. In sharp contrast is the fact that, a significant level of cooperation is necessary between channel members for the transfer of ownership and related physical distribution to be accomplished. As a result of the conflict-cooperation process and the ever dynamic nature of competition, marketing channels and participants must adapt continuously to their environment in order to avoid "economic obsolescence."⁵ Barnet, Levitt, and Schumpeter argue that this type of competition, usually referred to as innovating competition, is a prerequisite for economic growth.⁶

Marketing channels change because institutions are continually faced with pressure to improve performance and/or reduce costs. Such adaptation alters the organization of the channel and modifies the relative cost/benefit balance among channel alternatives.⁷ Bowersox has suggested that future changes in the productivity of the distribution system will not follow the traditional practice of technological adaptation. The forecasted slowdown in technological improvements related to channel interchange and the need to utilize marginally

⁵Bert C. McCammon, Jr., "Alternative Explanations of Institutional Change," Marketing Channels: A Systems Viewpoint, eds. William Moller and David Wilemon (Homewood, Ill.: Richard D. Irwin, Inc., 1971), p. 134.

⁶Edward M. Barnet, Innovate or Perish (New York: Graduate School of Business, Columbia University, 1954); see also Theodore Levitt, Innovation in Marketing (New York: McGraw-Hill Book Company, 1962); and Joseph Schumpeter, Capitalism, Socialism, and Democracy (New York: Harper and Brothers, 1947).

⁷Edwin H. Lewis, Marketing Channels: Structure and Strategy (New York: McGraw-Hill, 1968), p. 5.

productive workers will force managers to look for totally new ways to get the job done. The new ways include an innovative application of today's technology coupled with a new and permissive legal and regulatory framework.⁸ In a similar vein, Davidson has projected several major changes expected to occur in the distributive structure.

They are:

1. The rapid growth of vertical marketing systems.
2. The intensification of intertype competition (intertype competition is defined by Palamountain as competition between middlemen of different types in the same channel).⁹
3. The increasing polarity of retail trade (large mass merchandisers at one extreme and small boutiques at the other).
4. Acceleration of institutional life cycles.
5. The emergence of the "free-form" corporation as a major competitive reality in distribution (a free-form corporation is a distributive institution that does not feel constrained to operate in a single level of the channel or in a particular business classification).
6. The expansion of nonstore retailing.¹⁰

Heskett also predicts major changes among distributive organizations. They are:

⁸Donald J. Bowersox, "Showdown in the Magic Pipeline: Call for Priorities," Presidential issue, Handling and Shipping, Fall 1973, pp. 23-27.

⁹Joseph C. Palamountain, The Politics of Distribution (Cambridge, Mass.: Harvard University Press, 1955), p. 116.

¹⁰William R. Davidson, "Changes in Distributive Institutions," Marketing Channels: A Systems Viewpoint, eds. William Moller and David Wilemon (Homewood, Ill.: Richard D. Irwin, Inc., 1971), pp. 387-388.

1. The coordination of interorganizational policies and practices to enable cooperating channel members to perform their existing functions more effectively.
2. A negotiated shift of functions and responsibilities from one firm to another in a channel.
3. The creation of joint venture or third party institutions to eliminate duplication of the performance of functions in such channels.
4. The vertical integration of channel functions which is currently performed by different organizations.¹¹

Walter Friedman agrees with Heskett in the direction of future channel change. Friedman anticipates that cooperative sharing of facilities and services within the channel will increase substantially in the future. He suggests that this cooperation can lead to: (1) significant reduction in the cost of distribution, (2) improved relative marketing position, and (3) improved customer service performance.¹² The modifications projected by each of these authors reflect a trend that will probably accelerate in the future. There is, however, some question as to whether all members of the channel will warmly embrace such rapid structural change.

The small business frame of reference and expectations regarding change are quite different from those of the large business channel partners. Wittreich has reported that small retailers tend to have relatively static expectations.¹³ That is, they are interested in

¹¹ James L. Heskett, "Sweeping Changes in Distribution," Harvard Business Review, March-April 1973, p. 128.

¹² Walter F. Friedman, "Physical Distribution: The Concept of Shared Services," Harvard Business Review, March-April 1975, p. 24.

¹³ Warren J. Wittreich, "Misunderstanding the Retailer," Harvard Business Review, May-June 1962, pp. 147-155.

reaching a satisfactory profit level and then maintaining that plateau. Such small businesses do not encourage change. Instead, they resist change. A typical perception is that their position will not improve from new arrangements. In fact, any change could disrupt a reasonably attractive status quo. Kriesberg, after studying the behavior of retail furriers, reached essentially the same conclusion.¹⁴ Small furriers tend to value stability more than growth, and their continuing participation in the channel was motivated by a desire for security. Wittreich also concluded that differences in goals, viewpoint, language, and understanding between dealers and manufacturers creates problems. In his analysis of the retail appliance dealers, he notes that the dealer's primary focus is on satisfying local customer needs. In addition, the dealer perceives all actions of the manufacturer in terms of his own goals and point of view.¹⁵ These differences in viewpoint and the resultant barriers to change have a substantial effect on channel relationships.

Large firms also confront pressures to protect the status quo. Established organizations, even within relatively young and progressive industries, are frequently backward about radical change.¹⁶ The members of an organization and its customers may resist change because

¹⁴ Louis Kriesberg, "The Retailer Furrier: Concepts of Security and Success," American Journal of Sociology, March 1952, pp. 478-485.

¹⁵ Wittreich, "Misunderstanding the Retailer."

¹⁶ Richard Caves, American Industry: Structure, Conduct, Performance, Vol. 2 (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1967), p. 103.

it creates uncertainty, violates group norms, or may result in a loss of status. Thus, enterprises respond to change slowly unless the innovator has penetrated the firm's core market.¹⁷ Most firms appeal to a specific group of customers whose patronage is virtually assured (a core market).¹⁸ Should this core market be infringed upon, the enterprise is forced to change in order to survive. Because of this organizational rigidity, Kriesberg suggests that a firm completely outside the channel will typically be the innovator of basic change while existing channel members will generally make only tactical changes in the system.¹⁹

Channel members are continually confronted with change in various operations and structures of the channel. In order to remain competitive, alterations to existing structure and operations must result. The way in which the change process occurs can have significant implications for the survival of the channel system and its members. The study of such change in a specific industry was the focus of this research.

Channel Decisions

The paradox that the structure of distribution channels is constantly changing despite inherent resistance to change within the

¹⁷ Wroe Alderson, Marketing Behavior and Executive Action (Homewood, Ill.: Richard D. Irwin, Inc., 1957), p. 56.

¹⁸ McCammon, "Marketing Channels: Analytical Systems," p. 139.

¹⁹ Louis Kriesberg, "Occupational Controls Among Steel Distributors," The American Journal of Sociology, November 1955, pp. 203-212.

channel has a major impact on the formulation of managerial strategy. Earlier, it was pointed out that channel selection represents an important policy decision. Similar to most important strategic policy matters, objectives and resources of the enterprise combined with an influence of the economic, social, political, and legal environment influence channel decisions. The interrelationship of these factors is illustrated in Figure 1.²⁰

In addition to external factors which influence a channel decision, a distribution channel policy must consider factors which are internal and specifically related to the capability of available channel participants. Some such considerations include: total cost, investment requirements, control, operational stability, participant reliability, and inventory control. Thus, factors internal and external to the enterprise interact to influence channel decisions. Such factors are important because they determine the rate and dimension to change. An examination of the historical decision-making process as it relates to channel policies within an industry heeds further the potential to understand factors stimulating channel change and the procedures followed by the management of involved enterprises to adapt to such change.

²⁰ Bruce Mallen, "Interaction of Channel Selection Policies in the Marketing System," The Marketing Channel a Conceptual Viewpoint, ed. Bruce Mallen (New York: John Wiley and Sons, Inc., 1967), p. 102.

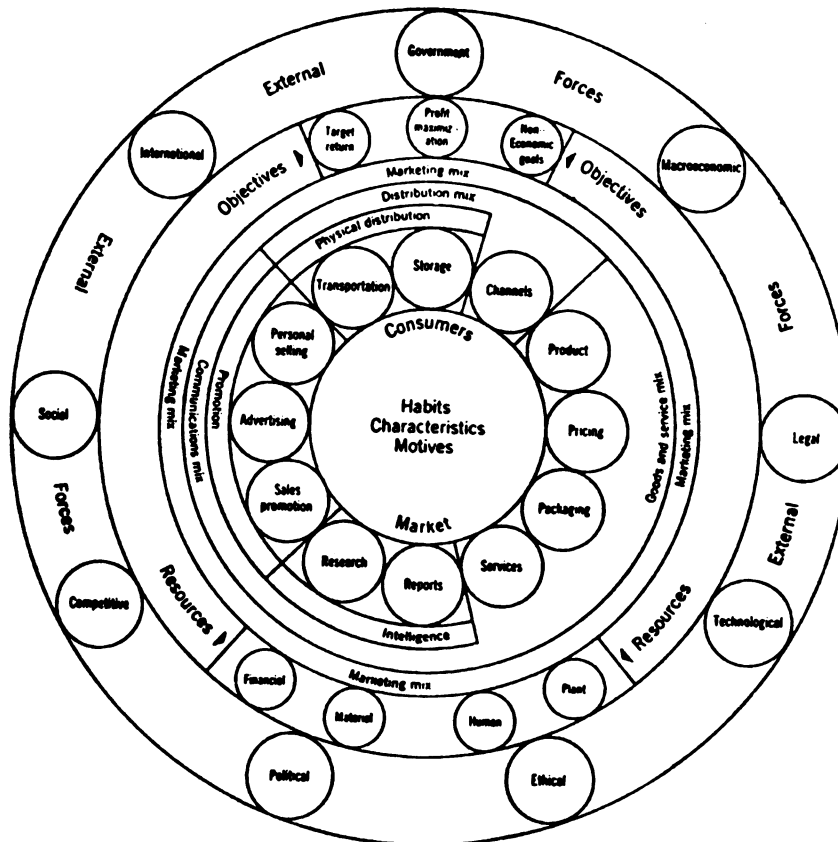


Figure 1. The channel manager's decision framework.

A Study of Institutional Change Processes

For many years, authors have theorized about channel relationships and change. The impact of a decision to modify an existing channel can be both drastic and enduring as such decisions normally involve a major resource commitment which is not easily reversed. In addition, an element of risk is always present when a manufacturer decides to use existing channels or develop new channels to market goods. Such risk can be minimized by using existing channels or by maintaining the status quo. The decision to change channels, however, represents an uncharted course which has great inherent risk for both the firm and channel members. Although the risk is high, it must be taken. Stern suggests that the change process is worthy of study primarily because it is often a determinant of an enterprise's profit or survival.²¹ Despite the many articles that have been written about the importance of such decisions, little empirical research has been undertaken on the change process.²²

Purpose and Objective

The basic objective of this study was to develop an understanding of the manner in which channel decisions were made during the development of the major appliance industry. These decisions

²¹Louis W. Stern, "Management Insights Through Historical Perspective," Business Topics 12 (Summer 1964): 47.

²²The notable exception to this is Richard M. Clewett, Marketing Channels for Manufactured Products (Homewood, Ill.: Richard D. Irwin, Inc., 1954).

resulted in the use of distinctly different channel arrangements by individual appliance manufacturers. The situation which resulted provides a unique opportunity to study the decision-making process.

The academic interest of the last few years in theoretical frameworks for explaining and predicting channel behavior has led to the development of models and hypotheses designed, at least in part, to help explain and/or predict the behavior of participants in channel systems. Few of these models, however, have been empirically tested. Consequently, there is always the danger that logically consistent and tightly reasoned models will fail to explain the way in which decisions are in fact made. The purpose of this research was to reconstruct the decision-making process which resulted in the formulation of today's channel arrangements in the major appliance industry and to compare decision behavior to existing theories of channel evolution and change.

Definitions of Key Terms

The study focused upon one of the country's largest differentiated oligopolies, the major appliance industry. This industry is composed of several companies that manufacture consumer durable goods such as: refrigerators, ranges, laundry equipment, dishwashers, compactors, and freezers. The significant competitors in the industry include: General Electric, Whirlpool, General Motors, and White Consolidated Industries.

The traditional channel structure of the industry consisted of a three-level arrangement of manufacturer to independent distributor to independent dealer. The independent distributor is a wholesaler who

serves the manufacturer and dealer by providing: sales promotion, personal selling, delivery, warehousing, inventory control, credit, and training. The independent dealer is the appliance retailer who provides showroom space, personal selling, delivery, advertising, and possibly, repair services. In recent years, some manufacturers have selected to replace independent distributors with factory branches. The factor branch typically performs functions similar to those of the independent distributor. The significant difference is that the factory branch is owned and operated by the manufacturer who assumes all associated risk. Some manufacturers have developed channel structures which utilize a combination of independent distributors and company branches. In addition, in recent years, selected manufacturers have begun to ship appliances direct to dealers, thereby bypassing, at least in a physical distribution sense, the entire wholesale function. Finally, several independent distributors have recently assumed a major role in their channel of distribution. These distributors have decided to contract out the production of appliances and then to distribute them under the Crosley brand name, thus creating an integrated wholesaler-retailer channel.²³

The interaction of channel participants has created several conflict situations. Conflict is a situation which occurs when one channel participant impedes the goals of another.²⁴ This conflict can

²³"Distributors Bring Back the Crosley Appliance," Business Week, January 31, 1977, pp. 92-93.

²⁴Raymond W. Mack and Richard C. Snyder, "The Analysis of Social Conflict--Toward an Overview and Synthesis," Journal of Conflict Resolution 1 (June 1957): 212-248.

at times be resolved through the use of power. Power is the ability of one channel member to get another channel member to do what the latter would not otherwise have done.²⁵

This variance in distribution channel structure and strategy was of particular interest because the industry fits the classical definition of a differentiated oligopoly. Whereas, the majority of industry historical practice appears to reflect the competitive interaction traditionally expected under the normative oligopolistic market structure. The observable variance in channel practice does not. Likewise, no particular theories of channel or institutional change currently found in the related literature appear to offer reasonable models to predict and/or explain reasons for the wide variety of channel formulations which now exist in the industry.

Outline of Study

The overall research is reported in six chapters following this introduction. The next chapter is devoted to a comprehensive review of channel literature. The review is divided into the four following areas: (1) the functional approach; (2) the economic approach; (3) the behavioral approach; and (4) the systems approach. Each covers an important aspect of channel literature coverage. Theoretical frameworks and models developed within each area are reviewed.

²⁵Louis W. Stern and Adel I. El-Ansary, Marketing Channels (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1977), p. 383.

Chapter III presents the research design. A conceptual framework for analysis of the appliance industry is developed and the specific research objectives as well as the procedures of the study are presented.

A historical sketch of the growth of the appliance industry and the development of prevailing channel structures is provided in Chapter IV. Attention is paid to the decision patterns that resulted in the existing distribution structure of the appliance industry. Chapter V presents the results of the field interviews conducted with executives of the appliance industry. Chapter VI interprets the material in the preceding two chapters to determine which channel theories explain or predict what actually occurred in the channel. In conclusion, Chapter VII synthesizes preceding chapters by using the framework developed in Chapter III to analyze the appliance industry. Conclusions are drawn as to which model or framework of change offers the greatest potential for explaining the channel decision-making behavior that has characterized the appliance industry.

The overall research is based on the belief that valuable insights into the decision-making process can be secured through an investigation of the way in which decisions were made. Stern suggests that "there exists both a practical and scientific need for a better illumination of the behavioral dimension of the distribution process."²⁶ However, he adds that "there has been a dramatic shifting away from

²⁶ Ibid., p. x.

empirical institutionally oriented studies."²⁷ Such study of channel decision making provides a potential to understand both how and why appliance channels developed.

Summary

The first chapter provided a background to the problem, purpose, and general outline of the study. Empirical research of decision making and change in channels of distribution has been neglected by researchers. The objective of this study is to develop an understanding of the manner in which channel decisions were made during the development of the appliance industry. A chronology of the distribution channel behavior is developed and compared to existing theories of channel evolution and change. The next chapter provides an analysis of the literature relating to distribution channel decision making and change.

²⁷ Ibid., p. xi.

CHAPTER II

RELATED LITERATURE

Introduction

The preceding chapter presented a generalized coverage of change and decision procedures in channel selection. This chapter focuses more specifically on the theory of change and decision making in the distribution channel as well as the theory of channel structure.

The purpose of this chapter is to review the various efforts and diverse approaches which are available to assist in understanding distribution channels. Channels of distribution have been analyzed in the literature from a number of approaches. These can be grouped into four major areas; they are: (1) the functional approach; (2) the economic approach; (3) the behavioral approach; and (4) the systems approach. An understanding of the four approaches is necessary to guide channel research since each approach analyzes different aspects of channel participant interrelationships. The intent of this review is to provide an overall perspective of the channel literature and not a critical evaluation of channel theory.

The Functional Approach

The structure of a distribution channel may be defined as all the institutions which perform the activities necessary to move a good from its point of production to its point of consumption.¹ From the earliest years of distribution analysis, there has been a great deal of interest in the nature and scope of these activities. In each case, the authors have attempted to classify the activities calling them the functions of marketing. A marketing function has been defined as "a major economic activity which is inherent in the marketing process, pervades it throughout, and which through a continuous division of labor tends to become specialized."²

Shaw was the first to develop a list of marketing functions for middlemen. He included: risk, transportation, selling, assembling, assorting, and reshipping.³ Later Weld⁴ and Cherington⁵ accepted Shaw's list of functions with only minor changes. However, they applied them to marketing as a whole. Each of them argued that such functions must be performed for ownership transfer to occur. In

¹Louis P. Bucklin, "The Economic Structure of Channels of Distribution," The Marketing Channel A Conceptual Viewpoint, ed. Bruce Mallen (New York: John Wiley and Sons, Inc., 1967), pp. 63-66.

²Richard Lewis and Leo Erickson, "Marketing Functions and Marketing Systems: A Synthesis," Journal of Marketing 33 (July 1969): 10-14.

³Arch W. Shaw, Some Problems in Market Distribution (Cambridge, Mass.: Harvard University Press, 1915), p. 76.

⁴L. D. H. Weld, "Marketing Functions and Mercantile Organizations," Economic Review, July 1917, pp. 306-318.

⁵Paul T. Cherington, Elements of Marketing (New York: MacMillan, 1920), p. 44.

addition, Cherington stressed that distribution activities should be analyzed separately from the institutions that were performing them. He viewed these activities as basic to ownership transfer, while the institutions performing them were a temporary structure.⁶ Over time, several authors developed lists of functions but they varied only slightly from those developed by Shaw, Weld, and Cherington.

In 1950, McGarry again stressed that the marketing functions are inherent in the marketing process. He viewed a marketing function as being related to the ultimate purpose of marketing. To illustrate this, he said,

The function of the heart is not simply to beat, which is its activity, but rather to supply the body with a continuous flow of blood. In like manner functions of marketing should denote a purposefulness in the marketing process; and the term should be used only in connection with activities that must be performed in order to accomplish the general purpose.⁷

Based on this, McGarry developed his list of functions which included: the contractual function, the merchandising function, the pricing function, the propaganda function, the physical distribution function, and the termination function.⁸ McGarry's functions, like those of Shaw, Weld, and Cherington, are macrooriented. Staudt, Taylor, and Bowersox, however, developed a list of marketing management functions

⁶Ibid., pp. 56-59.

⁷Edmund D. McGarry, "Some Functions of Marketing Reconsidered," Theory in Marketing, eds. Reavis Cox and Wroe Alderson (Homewood, Ill.: Richard D. Irwin, Inc., 1950), p. 268.

⁸Ibid., pp. 269-273.

which they view as being common to all types of producing enterprises. These functions are: the market delineation function, the purchase motivation function, the product-service adjustment function, the channel selection function, the physical distribution function, the communications function, the pricing function, the organization function, and the administration function.⁹

Bucklin, in his functional analysis of the channel, hypothesized a different approach. He identifies four criteria for marketing functions. They are:

1. The activities in each function must be related so that a firm must organize to perform all of them or none of them.
2. The scope of the activities must be broad enough to allow specialization by a firm in a specific function.
3. The activities should incur substantial costs.
4. Each marketing activity must be placed in one function and in one function only.

Based on these criteria, he selected the following five functions:

1. Transit (T): All activities required to move goods between two points.
2. Inventory (I): All activities required to move goods in and out of storage, sort, and store them.
3. Search (S): All activities required to communicate offers to buy and sell and to transfer title.
4. Persuasion (P): All activities incurred to influence the beliefs of a buyer or seller.

⁹Thomas Staudt, Donald Taylor, and Donald Bowersox, A Managerial Introduction to Marketing, Vol. 3 (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1976), pp. 37-49.

5. Production (Pr): All activities necessary to create a good with any desired set of specifications.¹⁰

By using these functions, he was able to symbolically define the structure of a number of different distribution channels. This was accomplished by using an abbreviation for each function to denote the performance of a function by an institution. Thus, he represented the familiar manufacturer, wholesaler, retailer channel as follows:

$$(PrITSP) \rightarrow (SITSP) \rightarrow (SISP) \rightarrow (STIC)$$

With this as a base, he went on to define several different channel structures under varying market conditions.¹¹

Mallen generalized the basic message of all functionalists as follows:

Marketing functions are tasks which channel members undertake; functions can be allocated in different mixes to different channel members; the functional mixes will be patterned in a way which gives greatest profit to either consumers or the most powerful channel member; if a channel member sees an opportunity to change the channel mix in a way which will give him more profit, he will attempt to do so; if this functional shift is successful and big enough, it will cause an institutional change in the channel.¹²

This functional transfer allows marketing functions to be shifted from one channel participant to another. Thus, change within the channel

¹⁰ Bucklin, "Economic Structure of Channels," pp. 63-66.

¹¹ Ibid., pp. 63-66.

¹² Bruce Mallen, "Functional Spin-Off: A Key to Anticipating Change in Distributive Structure," Journal of Marketing 37 (July 1973): 19.

structure occurs when channel members attempt to alter existing functional relationships in a way that increases the firm's profitability. Channel functionalists attempt to answer two basic channel questions: "What is the most efficient functional mix in a given situation?" and "How will this functional mix affect the channel structure?"¹³ To be a bit more specific, it may be possible to determine "why five different types of institutions are found in the channel for one good, while ten or twelve make up the channel for another; why two different channel structures exist for the same good; or what changes in existing channels for some commodity should be expected in the future."¹⁴

To predict change in a channel setting, one must be able to identify situations where a firm or firms would be better off with a different mix of functions. However, a framework must be identified which will allow the observer to pinpoint the areas in which change is most likely to occur. This calls for an economic analysis of the channel. Specifically, each firm must compare the cost of performing a function "in house" with the cost of "spinning off" that function to a specialist.

Alderson, however, argues that if the effect of this functional transfer is to be understood a broader perspective should be used. He suggests that functionalism will provide this perspective.

¹³ Ibid., p. 19.

¹⁴ Bucklin, "Economic Structure of Channels," pp. 63-66.

"Functionalism looks at a systematic structure to determine the present relationship between inputs and outputs and to lay groundwork for bringing about an improvement in these relationships."¹⁵ This concept will be discussed in some depth in the section on the systems approach.

The Economic Approach

Economic theory presents a logic explaining the actions and reactions of firms to competitive circumstances. If a firm's objective is to realize the largest return possible, they are viewed as acting logically. Jevons stated that, "the theory may be described as the mechanics of utility and self-interest."¹⁶ In order to apply this theory in a channel structure, it is first necessary to identify the existing channel structure and then evaluate if participants are in fact attempting to maximize efforts in the economists sense of the phrase.

This analysis is complicated by the existence of several different market structures. These market structures are diverse, and careful attention must be paid to them. For analysis, it is possible to group them into two broad areas: perfect competition and imperfect competition.

¹⁵ Wroe Alderson, Dynamic Marketing Behavior (Homewood, Ill.: Richard D. Irwin, Inc., 1965), p. 11.

¹⁶ Margaret Hall, "Economic Analysis of Retail Trade," Marketing Channels: A Systems Viewpoint, eds. William G. Miller, Jr., and David L. Wileman (Homewood, Ill.: Richard D. Irwin, Inc., 1971), p. 150.

Pure Competition

The purely competitive market is characterized by:

1. a large number of buyers and sellers;
2. freedom of entry and exit;
3. perfect knowledge on the part of buyers and sellers; and
4. a homogeneous product.¹⁷

As each firm in a purely competitive situation acts in its own self-interest, it automatically attempts to maximize profits. If there is any discrepancy in profits between industries, then there will be movement of firms from less profitable industries toward the more profitable ones. In the more profitable industry, the emergence of new firms and, consequently, new channel members cause greater competition which reduces profits. In the less profitable industry, there is a decrease in competition and shifts in channel structure as firms leave. This change process will continue until profit levels in all industries prohibit further adjustments and equilibrium is attained. Finally, in perfect competition, prices are identical in equilibrium because of the perfect knowledge possessed by all participants. Thus, perfect competition results in stable prices which covers the cost of efficient operation, including interest on the capital employed, and an adequate return for managerial effort.¹⁸

Figure 2 illustrates purely competitive equilibrium.¹⁹

¹⁷ Ibid., p. 152.

¹⁸ Ibid., pp. 152-153.

¹⁹ Ibid., p. 152.

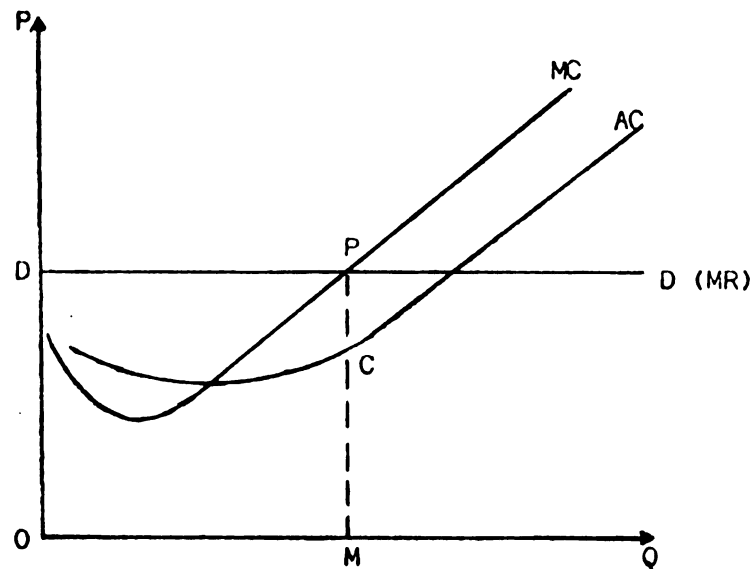


Figure 2. Equilibrium of the firm in perfect competition.

The assumption underpinning Figure 2 is that all firms sell one identical product. Economists hypothesize that initially as output increases both the total and the average costs of the production function will decrease (due to economies of scale) over a range of output and then will increase due to diseconomies of scale. This is the familiar U-shaped average cost curve. Each firm, because it has no impact on the market price, faces a horizontal demand curve DD; consequently, price is equal to OD.

Another concept illustrated is that of marginal cost of production (MC) and marginal transactional revenue (MR). Marginal cost is the increase in total cost incurred as a result of producing

an additional unit, and marginal revenue is the increase in total revenue derived from the sale of an additional unit. The individual channel member will attempt to realize a volume of participation where $MC = MR$. At that point, the quantity participation would be equal to OM.

Where $MC = MR$, profits to the firm will be maximized. To sell more than OM would reduce profits as the increase in costs would be greater than the increase in revenue from the sale. Neither would the firm wish to sell less than OM as profits could be increased by increasing sales as long as the extra revenue (MR) from the sale exceeded the extra cost (MC) of the sale. The profits of sales of OM would be $PC \times OM$ or the profit per unit times the number of units sold. If this level of profits is normal (high enough to keep businessmen in business but not high enough to attract new competitors), then no new firms would enter the industry. If these profits are abnormally high, then new competitors will be attracted to the industry causing an increase in selling costs (rent, wages, goods, etc.) or a reduction in the selling price which would in turn reduce profits.

Given this situation in the channel, each firm attempts to buy at the lowest possible cost and then sell at the market price a quantity equal to the point where the $MC = MR$. Any situation which would cause an increase in profits would be sought by the channel members.

Imperfect Competition

In pure competition, the individual firm is forced to sell at the market price as he has no market control or power. However, the

firm under conditions of imperfect competition may be able to influence the market and market price. Consequently, the demand curve for the firm in imperfect competition slopes down from the upper left to the lower right (see Figure 3).²⁰ Because of this, the marginal revenue curve will no longer correspond with the demand curve as it did under pure competition, and the concept of elasticity is thereby introduced.

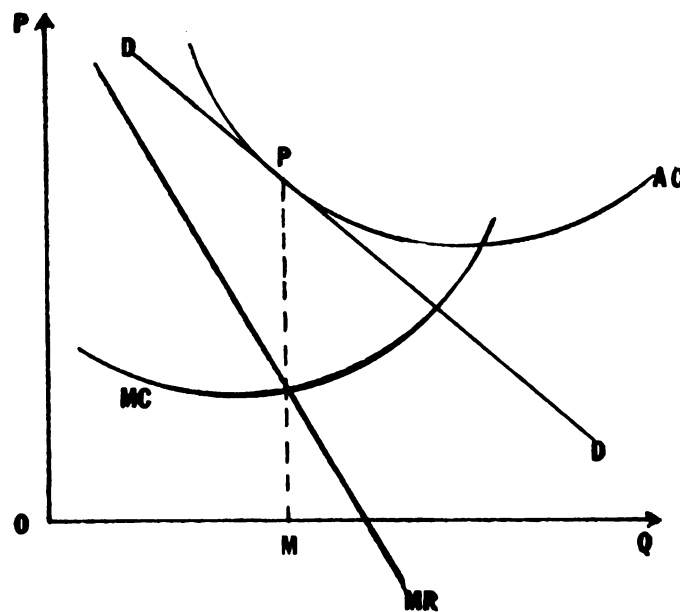


Figure 3. Equilibrium of the firm in imperfect competition.

The elasticity of demand can be defined in terms of changes in total revenue received by the firm. A demand curve is said to be elastic if the total revenue increases when the price is lowered or decreases when the price is raised. The demand curve is inelastic

²⁰ Ibid., p. 153.

if the total revenue decreases when the price is lowered or increases when the price is raised. A firm whose product has an elastic demand curve would thus want to reduce prices in order to increase both the quantity sold and revenue. However, if the firm's product has an inelastic demand curve, the firm would increase prices, reduce the quantity sold, and increase total revenue. This down sloping demand curve has other implications for the firm.

The demand curve DD in Figure 3 indicates that there is some element of monopoly power present. That is, there are differences either real or imaginary between products for which the consumer is willing to pay some premium. Unlike the situation in perfect competition which assumes homogeneous products, in imperfect competition, the product is heterogeneous. Thus, products are differentiated from each other in terms of style, performance, quality, features, and so on. Usually, a product has some distinguishing marks which make the brand sold by one firm different from that sold by a competitor.²¹ Consequently, there are very few markets where the product or product mix is homogeneous. In addition, it must be remembered that what a firm is really selling is the capacity to give the satisfaction, use, or profit desired by the customer. Thus, the product is more than just the sum of its physical characteristics. The total product includes any accessories needed, installation, delivery, instructions on use, the package, a brand name, and the assurance that service

²¹ Richard Caves, American Industry: Structure, Conduct, Performance, Vol. 2 (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1967), p. 18.

facilities will be available to meet the customers needs after the purchase.²²

The cost structure for the firm in imperfect competition can vary greatly. In Figure 3, we find both MC and AC declining as output increases, leveling off, and then increasing with higher output, thus forming the traditional U-shaped AC curve. However, L-shaped or continuously decreasing AC curves are possible. The AC curve for the firm is simply a composite of the AC curves for each of the activities that the firm undertakes. The average cost curves for each activity are derived and then added together to form the firm's average cost curve. Thus the shape of the firm's AC curve is a function of the shapes of the average cost curves of the activities which the firm performs.

Even with these variations from the purely competitive market, individual producers will still attempt to maximize their profits by equating MR and MC. Thus in Figure 3, the firm would set production at the point of intersection of MR and MC, producing an amount equal to OM and charging a price of PM. The profit generated by the firm is a normal profit as $AR = AC$. If the average cost curve fell below DD, then profit would be above normal and competitors would be attracted to the industry. Should the average cost curve lie above DD, then the firm would be forced to leave the industry or slowly go out of business. Firms will enter or leave the industry any time

²²Jerome E. McCarthy, Basic Marketing, Vol. 5 (Homewood, Ill.: Richard D. Irwin, Inc., 1971), p. 203.

profits deviate from the economists' conception of normal. This in turn stimulates change in the channel structure. As firms enter or leave the channel, new channel structures result and functions are allocated among channel participants.

Oligopoly

Oligopoly has been defined as a situation of a few sellers. "Few" means few enough so that a participant can keep a watch on the actions of his rivals and must consider their reactions to what he may do. Thus, independent action is not possible. Any action taken by one member of the oligopoly can have a substantial effect on the actions of the other members.

Fewness of sellers occurs under some very different circumstances. For example, it may arise where the capacity of each firm is large relative to the size of the market. This may be because the market itself is small (as in the case of a small town with only three appliance dealers) or if the market and the individual sellers are both large. The list of companies and industries which fall in this latter category would read like Who's Who of American Manufacturing. It would include the steel, automobile, aluminum, cigarette, sugar, distilling, tire, and appliance industries as well as many more.

These situations arise partly because of the economies of scale which exist in some industries. In industries using complex processes and large machine units, the optimum scale of the plant will be large. This effectively bars competitors from the industry because of the large amounts of capital necessary to begin production. Along with

the excessive capital requirements goes a great deal of risk, due to market and production uncertainties, which potential competitors may not be willing to assume. There may also be further economies in management when several firms can be merged under the control of a single management team.

Finally, the large oligopolist may be able to use this large size to his advantage. Size may make it easier to control the price of the product or may give the oligopolist bargaining advantages vis-a-vis his customers or suppliers.

The situation of a few sellers is more difficult to analyze than either that of pure competition or of monopoly. In pure competition, each producer tries to maximize his profits without considering the actions of his competitors. For the monopolist, there is no competitor to consider when making a decision. However, the oligopolist must ask himself not only, "What should I do?" but "What will the others do?" The answer to the second question may determine the answer to the first. This interdependence of action makes it difficult to predict the decisions of the oligopolist.

Competition: The Oligopoly Situation

In the earlier analysis of pure competition, it was demonstrated that the individual enterprise is forced to sell at the market price as the enterprise has no effect on the market. Raising the enterprise's price above the current market price would cause customers to patronize other firms in the industry thus reducing sales to zero. If, however, the producer lowers his price below the prevailing market

price, he loses again. He is already producing at maximum capacity; therefore, a reduction in price would only succeed in reducing total revenue as the quantity would remain fixed. The enterprise in an oligopoly, however, can have an impact on the market and on the market price.

Economic Model of Oligopoly

The demand curve facing a firm in an oligopoly is downsloping from left to right. The oligopolist, in Figure 4, is currently operating at E producing OQ units and charging a price equal to OP. Should he decide to change his price from OP, there are several possible outcomes. One is that all of his competitors will do just what he does, that is, raise prices when he does and lower them when he does. In this case, his demand curve will be represented by D_2D_4 . If all producers raise and lower their prices together, then each producer maintains his share of the market and the individual firm's demand curve has the same shape as the industry demand curve (assumes homogeneous products).

On the other hand if all sellers leave their prices unchanged when firm A changes price, then A's demand curve will be much more elastic and will resemble D_1D_3 . If A raises prices, the demand for its products will fall off drastically as all of its competitors would be selling at a lower price. Or if firm A lowers its price and the others do not, it will gain heavily in sales.

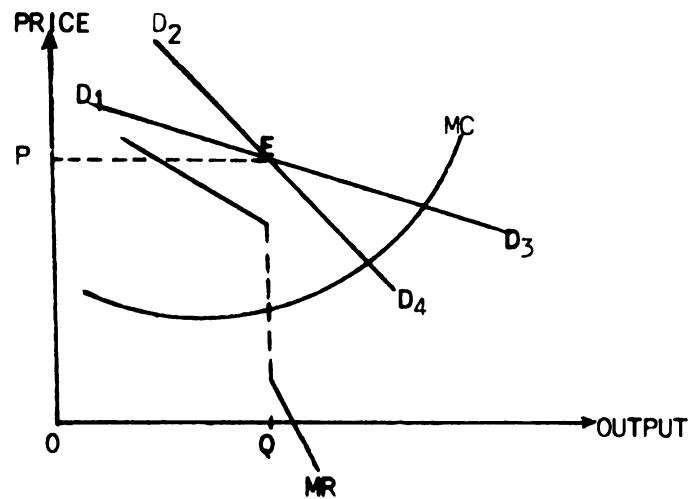


Figure 4. Kinked demand curve model.

Firm A may expect that its competitors will respond differently depending on the direction of the price change. That is a price increase may not be followed by the other firms while a price decrease would be immediately copied by the competition. Under these assumptions, the demand curve facing firm A takes on a different shape. It would now be D_1ED_4 . This is the familiar "kinked" demand curve of the oligopoly. The kink is caused by A's competitor's reaction to his price changes and would exist at the current price level.

The kink in the demand, or average revenue curve, causes a break in the marginal revenue curve (MR). If A cuts price and the others follow, then marginal revenue drops to a much lower level. Finally, a typical U-shaped marginal cost curve (MC) is assumed.

If the MC and the MR curves intersect in the vertical break of the MR curve, then the firm would be producing the optimal output at the most profitable price. In addition, if the vertical break in MR is great, there is little incentive to change price or output even if costs change substantially. MC can move upward to H or downward to L without upsetting the price or quantity supplied.

However, the price of a product in an oligopoly cannot be determined from a diagram for one seller alone. In an oligopoly, any seller can veto the price by selling at a lower price. Consequently, the industry price is the one that everyone finds is in their own best interest to observe.

Classical economic theory attempts to predict the competitive reactions of firms in an oligopoly by studying their pricing behavior. The assumptions that are made in this analysis unfortunately move the economic model further and further away from competitive reality.

Differentiated and Homogeneous Products

There are of course other factors which make an oligopoly competitive. Price is not the only competitive decision facing a manager in an oligopoly situation. Oligopolies can either sell a homogeneous or a differentiated product. In the former, the products are identical and will normally sell at the same price. Many industrial products such as steel, lead, zinc, aluminum, copper, and cement are virtually standardized products in the physical sense and are produced in oligopolies. In a differentiated oligopoly, this is not necessarily true. There are differences between differentiated products, either

real or imagined, which alter the shape of the demand curve facing the firm. Many consumer goods like automobiles, tires, petroleum products, soap, and appliances are differentiated and, consequently, prices within the oligopoly will vary.

Other Factors of Competition

Chamberlin has suggested that a firm in an oligopoly situation can do other things besides change price to affect its rate of sales. It can (1) differentiate its product or (2) change its advertising and promotional expenditures.²³

Product Differentiation

A general class of product is differentiated, Chamberlin states, "If any significant basis exists for distinguishing the goods (or services) of one seller from another."²⁴ Thus in a differentiated oligopoly, and to a lesser extent in an undifferentiated one, there are other factors which must be considered when studying competition in the industry. Even though an industry may offer identical physical goods, there are differences that do exist.

The basis for differentiation may either be real or psychological as long as it is of importance to the buyer and leads to a preference of one product over another. When such differences exist, buyers and sellers will be paired not by random chance but rather by

²³ Edward Chamberlin, The Theory of Monopolistic Competition (Cambridge, Mass.: Harvard University Press, 1933).

²⁴ Ibid., p. 56.

choice. With a differentiated product, buyers have an opportunity to express their preferences for one product over another.²⁵

Differentiation may be based on characteristics of the product itself, "such as exclusive patented features; trademarks; trade names; peculiarities of the package or container, if any; or singularity in quality, design, color, or style."²⁶ Sellers can alter the terms of sale, service, credit, speed of delivery, convenience of the sellers' location, the general tone or character of the establishment, the way of doing business, courtesy, efficiency, and all the personal links which attach customers to the product or seller. To the extent that these factors vary from seller to seller, the product in each case is different, because buyers take them into account, more or less, and purchase them along with the commodity.²⁷

The problem of product adjustment is imposed on the seller of a differentiated product. The volume of his sales depends in part on the manner in which his product differs from that of his competitor's. In some cases, these changes can be specific and definite, such as the adoption of a new design; while in others, like a change in the quality of service, it may be gradual or even unconscious. Each change, however, will have varying degrees of impact, either positive or negative, on the level of sales and profits of the seller.

²⁵ Ibid., p. 56.

²⁶ Ibid., p. 56.

²⁷ Ibid., p. 56.

Unlike changes in price, changes in product ordinarily involve changes in the cost of production. Changes in quality, design, or technology alter the cost of producing the product. In addition, they also alter the demand curve for the product. Figure 5 demonstrates a simplified case of only two varieties of product A and B with a fixed price of OP . The cost curve for product A is AA' with demand OG at a price of OP . The total profits of this product are $PMRC$ and the total cost is equal to $OGRC$. For product B, the total cost curve is BB' . The amount demanded at price OP is OH . The profit is $DQNP$ and total cost is $OHQD$. By comparing these two possibilities, it is clear that the profit generated by producing and selling OH quantity of product B is greater than selling OG quantity of product A. A similar analysis could be conducted for all the variations in product so that the seller could select the one product which seems most advantageous to him.

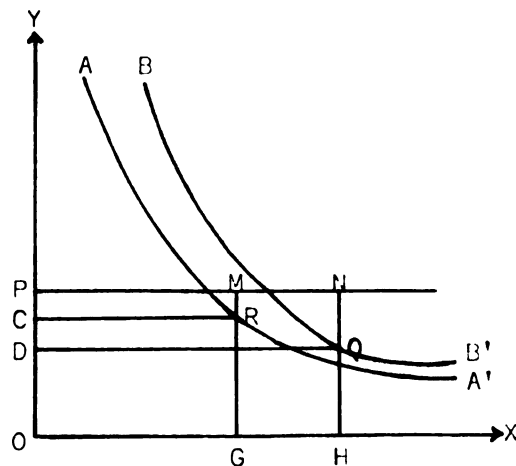


Figure 5. Changes in cost of production.

It should be remembered that the product selected might not necessarily be the one with the lowest cost curve or the highest demand. In addition, it should also be noted that production of the product bears no relation to the most efficient scale of production, identified by the lowest point on the cost curve of production.

Selling Costs

Selling costs are defined by Chamberlin as "costs incurred in order to alter the position or shape of the demand curve for a product." As such, they include "advertising of all types, salesmen's salaries, and the expenses of sales departments, margins granted to dealers (retail or wholesale) in order to increase their efforts in favor of particular goods, window displays, demonstrations of new goods, etc."²⁸

Advertising expenses are typical of these selling costs, and so the analysis of the effects of selling costs will concentrate on advertising. The shift in the demand curve for a product due to advertising is attributable to two factors: (1) imperfect knowledge and (2) the possibility of altering people's wants.²⁹

Lack of knowledge is a problem that faces many consumers. They often do not know or are only vaguely familiar with products they don't purchase. They are ignorant of comparative prices and quality of competing goods from different merchants. Advertising

²⁸ Ibid., p. 117.

²⁹ Ibid., p. 118.

increases a seller's market by spreading information on the product which buyers can use in making their choices. This, in effect, causes a change in the shape or location of the seller's demand curve. The shape of the demand curve will primarily be affected when the seller is engaged in price competition. The seller will increase his sales by making more consumers aware of his offer.

By reaching a larger number of buyers through advertising, the seller makes the demand for his product more elastic. At the lower price, the seller increases his sales, not only by the limited amount possible if only regular customers know of it, but by a larger amount depending upon the size of the advertising expense and the skill with which it is applied.

Advertising affects demand in another way, by altering the consumer's wants. Advertisements which merely display the name of a particular product may convey no information; yet if the name becomes familiar to purchasers, they are led to request it in preference to unadvertised brands. Similarly, advertisements, which play upon the emotions of the purchaser and use the theories of psychology to induce purchasing behavior by restructuring the motives of the buyer, add little to the buyer's knowledge. However, this type of advertising does cause a shift to the right of the product's demand curve, resulting in a higher demand at the current price. Because of this, the demand for other competing products is diminished.³⁰

³⁰ Ibid., p. 119.

In addition to promoting the product to the final consumer, the seller must also convince middlemen to carry the product. The dealer cannot stock everything and, just as the consumer tries to apportion his income to maximize his satisfaction, the dealer tries to allocate his capital and facilities so as to maximize his profits. He must be convinced that the product is going to succeed, and this may require all the selling that is so necessary with the consumers.

Thus, the manufacturer is faced with a dual promotional problem. He must promote his product to the final consumer as well as secure the desired aggressiveness of the middlemen. The former can generally be accomplished through good advertising. Chamberlin suggests that the latter may be achieved by: (1) providing higher margins to middlemen; (2) granting exclusive distribution territories; or (3) ownership by the manufacturer of the distribution outlets.

The complexity of the channel is increased by the fact that consumers and channel members are spread over space and costs of transport either for the consumer to visit the channel member or for the channel member to deliver the goods will be different for each customer. Numerous models have been proposed to explain the location of producers and the effect that location and transportation costs have on the prices the firm charges.³¹ Because of the cost of

³¹Harold Hotelling, "Stability in Competition," Economic Journal 39 (1929): 41-57. See also Melvin L. Greenhut, Plant Location in Theory and Practice (Chapel Hill: The University of North Carolina Press, 1956); A. Cournot, Recherches sur les Principes Mathematiques de la Theorie des Richesses (Paris: Hechetti, 1838); Arthur Smithies, "Optimum Location in Spatial Competition," Journal of Political Economy, June 1941; and Nicos E. Devietoglau, "A Dissenting View of Duopoly and Spatial Competiton," Economica, May 1965, pp. 140-160.

transportation, the further a product must be shipped from its point of manufacture the higher will be its price. Consequently, it becomes difficult for a firm to compete in distant markets because of the cost disadvantages. However, the spatial separation of products causes them to become differentiated from one another. Pure competition cannot exist under these circumstances. Thus, any industry that competes over space will result in a "chain oligopoly" and produce a differentiated product. In addition to spatial separation, other factors affect the economic situation in the channel.

The Channel as an Economic Organization

From an economic viewpoint, a more comprehensive analysis must be of firms entering a market. It cannot be assumed that barriers to entry will be limited only by profit potential. A new retailer or wholesaler is logically expected to evaluate the fact that entry into the market will require the firms to share available profits. The lack of adequate profit potential does serve as a barrier to entry for new firms in the channel.³² However, Caves has identified other barriers to entry. They are: scale economies, absolute cost disadvantages, and product differentiation.³³ Each of these retard change in the channel by reducing the number of potential entrants. Stigler, Coase, Heflebower, and Mallen have constructed models which attempt to explain and predict channel evolution.

³²Hall, "Economic Analysis of Retail Trade," p. 153.

³³Caves, American Industry, pp. 22-29.

Stigler suggested that the functions which the firm performs can be represented by different shaped average cost curves (see Figure 6).³⁴ Some of them would fall continuously with increased output (F1), while others would rise continuously (F2), and still others would follow the typical U-shaped average cost curve (F3).³⁵ These average cost curves for each function can then be aggregated into a company average cost curve (AC). The firm, if it wished to minimize costs, would logically produce at the lowest point on the average cost curve. At this point, economies may still be gained in decreasing cost functions if output is increased. However, the existing firm would not expand output because there are other functions subject to decreasing returns. Thus, if the firm increased output, it would increase average costs. Stigler suggests that at this point the channel is ideal for entry of an innovator. A new firm, specializing in a marketing function with a decreasing cost curve can aggregate the requirements of its clients and supply the activity at a lower cost.

The abandonment of a function by the original firm will have an effect on the cost curves of the firm. The cost curve for F1 would be replaced by a horizontal line at the price charged by the new firm. This would cause a shift in the original firm's average cost curve (see broken line in Figure 6). In addition, there may be shifts in

³⁴ George J. Stigler, "The Division of Labor Is Limited by the Extent of the Market," Marketing Channels: A Systems Viewpoint, eds. William Moller and David Wilemon (Homewood, Ill.: Richard D. Irwin, Inc., 1971), pp. 29-31.

³⁵ Ibid., p. 30.

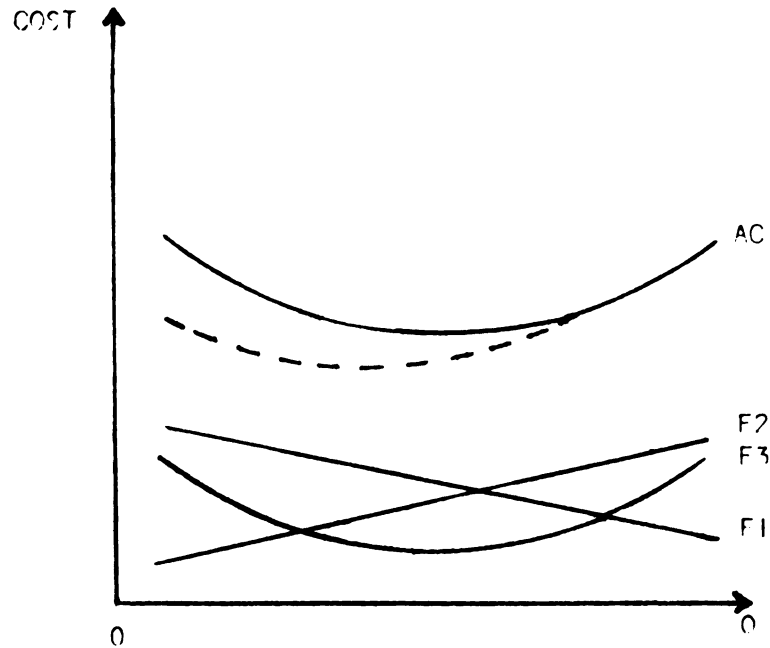


Figure 6. Total average cost curves.

cost curves F2 and F3. If functions F1, F2, and F3 rival each other for the resources of the firm, which is true in many cases, then the abandonment of a function will make additional resources available for performance of the other functions. The minimum point on the AC curve may be at an even higher output. Consequently, the firm will increase its output of the final product when it abandons a function.

Finally, as the client firm gets larger, it may once again pay them to perform the function themselves as their average costs for this activity will be less than the price they must pay the functional specialist. In the case of a rising functional cost curve, economies

could be gained when a larger firm delegates this function to a small specialist.³⁶

Mallen with his concept of functional spin-off has added to Stigler's work in two important areas: (1) he presents a detailed discussion of both the U and L-shaped functional average cost curves and (2) he defines more closely the areas where structural change may occur.

Mallen suggests that there may be other reasons why the firm would retake a previously delegated function. The firm faced with the typical U-shaped average cost curve (see Figure 7)³⁷ would find it beneficial to spin off the function to a larger middleman at a quantity between 0 and Q_1 . The middleman could aggregate the requirements of a number of manufacturers and supply the function at a quantity consistent with a lower average cost. At a quantity between Q_1 and Q_2 , it would make little difference who performs the function as the economies are the same. However, after a volume of Q_2 , it would benefit the producer to resume the performance of the function unless the middlemen split themselves up and formed smaller firms.

Mallen also introduced the possibility that the same function may have a different cost curve in different channels. He illustrates his point with the L-shaped functional cost curve (see Figure 8).³⁸

³⁶ Ibid., pp. 27-38.

³⁷ Mallen, "Functional Spin-Off," p. 21.

³⁸ Ibid., p. 22.

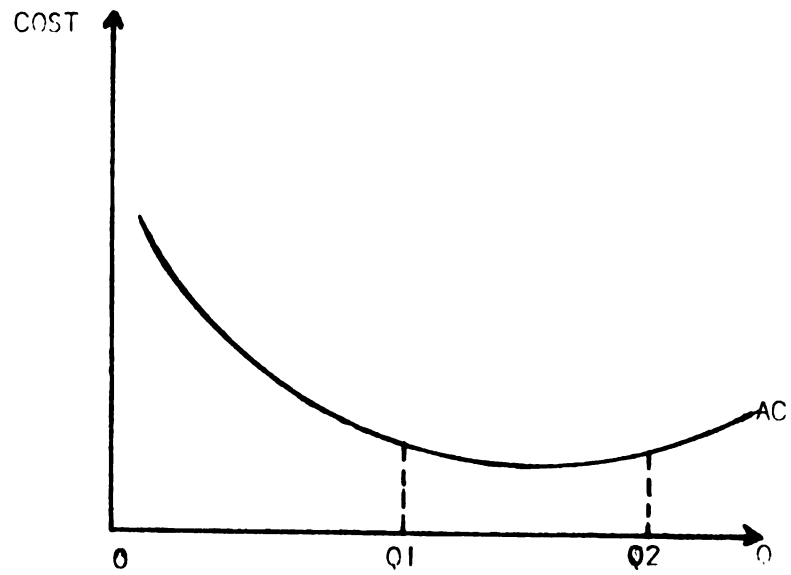


Figure 7. Effect of U-shaped average cost curve on the performance of a function.

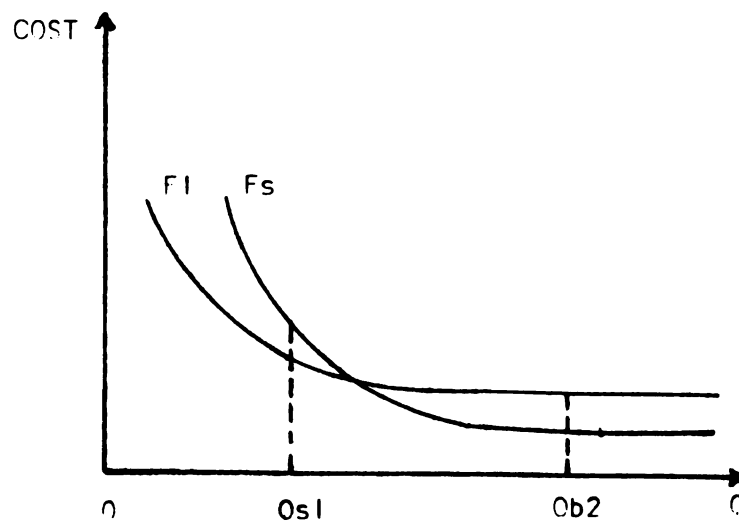


Figure 8. Effect of L-shaped average cost curve on distribution in different channels.

F_l is the average cost curve of a given function for a manufacturer marketing to large retailers while F_s is the average cost curve of the same function when the manufacturer markets to small retailers. For example, if the manufacturer were selling a quantity O_{b2} to large retailers and O_{s1} to small retailers, then lower average costs could be attained by selling at higher volumes to the small retailers. Thus, it makes sense for the producer to spin off this function to middlemen who could aggregate the needs of a number of producers and perform the function at a lower average cost. At O_{b2}, no further economies are possible, and consequently, nothing is gained by spinning off this function (f_l). Thus, it is possible to explain why two different channels could exist in the marketing of the same product. Mallen, like Stigler, suggests that through the analysis of functional average cost curves the marketer may better predict when and where innovation will occur in the channel.

Through the use of functional analysis, Mallen suggests that there are several dimensions of channel structure where change may occur. These dimensions include:

1. The number of channel levels.
2. The number of channels or whether one, two (dual), or more (multi) channel types will be used.
3. The types of middlemen that will evolve.
4. The number of middlemen that will develop at each level.³⁹

³⁹ Ibid., p. 19.

With regard to the number of levels in the distribution channel, Mallen has suggested that:

1. Firms with a downsloping functional average cost curve will spin off these functions. If this situation is typical of most firms in the industry, then intermediaries will become characteristic in the industry.
2. If continual economies exist, middlemen will become bigger and bigger.
3. Producers will perform the marketing function if their costs are equal or less than the middleman's.
4. Intermediaries will spin off functions to more specialized firms if the more specialized intermediaries can perform it more efficiently.

With regard to the number of channels:

5. If a producer finds it economical to spin off functions only in certain markets, then he will do so and retain these functions in other markets where it is economical to do so.

As related to middleman types:

6. If marketing intermediaries characterize an industry, their nature will be determined by the mix of functions spun off.

As related to the number of middlemen:

7. The greater the market size in relation to the optimum firm size the greater the number of middlemen in the channel.
8. Any change in technology which increases the optimum size of the middleman will cause a reduction of the number of middlemen in the channel.⁴⁰

The cost-oriented models of both Stigler and Mallen, with their heavy emphasis on functional costs and external economies, can provide a potential conceptual base for decision making. Their models also

⁴⁰ Ibid., p. 24.

help explain current interfirm alignments and aid in predicting the changes in channel structure which are likely to occur due to changes in functional costs.

Coase has taken a position similar to Stigler's and Mallen's. Coase relies on cost data to explain managerial decisions and contends that a firm will perform functions if it can do so at an internal cost that is lower than the current market prices and will use outside suppliers if the firm's internal costs are greater than current market prices. Thus, middlemen exist because they can perform functions at a lower cost per unit than the producer. Stigler and Mallen also suggest that these external economies are the most serviceable basis for explaining interfirm alignments and may also shed some light on channel decision making.⁴¹

Bucklin takes a similar approach when studying channel relationships.⁴² His analysis, like Stigler's, Mallen's, and Coase's, begins with an identification of the functions performed in the marketing channel. Bucklin has identified the following functions: transit, inventory, search, persuasion, and production. He then describes the members of the channel in terms of the functions they perform. After describing the channel, he then proceeds to develop an average cost curve for each of the functions performed by the firm. He assumes that the average cost curves for each function is U-shaped

⁴¹R. H. Coase, "The Nature of the Firm," Economica, New Series, November 1937, pp. 386-405.

⁴²Bucklin, "Economic Structure of Channels," pp. 63-66.

and that the average cost curve for the firm can be obtained by aggregating the costs associated with each function. Besides providing a basis for analysis of the cost volume relationships in the channel, he also suggests a framework for explaining and predicting the changes in interorganizational relations in the channel.

Bucklin uses the term "normative channel" to describe the ideal channel. This channel is the one that best fits the economic conditions expected to prevail in the future. He then compares the normative channel with the extant channel (the one currently in existence) to determine what changes are likely to occur. "Bucklin's analysis differs from Stigler's and Mallen's in two important respects. First, he focuses more specifically on the marketing implications of functional cost analysis than does Stigler or Mallen; and second, he is more explicit in his treatment of demand analysis as a basis for explaining the firm's behavior."⁴³ While Stigler and Mallen focus on the interfirm changes that are caused by an increase in demand, Bucklin analyzes the interfirm alignments that may occur in six different and progressively more complex environments. They are "perfect competition, pure competition, monopolistic competition caused by spatial differentiation, monopolistic competition caused by product differentiation, and oligopoly."⁴⁴ Bucklin thus provides a basis for determining changes

⁴³Bert C. McCammon, Jr., and Robert W. Little, "Marketing Channels: Analytical Systems and Approaches," Science in Marketing, ed. George Schwartz (New York: John Wiley and Sons, Inc., 1965), p. 340.

⁴⁴Bucklin, "Economic Structure of Channels," p. 65.

in existing channel structure given cost, demand, and competitive data.

Still other theories have a different explanation for the change in channel institutions. Cycle theories of change are based on the premise that a rhythm of change is present in the evolution of channel institutions.⁴⁵ There are two major cycle theories: the wheel theory and the institutional life cycle. Perhaps the best known is the wheel theory. The wheel theory depicts the institution as evolving from a low price, low margin, low status operation. Then, the institution gradually begins to add services and improve facilities causing higher operating costs. Finally, it evolves into a high priced, high margin, high status institution which becomes vulnerable to competition from low price, low margin, low status competitors.⁴⁶

Several explanations for the wheel theory have been proposed. They include: (1) retail personalities (founder is highly aggressive cost cutter but later managers are not); (2) misguidance (advertising has induced merchants to add superfluous modernization); (3) imperfect competition (this causes merchants to differentiate product by increasing service rather than competing on the basis of price); (4) excess capacity (this ties rising margins to increases in excess capacity); (5) secular trend (as consumer incomes increase, they demand more

⁴⁵ Ronald R. Gist, Marketing and Society (New York: Holt, Rinehart, and Winston, Inc., 1971), p. 364.

⁴⁶ Malcomb P. McNair, "Significant Trends and Developments in the Postwar Period," ed. A. B. Smith, Competitive Distribution in a Free High Level Economy and Its Implications for the University (Pittsburgh, Pa.: University of Pittsburgh Press, 1958), pp. 17-18.

services thus increasing dealer margins); and (5) illusion (the increased margins are caused by changing product mix). Even though several explanations of the wheel theory have been advanced, there are numerous exceptions. This has caused Hollander and others to question its validity.⁴⁷

Another cycle theory is the institutional life cycle. This theory contends that institutions move through a life cycle similar to the familiar product life cycle. The institutional life cycle has four stages. They are: (1) innovation, (2) accelerated development, (3) maturity, and (4) decline.⁴⁸

The innovation stage is characterized by rapidly increasing sales. However, profits lag behind because of high start-up costs and/or problems of achieving economies of scale. Accelerated development is characterized by rapidly increasing sales and profits. The third stage, maturity, is a period of moderate to slow growth in sales and low profitability. Finally, decline is characterized by slow-to-negative sales growth and low profitability.

It is also possible to view institutional change in the channel as a dialectic process in which there is a thesis (established institution), an antithesis (the innovative institution), and a synthesis (a new form drawing its attributes from the other two).⁴⁹

⁴⁷ Stanley C. Hollander, "The Wheel of Retailing," Journal of Marketing 24 (July 1960): 37-42.

⁴⁸ William R. Davidson, Albert D. Bates, and Stephen J. Bass, "The Retail Life Cycle," Harvard Business Review, November-December 1976, pp. 89-96.

⁴⁹ Gist, Marketing and Society, pp. 370-372.

Through this process, existing channel participants can be seen as changing their attributes to conform more closely with a new innovative competitor. In addition, the emergence of a new form of dealer can be viewed as the result of the synthesis of two old competitors.

The economic analysis of the channel is based primarily on the development and analysis of functional average cost curves. However, because of the difficulties involved, relatively few empirical studies of cost behavior have been undertaken.⁵⁰ The absence of empirical studies is particularly noticeable in the fields of retailing and wholesaling. The work done by Dean and subsequent studies undertaken by Douglas, Bass, and Bellamy, among others, constitutes the extent of the literature. All these studies are concerned with cost relations at the firm level rather than the functional level.⁵¹ In addition, McCammon and Little suggest that the assumptions that are made in the analysis of cost curves are invalid and rarely occur in real life. Some of these assumptions are: (1) that the product is homogeneous at each successive level of output, (2) that the nature of the output can be defined rigorously, (3) that plant capacity can be measured precisely, and (4) that most of the costs incurred by the firm are production rather than selling costs.⁵² It would appear that the economist has provided us with a

⁵⁰ McCammon, "Marketing Channels," p. 341.

⁵¹ Ibid., p. 340.

⁵² Ibid., p. 341.

convenient conceptual approach for explaining and predicting the nature of interfirm relations rather than a decision-making framework for a channel manager.

The Behavioral Approach

One may conclude that channel relationships are predominately economic. However, Boulding points out "that no sharp line divides the economic from the noneconomic organization, or even the economic from the noneconomic aspect of a single organization."⁵³ Parsons and Smelser have observed that economics defines parameters for the problems it studies by the assumptions it makes. These assumptions may be unrealistic and frequently force analysts of the channel to concentrate myopically on the economic variables of the system. The specifically economic aspect of social system theory is a subsystem of a more general theory of the social system. Thus, clarification of the position of economics relative to other special cases is necessary in order to locate it in relation to other theories. The basic variables operative in all the special cases are the variables of a more general theory. The distinction between economic and other theories is not in the variables employed but rather in the parameters which they define for themselves.⁵⁴ Thus, an economic analysis of the channel is also a

⁵³ Kenneth E. Boulding, The Organizational Revolution (Chicago: Quadrangle Books, 1953), p. 5.

⁵⁴ Talcott Parsons and Neil J. Smelser, Economy and Society: A Study in the Integration of Economic and Social Theory (New York: The Free Press, 1956), p. 6.

social analysis because the basic variables are social ones. Channels of distribution are a complex of interacting subsystems. They include elaborate economic, political, and social systems with many decision makers spread over a wide geographic area. The following analysis will concentrate on channels as political and social systems.

Channels as Political Systems

McCammon and Little have suggested that the channel is a political system in three ways.

First, some or all of its participants may achieve a high degree of group solidarity so that they bargain with other social systems on a collective as well as individual basis. Second, the marketing channel is a political system because the participants strive to control the behavior of other members. Finally, a channel is a power entity because the participants constantly bargain for favorable terms of trade--a process that involves strategy, bluff, subterfuge, and other political devices.⁵⁵

Palamountain has suggested that the very errors of classical economic analysis best reveal the role of politics. He isolates three; they are: first, economists grossly minimize the need for rules of business conduct; second, that organization and grouping of individuals in order to achieve an increase in economic rewards necessarily creates power; finally, conditions of mutual dependency, with concomitant power relations, limit the market mechanism.⁵⁶ Consequently, the ability of a firm to make decisions in the channel is related to the power that firm possesses vis-a-vis the other channel members.

⁵⁵ McCammon, "Marketing Channels," pp. 343-344.

⁵⁶ Joseph Cornwall Palamountain, The Politics of Distribution (Cambridge, Mass.: Harvard University Press, 1955), p. 116.

"To the extent that distribution channels are imperfect, participants possess power. Organization, which is usually the basis of dynamic and creative marketing changes, breeds more power. And organization tends to induce counter-organization and yet more power."⁵⁷ Palamountain suggests that the power or a change agent, which usually derives from large scale organization, may enable him to introduce almost explosively creative improvements in product or service.⁵⁸

Joseph Schumpeter was the first to argue that rapid technological change requires some degree of monopoly power. He felt that the fundamental impulse of economic progress was creative destruction in which old forms of organization and production are destroyed in the creation of new ones and that competition based on price was of little consequence. The competition from the new commodity, the new technology, the new source of supply, the new type of organization--competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of existing firms but at their foundations and very lives."⁵⁹ This is the basic force which makes the economic system competitive. This innovative competition can then be seen as the driving force of channel competition. In order to bring about these massive changes, Schumpeter felt that some degree of monopoly power was necessary to protect the innovating firms.

⁵⁷ Ibid., p. 254.

⁵⁸ Ibid., p. 260.

⁵⁹ Joseph Schumpeter, Capitalism, Socialism, and Democracy (New York: Harper and Brothers, 1947), p. 84.

Caves points out that highly competitive industries with little concentration rarely support extensive research and development and hardly ever alter existing structure.⁶⁰ This tends to be supported by the work of Wittreich,⁶¹ Kriesberg,⁶² Vidich and Bensman.⁶³ They have pointed out that small resellers have relatively static expectations, are not interested in growth, and are motivated by a strong desire for security. In addition, since small resellers tend to align themselves with large manufacturers, it is the large manufacturer who will typically make the channel decisions.

However, there are pressures on the large firm to maintain the status quo. Established firms, even within young and progressive industries, are frequently backward about radically new changes.⁶⁴ However, these pressures can be overcome through the underwriting of elite activities. Stinchcombe⁶⁵ and Hill and Harbison⁶⁶ have studied the relationship between organizational change and the number of elite or staff personnel employed. Their findings indicate that firms or

⁶⁰Caves, American Industry, p. 102.

⁶¹Warren J. Wittreich, "Misunderstanding the Retailer," Harvard Business Review, May-June 1962, pp. 147-155.

⁶²Louis Kriesberg, "The Retail Furrier: Concepts of Security and Success," American Journal of Sociology, March 1952, pp. 478-485.

⁶³Arthur J. Vidich and Joseph Bensman, Small Town in Mass Society (Garden City, N.Y.: Doubleday, 1960), pp. 73 and 91-93.

⁶⁴Caves, American Industry, p. 103.

⁶⁵Arthur L. Stinchcombe, "The Sociology or Organization and the Theory of the Firm," The Pacific Sociological Review, Fall 1960, pp. 75-82.

⁶⁶Samuel E. Hill and Frederick Harbison, Manpower and Innovation in American Industry (Princeton University Press, 1959), pp. 16-27.

industries with a high ratio of professional personnel to proprietors and managers are more likely to make decisions which call for substantial change in organizational policy.

Channels as Social Systems

The analysis of the channel must by its nature take into account the actors in this social system. A social system is "a system generated by any process of interaction, on the sociocultural level, between two or more actors. The actor is either a concrete human individual (a person) or a collectivity of which a plurality of persons are members."⁶⁷ The individual firms of the channel are each a collectivity; and consequently, the interaction between these actors (collectivities) constitutes a social system.

Channel Conflict

The need for cooperation within the channel is evident for without some level of cooperation distribution could not be accomplished. It would appear that there are different forms of conflict that can exist in the channel which tend to disrupt this cooperation.

They are:

1. Horizontal competition: This is competition between middlemen of the same type; for example, department store versus department store.
2. Intertype competition: This is competition between middlemen of different types in the same channel sector; for example, department store versus mass merchandiser.

⁶⁷Parsons, Economy and Society, p. 8.

3. Vertical conflict: This is conflict between channel members of different levels; for example, department store versus manufacturer.⁶⁸
4. Systems competition: This is competition between different yet competing vertical market systems; for example, the entire channel of one manufacturer competes with the entire channel of another manufacturer.

In addition, much work has been done lately on conflict in the channel of distribution. Some authors have confined themselves to a general or empirical discussion of the causes and outcomes of conflict situations⁶⁹ while others have endeavored to construct models of conflict in the channel.⁷⁰

Stern and Gorman view channel conflict as an ongoing process and related closely to change. Conflict can be viewed as a process of two broad classes on change: (1) a change that precipitates the conflict relationship and (2) a change in response to conflict which

⁶⁸ Palamountain, Politics of Distribution, p. 50.

⁶⁹ Ibid. See also Wroe Alderson, "Cooperation and Conflict in Marketing Channels," Distribution Channels: Behavioral Dimensions, ed. Louis W. Stern (Boston: Houghton Mifflin Co., 1969); and Henry Assail, "The Political Role of Trade Associations in Distributive Conflict Resolution," Distribution Channels: Behavioral Dimensions ed. Louis W. Stern (Boston: Houghton Mifflin Co., 1969).

⁷⁰ Bruce Mallen, "Conflict and Cooperation in Marketing Channels," The Marketing Channel a Conceptual Viewpoint, ed. Bruce Mallen (New York: John Wiley and Sons, Inc., 1967), pp. 124-134; Bert Rosenbloom, "Conflict and Channel Efficiency: Some Conceptual Models for the Decision Maker," Journal of Marketing 37 (July 1973): 26-30; Larry J. Rosenberg and Louis W. Stern, "Toward the Analysis of Conflict in Distribution Channels: A Descriptive Model," Journal of Marketing 34 (October 1970): 40-46; and Bruce Mallen, "A Theory of Retailer-Supplier Conflict," Distribution Channels: Behavioral Dimensions, ed. Louis W. Stern (Boston: Houghton Mifflin Co., 1969).

either leads to resolution or to system disintegration.⁷¹ Thus, a change in the channel can both cause and be the outcome of conflict.

Because the components of the channel are interdependent, the behavior of one component has implications for the level of satisfaction achieved by the other components.⁷² Conflict is thus the outcome of the inherent dependency that exists in the system. It arises when one member impedes the aims of another. This dependency is expressed as conflict when there are "(1) incompatibility of goals among members; (2) differences in perceptions of reality which call forth conflicting solutions to the same problems during the suboptimizing process within the system."⁷³ Once a conflict situation exists, it may have an effect on behavior of the system components.

Rosenbloom⁷⁴ suggests that channel conflict can have a significant impact on the level of channel efficiency and, thus, the ability of the channel to meet system competition. He maintains that conflict within the channel can have varying effects. It can lead to: increased efficiency, decreased efficiency, or have no effect on the efficiency of the channel. Based on these assumptions, he developed

⁷¹ Louis W. Stern and Ronald H. Gorman, "Conflict in Distribution Channels: An Exploration," Distribution Channels; Behavioral Dimensions, ed. Louis W. Stern (Boston: Houghton Mifflin Co., 1969), p. 157.

⁷² Louis W. Stern and J. L. Heskett, "Conflict Management in Interorganization Relations: A Conceptual Framework," Distribution Channels; Behavioral Dimensions, ed. Louis W. Stern (Boston: Houghton Mifflin Co., 1969).

⁷³ Ibid., p. 293.

⁷⁴ Rosenbloom, "Conflict and Channel Efficiency."

a general model of the relationship between the level of channel conflict and channel efficiency (see Figure 9).⁷⁵ His model suggests that a level of tolerance exists between 0 and C where there would be no change in channel efficiency as the level of conflict increases. From C to C1 any increase in the level of conflict would cause an increase in channel efficiency. When the level of channel conflict reaches C1, channel efficiency has reached its peak. Beyond C1, increased levels of channel conflict lead to decreases in channel efficiency. Finally, there may be a level of conflict which leads to anarchy C2. At that point, there is a high probability that the conflicting dynamics of the channel will destroy it, thus reducing efficiency to 0. These overt reactions to conflict can be classified into two broad categories: (1) intraorganizational change and (2) the exercise of power.⁷⁶

A useful model for describing the intraorganizational change process is the crisis change model.⁷⁷ This model isolates four distinct phases that an organizational system passes through as it adapts to crisis situations. These stages are:

1. Shock: Occurs when channel members become aware of a threat to their survival.
2. Defensive Retreat: The channel member mobilizes its forces to reduce the threat typically relying on stopgap measures.

⁷⁵ Ibid., p. 29.

⁷⁶ Stern, "Conflict in Distribution Channels," p. 161.

⁷⁷ Stephen L. Fink, Joel Beak, Kenneth Taddeo, "Organizational Crisis and Change," Journal of Applied Behavioral Science 1 (January-February 1971): 15-37.

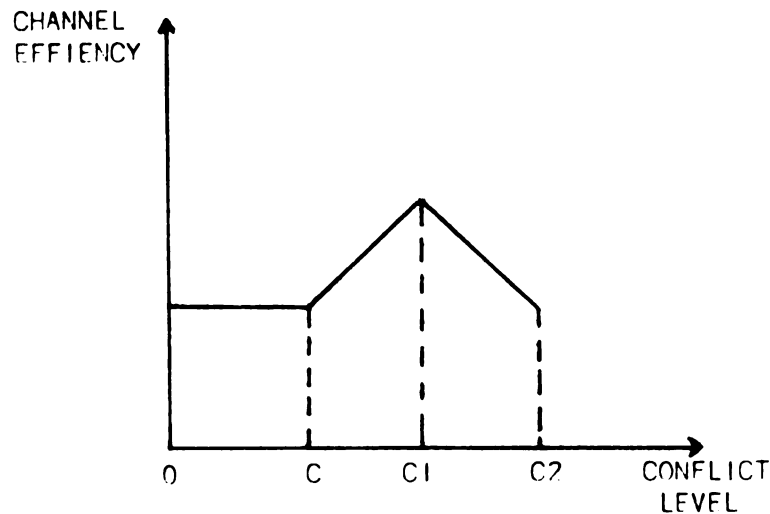


Figure 9. Rosenbloom model of channel conflict.

3. Acknowledgment: The channel member engages in a period of self-examination.
4. Adoption and Change: The channel member is able to effectively cope with the situation and change leads to renewed growth.

Power of the Channel

The impact, use, and management of power in the channel has been the subject of a number of authors.⁷⁸ Beier and Stern suggest

⁷⁸Frederick J. Beier and Louis W. Stern, "Power in the Channel of Distribution," Distribution Channels; Behavioral Dimensions, ed. Louis Stern (Boston: Houghton Mifflin Co., 1969); Louis P. Bucklin, "The Locus of Channel Control," Marketing Channels and Institutions: Readings on Distribution Concepts and Practices, eds. Bruce Walker and Joel Haynes (Columbus: Grid, Inc., 1973), pp. 171-182; Michael Etgar, "Channel Domination and Countervailing Power," Journal of Marketing Research 13 (August 1976): 254-262; John K. Galbraith, "The Concept of Countervailing Power," The Marketing Channel A Conceptual Viewpoint, ed. Bruce Mallen (New York: John Wiley and Sons, Inc., 1967), pp. 119-123; Shelby Hunt and John A. Nevin, "Power in Channels of Distribution:

that within the channel, power finds its base in the following areas: rewards, coercion, expertise, legitimacy, and identification.⁷⁹ In addition, in a monopolistically competitive market, the degree of power of the producer is closely related to the producer's ability to differentiate his product. While in an oligopolistic market, which may or may not have a differentiated product, power is generated primarily from (1) the small number of firms and (2) the barriers to entry.⁸⁰

A channel member seeking to increase his control over other members of the channel must increase his power by building upon one of these bases. However, Galbraith has theorized that:

private economic power is held in check by the countervailing power of those who are subject to it. The first begets the second. The long trend toward concentration of industrial enterprise in the hands of a relatively few firms has brought into existence not only strong sellers . . . but also strong buyers. . . . The two

Sources and Consequences," Journal of Marketing Research 11 (May 1974): 193-196; Robert Lusch, "Sources of Power: Their Impact on Intrachannel Conflict," Journal of Marketing Research 13 (November 1976): 382-390; Valentine F. Ridgeway, "Administration of Manufacturer-Dealer Systems," Administrative Science Quarterly 1 (March 1957): 464-483; Conway Taylor Rucks, Jr., "Power in the Distribution Channel: An Empirical Investigation" (doctoral dissertation, Louisiana Tech University, 1974); Robert Adolph Schulz, "A Laboratory Study of Power Base-Conflict Relationships--As Applicable to Distribution Channels" (doctoral dissertation, The Ohio State University, 1971); Orville Charles Walker, Jr., "An Experimental Investigation of Conflict and Power in Marketing Channels" (doctoral dissertation, The University of Wisconsin, 1970); and David L. Wilemon, "Power Negotiation Strategies in Marketing Channels," The Southern Journal of Business 7 (February 1972): 71-82.

⁷⁹ Beier, "Power in the Channel of Distribution," p. 95.

⁸⁰ Ibid., p. 98.

developed together, not in precise step but in such a manner that there can be no doubt that the one is in response to the other.⁸¹

On the other hand, Heflebower suggests that channel members attempt to increase their control over the channel by dealing with smaller channel members. He states that "there is considerable evidence that mass distributors tend to buy from small firms in the distributive trade."⁸² Others have suggested that the amount of supplier control is related to the characteristics of demand, the marketing technology used, and interchannel competition⁸³ and that administratively controlled vertical marketing systems may be more efficient than market controlled systems.⁸⁴

The Control of Channel Members

Bucklin has developed a theory of channel control which attempts to conceptualize the relationship between supplier and middleman.⁸⁵ He views this relationship as being a function of the profits that accrue to the middleman from accepting authority

⁸¹Galbraith, "The Concept of Countervailing Power," p. 119.

⁸²Richard B. Heflebower, "Mass Distribution: A Phase of Bilateral Oligopoly or of Competition," The Marketing Channel, ed. Bruce Mallen (New York: John Wiley and Son, 1969), p. 196.

⁸³Michael Etgar, "Channel Environment and Channel Leadership," Journal of Marketing Research 14 (February 1977): 69-76.

⁸⁴Michael Etgar, "Effects of Administrative Control on Efficiency of Vertical Marketing Systems," Journal of Marketing Research 13 (February 1976): 12-24.

⁸⁵Louis P. Bucklin, "A Theory of Channel Control," Journal of Marketing 38 (January 1973): 29-37.

(payoff function) and the middleman's feeling of burden of sacrifice incurred from yielding to supplier authority (tolerance function) (see Figure 10).⁸⁶

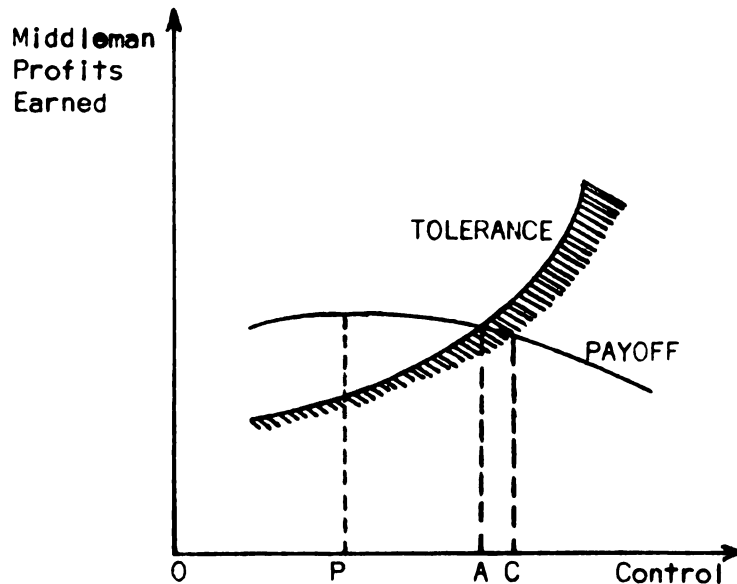


Figure 10. Bucklin model of channel control.

The manufacturer wishing to increase his control over the middleman has different options available to him. Between 0 and P, the manufacturer needs to use persuasion to get middlemen to accept higher levels of control. Here the middleman's tolerance function lies below his payoff function; in addition, he receives higher levels of profits as the manufacturer increases the level of control.

⁸⁶ Ibid., p. 42.

At P, the middleman's payoff function is at its peak; and it is still well above the tolerance function. To get the middleman to accept manufacturer control between points P and A requires some degree of authority on the part of the manufacturer. Between P and A, the middleman's payoff function is decreasing while the burden he feels from accepting the control is increasing. At A, the middleman will no longer accept the manufacturer's authority. Beyond A, the manufacturer must rely on coercion to get the middleman to accept lower profits and a higher level of manufacturer control. This necessarily implies a shift to the right of the tolerance function (dotted line).

El-Ansary and Robicheaux have expanded on Bucklin's theory of channel control.⁸⁷ They have included not only supplier control over middlemen but also middleman control over the supplier (see Figure 11).⁸⁸ Their model consists of a tolerance function and a payoff function for both supplier and middleman. Through the use of this model, one can estimate the point at which either the supplier or the middleman would withdraw from the channel relationship and over what range bargaining would take place.

T_m = The middleman's tolerance function is the maximum level of supplier control tolerated by the middleman at each level of middleman payoff or profits.

P_m = The middleman's payoff function describes the profits that the middleman believes he would enjoy at each level of supplier control.

⁸⁷Adel I. El-Ansary and Robert A. Robicheaux, "A Theory of Channel Control: Revisited," Journal of Marketing 38 (January 1974): 2-7.

⁸⁸Ibid., p. 4.

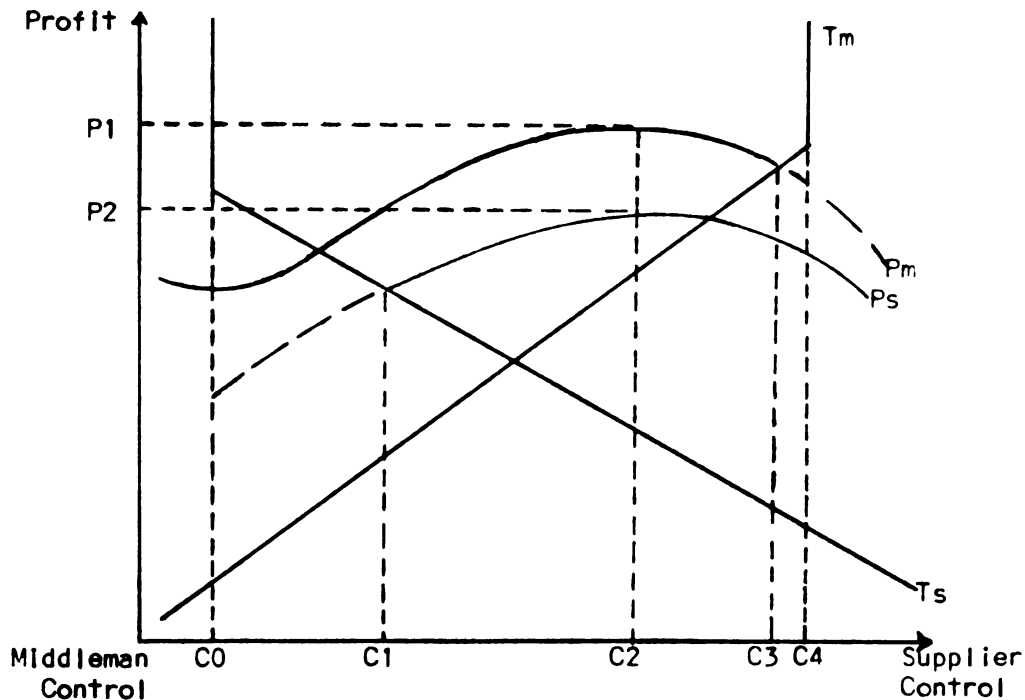


Figure 11. El-Ansary Robicheaux model of channel control.

T_s = The supplier's tolerance function is the maximum level of middleman control over some issues that the supplier would tolerate at each level of profits.

P_s = The supplier's payoff function describes the profits that the supplier believes he would enjoy at each level of middleman control.⁸⁹

Taken together these four functions identify the limits of supplier and middleman control as well as the range of supplier control within which the two parties would bargain. The maximum amount of supplier control that the middleman will accept is indicated

⁸⁹Robert L. Kahn and Donald Wolf, "Role Conflict in Organizations," Power and Conflict in Organizations, eds. Elise Boulding and Robert Kahn (New York: Basic Books, Inc., 1964), p. 5.

at C4 while the maximum level of middleman control the supplier would tolerate is indicated at C0.

The supplier would not bargain at any level of supplier control less than C1 as his payoff function (P_s) lies below his tolerance function (T_s). The middleman would not be willing to bargain at any level of supplier control higher than C3 as the middleman's payoff function (P_m) lies below his tolerance function (T_m) beyond C3. Thus, the range in which bargaining may take place is between C1 and C3.

At C2, both the middleman and supplier reach their peak profit position on their respective payoff functions. This is the level of supplier control that would be negotiated. However, if these two payoff functions were to peak at different levels of control, then one would expect that intensive bargaining would take place between these two peaks.

Finally, both models offer a general indication when and where a supplier or middleman will seek a change in the distribution channel. Should either the middleman or the supplier become dissatisfied with the existing situation (their tolerance function would be above their payoff function) then either or both may terminate the relationship causing change within the channel. The conceptual framework provided here may offer some clues to this decision-making process.

The emphasis in both the Bucklin and El-Ansary Robicheaux models has been on the interaction between two members of the channel. However, many authors would suggest that in order to understand what

is happening in the channel that the analyst must look at the whole rather than each separate part.

The Systems Approach

Several approaches have been discussed in this review of channels literature. Among these are the functional, economic, behavioral, and finally, the systems approach. Each of these has made a valuable contribution to the channels literature. The goal of the systems approach is to provide a conceptual framework for the synthesis and integration of channel literature.

Much has been written about the systems approach since its introduction during World War II. Von Bertalanffy defines systems "as a set of objects together with the relationship among them and their attributes."⁹⁰ Parsons and Smelser offer an interesting view of the channels system in relation to other existing systems. They view the social system as being composed of four subsystems: the Economy Subsystem, the Polity (government) Subsystem, the Integrative (churches) Subsystem, and the Latent Pattern Maintenance and Tension-Management (family) Subsystem. They further divide the economic system into four subsystems, one of which is the firm. The firm is then divided into four subsystems; one of these is labeled the marketing subsystem.⁹¹ The marketing subsystem may then be perceived in terms

⁹⁰ Arthur D. Hall, A Methodology for Systems Engineering (Toronto, Canada: Van Nostrand, 1962), p. 60.

⁹¹ Talcott Parsons and Neil Smelser, Economy and Society: A Study in the Integration of Economic and Social Theory (New York: The Free Press, 1956).

of small, middle range, and large systems.⁹² The distribution channel would be considered a large system encompassing a number of independent organizations.

Alderson, Mallen, Ridgeway, and others have suggested that the marketing channel is an operating system within specific identifiable behavior patterns.⁹³ Ridgeway illustrated this approach when he said:

The economic process, beginning with the acquisition of resources and running through manufacturing to the ultimate consumption of its products, is a continuous process, but in many industries the economic flow is the result of the work of a number of organizations, each with an independent identity and a separate legal status. The manufacturer has crucial relationships with both suppliers and distributors. Despite the independent identity of these three classes of organizations, their activities must form one extended system--a fact usually ignored in administrative and organization theory.⁹⁴

Thus, a legal entity in the channel is not necessarily a marketing entity. The channel should be viewed by all members as a social system or one entity which has been formed to complete some basic marketing functions.

Earlier in this chapter, Alderson's functionalism was discussed. He sees functionalism as "a commitment to what is coming to be known as

⁹² Wroe Alderson, Dynamic Marketing Behavior (Homewood, Ill.: Richard D. Irwin, Inc., 1965), Chapter One.

⁹³ Wroe Alderson, Marketing Behavior and Executive Action (Homewood, Ill.: Richard D. Irwin, Inc., 1957); Bruce Mallen, "Interaction of Channel Selection Policies in the Marketing System," The Marketing Channel a Conceptual Viewpoint, ed. Bruce Mallen (New York: John Wiley and Sons, Inc., 1967), pp. 99-107; and Valentine F. Ridgeway, "Administration of Manufacturer-Dealer Systems," Administrative Science Quarterly 1 (March 1957): 464-483.

⁹⁴ Ibid., p. 464.

the total systems approach. To ask how marketing works is to ask how all its component parts and constituent activities work together to produce an end result."⁹⁵

Marketing functions are discharged by behavior systems or by individuals acting within systems. The type of system of interest here is classed as an ecological system because of the particular nature of the bond among the components. They are sufficiently integrated to permit the system to operate as a whole, but the bond is loose enough to allow for the replacement or addition of components.⁹⁶

Thus, the channel is part of a larger and more complex system and is interrelated and interconnected with components of other systems.

When describing the channel as an operating system, many writers would agree with the following formal characteristics:

1. The channel consists of interrelated components that are structured to produce predetermined results.
2. The channel members strive to achieve mutually acceptable objectives.
3. Activities performed by channel members are undertaken in sequential order and thus can be considered marketing flows.
4. The channel is an open system in that a firm's participation is voluntary, and they may enter or leave as they wish.
5. A single organization usually "administers" most of the activities in the channel.
6. The behavior of firms, particularly in well-established channels, is regulated by a code which specifies types of acceptable behavior.⁹⁷

⁹⁵ Ibid., p. 24.

⁹⁶ Wroe Alderson, Marketing Behavior and Executive Action (Homewood, Ill.: Richard S. Irwin, Inc., 1957), p. 32.

⁹⁷ McCammon and Little, "Marketing Channels: Analytical Systems and Approaches," pp. 329-330.

These formal characteristics convey the impression that channels are well-organized, finely-tuned systems that are headed up by a channel administrator who is usually the manufacturer. However, this may not be the case.

Alderson, for example, states that "the marketing channel exists but it would be stretching the point to call it an organized behavior system with a tendency to persist over a long period of time. At best it is a pseudosystem in which there is a fair amount of cooperation over a short interval but with no commitments over the longer run."⁹⁸ McVey holds a similar position. He points out that "the middleman is not a hired link in a chain forged by a manufacturer, but rather an independent market, the focus of a larger group of customers for whom he buys. Subsequent to some market analysis of his own, he selects products and suppliers, thereby setting at least one link in the channel."⁹⁹

Thus, firms in the channel are not primarily concerned with the growth and prosperity of the channel but, rather, they are preoccupied with their own internal operations and rate of growth. Consequently, because channel systems do not inspire a great deal of loyalty, they generally do not persist for long periods of time. However, smoothly operating channel systems appear to be competitively superior.¹⁰⁰

⁹⁸ Alderson, Dynamic Marketing Behavior, p. 44.

⁹⁹ Phillip McVey, "Are Channels of Distribution What the Textbooks Say?" Journal of Marketing, January 1960, p. 65.

¹⁰⁰ McCarthy, Basic Marketing, p. 312.

McCammon and Little have identified several basic advantages to the systems approach. One, it identifies the interrelationships that must exist among all intermediaries and institutions in the channel. Two, it stresses the need for cooperation among channel members. Three, the systems approach recognizes that the channel is a basic unit of competition. Finally, the systems approach provides a method for identifying imperfection in the channel.¹⁰¹

The systems approach of investigating channels of distribution emphasizes the interdependence of the channel members and the need for cooperation to achieve channel goods. Without this conceptual approach, the growth or survival of the channel could be jeopardized. The systems approach stresses the advantages that accrue to the individual organization through group membership. This approach may also require the suboptimization of some or all the channel members so the entire system may be optimized.

Summary

Although our knowledge of decision making in the channel of distribution is in an infant stage of development, important conceptualizations of this process have evolved in the past few years. This chapter has reviewed the developments in the various approaches to channels. In each area, a different approach to the study of channel decision making was found. The approaches that were discussed

Bert C. McCammon, Jr., and Robert W. Little, "Marketing Channels: Analytical Systems and Approaches," Science in Marketing, ed. George Schwartz (New York: John Wiley and Sons, Inc., 1965), p. 330.

have various advantages and disadvantages for the decision maker. However, an understanding of each approach is necessary if one wishes to understand the decision-making process in the channel.

CHAPTER III

RESEARCH DESIGN

Chapter II presented a summary of the major approaches to understanding distribution channels. Chapter III provides a conceptual framework for analysis and the research design used in the study.

The purpose of Chapter III is to outline the conceptual framework, objectives, and methodology for the research. In order to achieve this, the chapter is organized in the following manner: (1) conceptual framework, (2) research objectives, (3) design and procedures of the study, (4) reporting format, (5) limitations of the study, and (6) summary.

Conceptual Framework

Change in the distribution channel is conceptualized as decision making in which numerous variables can initiate the process. The literature review outlined channel theories which help to explain and/or predict the change process. The scheme used to classify channel literature is not specific enough to offer a framework for empirically studying change in a specific industry. A framework to classify literature is developed for this study on the basis of: (1) macroeconomic environment, (2) microeconomic environment, (3) power, and (4) conflict.

This framework provides a basis to organize related channel theories. It allows for the interaction of similar theories and provides a basis for analysis. This section summarizes the theories that offer promise in predicting and/or explaining decision making and change in distribution channels. In Chapter VI, Behavioral Interpretation, this conceptual framework is used to analyze the practices of the appliance industry. It is applied again in Chapter VII to determine which, if any, theoretical approaches offered the potential to predict and/or explain change that, in fact, occurred in the distribution channel.

Macroeconomic Environment

Macroeconomic theories of channel evolution and change concentrate on the enterprise's relationship with its competitors and the effect of the overall level of economic activity on the channel of distribution. There are several theories which fall into this classification. Perhaps the most significant of these is the economic theory of oligopoly.

The situation of a few sellers in an industry is more difficult to analyze than either of the other two economic models--pure competition and monopoly. The oligopolist must not only concentrate on the internal operations of his firm but also must be cognizant of changes in the competitive structure of the industry of which he is a part. He must constantly monitor the actions of his rivals and in turn must consider their reactions to the decisions he makes. Consequently, independent action is not possible, and any competitive action taken

by one member of the oligopoly can have a substantial effect on the actions of other members.

Changes in any aspect of the enterprise's price, product, promotion or distribution channel would be monitored by competitors. Changes which are perceived as being significant would be counteracted or emulated by competitors. Consequently, one would expect in an oligopolistic industry that firms would copy changes, especially those which prove profitable. In addition, Bucklin suggests that changes within the industry evolve in a logical manner.¹

Bucklin contends that firms identify the economic conditions that are expected to prevail in the future. The channel of distribution which best fits these conditions he calls the normative channel. This channel then serves as the goal for existing channel members. Changes then occur in the existing channel structure (extant channel) to insure that the normative channel becomes reality in the future. Channel members alter their functional mixes and may be forced out of the market as changes are made to the extant channel. Bucklin attempted to define some of the factors which influence channel structure and suggested that the relative costs of a speculative inventory, the inventory carrying costs for the dealer, and the cost of a direct shipment would determine if inventories would be present in the market.

Other theories suggest that these changes occur in cycles. Some contend the cycle is caused by dealers adding services and improving

¹Louis P. Bucklin, "The Economic Structure of Channels of Distribution," The Marketing Channel A Conceptual Viewpoint, ed. Bruce Mallen (New York: John Wiley and Sons, Inc., 1967), pp. 63-66.

facilities which cause margins to increase (wheel theory). While others propose that the cycle is a process which all institutions go through (institutional life cycle).

Finally, economic factors may also play a significant role in causing change in the distribution channel. Shifts in the market or market demand caused by recessions, depressions or booms can cause major changes in the channel. A firm's reaction to such changes can determine its growth or survival.

Theories categorized under the heading macroeconomic environment may be able to explain a number of aspects of change in the appliance channel. Bucklin's theory of the normative channel may be useful in explaining why changes occurred in the channel and in predicting the timing of change. If cost, demand, and competitive data are available, the prediction of change, as the extant channel alters functional mixes and/or deletes middlemen, should be possible.

Manufacturers operating in an oligopoly take their cues from competitor's action. As the extant channel moves toward the normative channel, macroeconomic channel theories would predict that changes would be similar for manufacturers. That is, they would be moving toward the normative channel and would also be monitoring each other's decisions. Thus, macroeconomic theories may be able to explain and/or predict the rate and direction of change.

Microeconomic Environment

Microeconomic theories of channel decision making concentrate on the internal cost structure of the firm.² The emphasis is on the identification and analysis of the costs associated with the performance of various functions within the firm. It is assumed that each firm performs functions which can be identified and that the cost of performing the function can be determined.

The theory suggests that channel managers determine the average cost curve for every function performed. An attempt is then made to minimize the cost of distribution on a function-by-function basis or simply to minimize the total cost of distribution. In either case, the ultimate goal of the channel manager is to develop a channel system that operates at the lowest possible cost. This is accomplished through the analysis of functional average cost curves. The channel decision maker identifies the various functional costs and then transfers to middlemen those functions which they can perform at a lower cost. By transferring costly functions to middlemen the manufacturer's cost is reduced while

²George J. Stigler, "The Division of Labor Is Limited by the Extent of the Market," Marketing Channels: A Systems Viewpoint, eds. William Moller and David Wilemon (Homewood, Ill.: Richard D. Irwin, Inc., 1971), pp. 29-38; Bruce Mallen, "Functional Spin-Off: A Key to Anticipating Change in Distributive Structure," Journal of Marketing 37 (July 1973): 18-25; R. H. Coase, "The Nature of the Firm," Economica, New Series, November 1937, pp. 386-405; Louis P. Bucklin, "The Economic Structure of Channels of Distribution," The Marketing Channel A Conceptual Viewpoint, ed. Bruce Mallen (New York: John Wiley and Sons, Inc., 1967), pp. 63-66; and Louis P. Bucklin, "Postponement, Speculation and the Structure of Distribution Channels," Journal of Marketing Research 11 (February 1965): 2-7.

the efficiency of the channel is improved. However, the transfer of a high cost function to a middleman does not always reduce the internal costs of the firm.

The abandonment of a function by the original firm will have an effect on the remaining cost curves of the firm. If functions rival each other for the resources of the firm, the abandonment of a function will make additional resources available for the performance of other functions and thus reduce their cost. It is also possible that the reverse may be true. That is, the abandonment of a function may cause the average cost of remaining functions to rise. Consequently, it is necessary that the channel decision maker consider the total cost of distribution when making the decision to transfer functions.

Theories classified as being part of the microeconomic environment may be useful in predicting and explaining channel change. It may be possible to explain why some manufacturers distribute their appliances direct to the dealer while others use independent distributors, or why a producer uses independent distributors in some markets but not in others. Finally, theories categorized as part of the microeconomic environment may help explain the emergence, growth, and mix of functions performed by independent distributors, dealers, and other institutions in the channel of distribution for appliances. Thus, microeconomic theories may be able to explain and predict different types of channel alignments, the existence and size of middlemen, and the mix of functions that channel members perform.

Power

Power in the distribution system is based in several areas. Some sources of power include: rewards, coercion, expertness, identification, and legitimacy.³ Producers who have been able to successfully differentiate their products acquired some degree of power or control over activities of other channel members. In addition, the nature of the industry can contribute to an enterprise's power. Barriers to entry and the small number of firms present in an oligopoly increase the power of the oligopolist vis-a-vis other channel participants. The ability of the enterprise to make decisions for change in the channel is directly related to the amount of power the enterprise possesses. The more power the enterprise possesses the greater its ability to introduce significant change in the market. However, the increase in power of one participant in the channel causes an increase in the power of other participants and increases the possibility of a stalemate. Galbraith has theorized that economic power is held in check by the countervailing power of those subject to it.⁴ As the power of one channel participant increases, the relative power of other channel participants would rise to offset it.

The firm which possesses power in the channel attempts to use that power to control other channel members and to shift high costs or

³John R. P. French and Bertrom Raven, "The Bosses of Social Power," Studies in Social Power, ed. Darwin Cartwright (Ann Arbor, Mich.: University of Michigan Press, 1959), pp. 150-167.

⁴John K. Galbraith, "The Concept of Countervailing Power," American Capitalism, rev. ed. (Boston: Houghton Mifflin Co., 1956).

unwanted functions. No channel participant is without some degree of power. Consequently, some bargaining may occur in the channel before decisions are made. Bucklin⁵ and El-Ansary and Robicheaux⁶ have developed models which explain how firms attempt to control, through the use of power, other channel members.

Through the use of power-based theories, insight into the processes of change may be facilitated. Theories in this area may make it possible to predict which channel members are most likely to institute change. Such change may take the form of functional transfer or the elimination of channel members. Additionally, shifts in power from manufacturers to dealers may forecast a reallocation of functions within the distribution system. Finally, the type and amount of power that is used by channel participants may cause an increase in the level of conflict.

Conflict

The participants of the channel are interdependent. Thus, the behavior of one participant has implications for the level of satisfaction achieved by the other participants. Conflict is a significant result of the inherent dependency that exists in the channel system. Conflict is closely related to change and can be both the cause and effect of change.

⁵Louis P. Bucklin, "A Theory of Channel Control," Journal of Marketing 38 (January 1973): 29-37.

⁶Adel I. El-Ansary and Robert A. Robicheaux, "A Theory of Channel Control: Revisited," Journal of Marketing 38 (January 1974): 2-7.

Although four types of conflict have been identified, vertical conflict between customer and supplier has the greatest significance for this study.⁷ Conflict arises when one member impedes the activities of another. It results from the incompatibility of goals among members and/or from differences in perceptions of reality which call forth conflicting solutions to the same problems. The result of the conflict can be change in some aspect of the channel. In addition, it has been suggested that changes in channel institutions occur in four different phases including: shock, defensive retreat, acknowledgment, and adoption.

When conflict exists between participants in the channel, change may occur. Thus by identifying conflict situations, it may be possible to predict change and explain its cause. When the goals of channel members are incompatible or when their perceptions of problems differ, conflict situations can arise. Thus, the identification of conflict situations can provide a basis for predicting change in the channel.

Numerous theories of change have been proposed in the literature. These theories can be broken down into microeconomic, macroeconomic, power, and conflict. Each area takes a different approach to the analysis of change. This framework is applied to the historical behavior of the appliance industry in an effort to determine which combination of theories offers the greatest potential for explaining development of distribution arrangements in the appliance industry.

⁷Joseph C. Palamountain, The Politics of Distribution (Cambridge, Mass.: Harvard University Press, 1955).

Research Objectives

The basic objective of the study is to understand channel decisions made during the development of the appliance industry. As a result of these decisions, several different and distinct channel arrangements are currently used by major appliance manufacturers. Several companies have recently modified the traditional methods by which they distribute their products. Instead of following the traditional channel through independent distributors and independent dealers, some have chosen to market their appliances directly to dealers through company-operated wholesale branches, thereby eliminating independent distributors. Other manufacturers have maintained the traditional distributor structure to replenish dealer inventories. Still a third category of manufacturers have modified their distribution structures to incorporate a blend of company branches and independent distributors. Finally, during recent years, selected manufacturers have begun to ship appliances direct to dealers, thereby, bypassing, at least in a physical distribution sense, the wholesale function. This affords the opportunity to analyze the decision-making criteria used by different manufacturers in comparison to existing channel change models.

This research reconstructs the decision-making process which resulted in today's channel arrangements and compares this behavior to theories in channel evolution and change.

The first two research objectives outline the development of the appliance industry and isolate the manner in which channel decisions were made. Specifically, they are:

1. To develop a chronology of the growth of the appliance industry and the development of prevailing channel structures from inception to present.
2. To isolate the manner in which vertical channel decisions relative to structure were made by executives holding representative roles within the major firms constituting the appliance industry.

This descriptive analysis of channel activities and the accumulation of observations is important to marketing. It is only through this process of specialized research and generation of facts that a broad basis for channel theory can be laid. This foundation adds legitimacy to marketing channels and serves to further channel thought by citing empirical data on which channel theories can later be developed.

The major purpose of channel theory is to order facts so they facilitate the explanation, comprehension, and prediction of channel phenomena. Few of the theories relating to the distribution channel have been empirically tested. Without an empirical test of these theories, the danger always exists that logically consistent and tightly reasoned models will fail to explain the way decisions are in fact made. This research provides an analysis of the current channel theories, and conclusions are drawn as to which channel theories offer the greatest insight into decision making in the channel. The final research objective directs attention to this problem. The final research objective is:

3. to interpret which if any behavioral and/or economic theories of channel formulation and change could have predicted or explained what actually occurred in the appliance industry.

Design and Procedures of the Study

The Industry

Consistent with the objectives of this research, the manufacturers of nationally branded appliances were selected for study. The appliance industry was selected because of the range and magnitude of recent channel decisions implemented by firms within this industry and because of its long history of changing distribution practices. In addition, because of the relative newness of the appliance industry, a great many of the executives that made channel decisions and/or their immediate replacements are available to help reconstruct the climate and pressure of the growth years. This affords the researcher the opportunity to gain primary data for the analysis of the decision-making process.

The appliance industry, a differentiated oligopoly, is composed of a small number of manufacturers. The manufacturers of major ticket items have been selected for analyses. Some of the major manufacturers in this industry are: General Electric, Westinghouse, Whirlpool, White Consolidated Industries, Frigidaire Division of General Motors, Philco Division of Ford, and Maytag. In addition, there are several small manufacturers including: Magic Chef, Amana, and Norge Fedders.

The Sample

From these firms a selected rather than a probability sample was devised. Firms were selected on the basis of their share of market and leadership in the industry. The participating firms included: White-Westinghouse, Whirlpool, Frigidaire Division of General Motors

Corporation, Kelvinator, and Gibson. These firms are among the leaders in the appliance industry and constitute approximately 65 percent of industry sales. The major appliance division of General Electric Corporation was unable to directly participate because of pending government investigation of their major appliance business. The information on General Electric was collected from secondary sources as well as what was provided through interviews with General Electric competitors.

Executives who are or were intimately involved in channel decisions were identified from participating firms. The sample structure was designed to include executives having an extensive background in appliance industry channels in an effort to accumulate an accurate assessment of the decision-making and change process. Executives who represent their organizations in dealings with other channel members are traditionally referred to as playing a representative role in channel literature. Such key individuals are expected to be knowledgeable of competition, channel structure, and their firm's policies.

Following certification of key executives, personal interviews were arranged, with the exception of General Electric. Personal interviews were selected because of the exploratory nature of the research and the broad scope of the research objectives. The personal interviews made it possible to gather a wider range of data and to explore that data in depth with each respondent.

The interview format was unstructured and direct. That is, the interview did not follow a sequence of questions. In contrast,

discussion areas were introduced during the interview to direct communication to areas related to change and related procedures.

This unstructured approach offered the following advantages:

1. Verification that all members of the sample have been involved in the process of channel policy formulation is assured.
2. There is the opportunity to gain more information than with a structured interview due to open exchange of experience in a free flow manner.
3. It offers greater flexibility to adapt questions to respondents and to pursue areas of interest or potential insight.
4. The flexibility and informality of this type of interview may lead to increased amounts of information.
5. Finally, the direct approach is appropriate as the information is known to the respondent who is expected to discuss it freely.

During the interview, the following questions were directed to the respondent, and they were explored in depth.

1. Do you consider the cost of providing various functions when deciding on the structure of distribution channels?
2. Is the total cost of distribution a significant factor when making decisions on channel structure?
3. Is control over the distribution channel an important factor when deciding whether or not to integrate the channel?
4. Does vertical conflict (between manufacturer and wholesaler) play a role in the decision to integrate the channel?
5. Is the increased risk of carrying inventory an important factor when deciding to integrate the channel?
6. Is the potential for increased sales and/or profits an important factor when deciding to integrate the channel?

7. Are the salient factors involved in the decisions to integrate the channel beyond your control? (For example, resources or objectives of the firm.)
8. Was the decision to integrate the channel part of an overall strategy or a reaction to changing conditions in the channel?

These questions were introduced as general topics of discussion, and the respondent was allowed to express his feelings and experiences with each of the areas. An attempt was made to uncover any and all salient factors which appeared to be important to those who made channel decisions. Emphasis was placed on questions which developed an understanding of the relative importance the respondents place on: (a) the cost of performing functions in the channel; (b) the total cost of distribution in vertically integrated and traditional channels; (c) the profit and sales potential in vertically integrated and traditional channels; (d) the level and importance of conflict and power channels; and (e) the importance of risk. These questions were developed from the channel literature and used in conjunction with the conceptual framework in the analysis of the channel.

Reporting Format

The objectives of this research are interrelated. The attainment of the third objective is dependent on both objectives one and two being met. Likewise, the attainment of the second objective is dependent on the first. Consequently, it is imperative that the objectives be accomplished in a prescribed order. The method for reporting these objectives is: objective one is reported in Chapter IV;

objective two is reported in Chapter V; objective three is reported in Chapter VI; and Chapter VII synthesizes all the objectives of the study.

Limitations of the Study

The limitations of the study are:

1. The data for the study was collected using a nonprobability sample, and consequently, generalizations to the national population of firms cannot be made.
2. The research focused on one industry and on the manufacturers' level of decision making. Attempts to generalize the findings to other levels of decision making and other industries are limited.
3. The sample size is small. Consequently, care should be taken when making generalizations to the industry.
4. The research focused on the perceptions of knowledgeable individuals within each company. These individuals may not have accurately reflected the official position of their organization. This is especially true since these executives have the benefit of 20/20 hindsight.
5. Data for the study was collected through personal interviews, and the danger always exists that distortion may occur in the communication process thus affecting the outcome of the research.
6. The research focuses on the distribution of national branded appliances. No attempt was made to include private brands.

Summary

This research involves the institutional change process in the distribution channels of manufacturers of nationally branded major appliances. This chapter has outlined the conceptual framework for analysis, the procedures, and objectives of the study. The objectives of the research are: (1) to develop a chronology of the growth of the

appliance industry and the development of prevailing channel structures, and describe the formulation of distribution channels in the appliance industry; (2) to isolate the manner in which channel decisions relative to structure were made by executives; and (3) to interpret which behavioral and/or economic theories of channel formulation and change could have predicted or explained what actually occurred in the channel of distribution for appliances. Chapter IV presents a detailed discussion of the historical behavior of the appliance industry.

CHAPTER IV

INDUSTRY HISTORICAL DEVELOPMENT

The preceding chapter outlined the conceptual framework for analysis of structural change in the channel and the design and procedures of the study. The first objective of this research was: to develop a chronology of the growth of the appliance industry and the development of prevailing channel structures from inception to present. Chapter IV satisfies the objective by providing an in-depth review of the historical growth and development of competitive practices and the formulation of channel structures in the appliance industry. Specifically, attention is paid to the structure of the appliance industry and the conduct of manufacturers as it relates to decision making in the distribution channel. In order to attain these objectives, the chapter is organized around the following format: General Introduction, Channel Determinants, The Appliance Industry as an Oligopoly, Channels of Distribution to 1930, Channels of Distribution in the 1930s, Distribution Channels in the Post-War Era, and Summary.

The first three sections of this chapter are General Introduction, Channel Determinants, and The Appliance Industry as an Oligopoly. They provide a background of the industry including: the types of products (with specific sections on the refrigerator, washer, and range) and an analysis of the industry as a differentiated oligopoly.

The last three sections are Channels of Distribution to 1930, Channels in the 1930s, and Distribution Channels in the Post-War Era. They provide a chronology of changes in distribution at the manufacturer, distributor, and dealer levels.

General Introduction

The home appliance industry has been a part of American manufacturing for over one hundred years. Early appliance models were generally poor substitutes for doing the job by hand, and consequently, they never effectively penetrated the market. For example, the washing machine has been in existence since the Civil War. At that time, they were constructed of wood and driven by ineffective mechanical power which was no better and sometimes more dangerous than doing the job by hand. Because of the lack of consumer acceptance the manufacturers remained small and distribution was limited to the market immediately adjacent to the plant.

The forerunner of today's modern refrigerator was the ice box. The early manufacturers of this home appliance were located in the midwest because of the availability of raw materials such as ash and other hardwoods so prized in the construction of the ice box. Markets were generally limited to local areas because of high transportation costs. The distribution of early appliances was limited primarily to the direct-to-dealer channel, as there was little need for distributors when dealing with a local market.

Besides the washer and ice box, other appliances were being introduced to a consuming public. In 1893 the standard dry iron, toaster, and coffeemaker made their appearance. By 1903 approximately one million homes had electrical service. This opened up a substantial market for electrical appliances of all types. Consequently, other electrical appliances were introduced in fairly rapid succession. Table 1 is a list of appliances with the year in which they were introduced.

By 1920 the potential market for electrical appliances had grown by over 800 percent, and 8,700,000 homes had electrical service. This number would soar to over 60,000,000 by 1968. The large number of homes with electrical service together with the increasing dependability and variety of appliances provided the impetus for the growth of the electric appliance industry from its insignificant beginnings to a multibillion dollar industry dominated by such giants as General Motors, General Electric, Whirlpool, and White Consolidated Industries.

Because of the complex nature of the appliance industry, the discussion of the industry and its distribution practices will be limited to major electrical appliances. This would include: refrigerators, laundry products, ranges and ovens, dishwashers, freezers, compactors, and air conditioners. From this group, it would appear that refrigerators (1912), laundry equipment (1907), and electric ranges (1909) have had the greatest impact on the industry's growth and distribution practices.

Table 1. Introduction of Electrical Appliances

Year	Appliance
1903	Electric range
1907	Washer and vacuum cleaner
1908	Ironer
1910	Hot plate
1912	Refrigeration
1914	Dishwasher
1916	Food mixer, fan, clock and air conditioner
1920	Home radio
1921	Electric water heater
1922	Humidifier
1925	Lawn mower
1926	Steam iron and automatic toaster
1930	Shaver
1932	Room air conditioner
1937	Automatic washer
1938	Food waste disposer and blender
1939	Black and white television and clothes dryer
1940	Home freezer
1946	Tape recorder
1954	Color television
1955	Electronic range
1969	Trash compactor

Source: Association of Home Appliance Manufacturers.

In the all-important first years of the industry, when many channel decisions were being made, the refrigerator and wringer washer accounted for almost all of the appliance sales. By 1930 refrigerators, laundry equipment, and ranges accounted for 95 percent of unit sales, and in 1969, after the introduction of numerous appliances, these three products still accounted for 63 percent of unit sales. The refrigerator not only was one of the first appliances introduced but has historically been the most important to the industry. Over the years, refrigerators have averaged 29 percent of unit sales of all major appliances. If this unit sales figure was converted to dollars, the percentage would be even higher as refrigerators are the most expensive major appliance.

This dominance can be seen in the strong position that refrigerator manufacturers have held over the years and the fact that every major manufacturer of appliances has produced or sold a refrigerator. In addition, several major manufacturers started in the appliance business by producing a refrigerator. These include General Motors and Kelvinator, and other manufacturers added this product to their line early. Table 2 lists the approximate year when manufacturers added these products to their lines.

Because of the significant impact these products have had on the appliance industry, it is necessary to have a background in the development of these appliances. Changes in the physical characteristics of the appliance have had a great influence on distribution channels. The following section provides a brief history of the washer, refrigerator, and range, as well as the companies that introduced or made significant changes to the product.

Table 2. Year of Introduction of Selected Major Electrical Appliances at Selected Companies

Company	Product		
	Refrigerator	Range	Automatic Washer
General Electric	1926	1906	1952
Frigidaire (G.M.)	1918	1937	1947
Kelvinator (White)	1916	1939	1953
Westinghouse (White)	1930	1908	1946
Gibson (White)	1933		
Whirlpool	1955	1955	1947

A Brief History of Products and Companies

The Washer

The major electric appliance industry started with the development of the washing machine. In 1899 a firm in St. Joseph, Michigan made the first agitator washer and named it the "1900 washer." The hand-driven washer revolutionized home laundering and made it a semiautomatic process. The 1900 Washer Company later became the Whirlpool Corporation.

Between 1900 and 1910, a number of other manufacturers including Maytag, Easy, and Speed Queen, developed a similar product. However, in 1906 the Hurley Machine Company began manufacturing an electric washing machine with a chain drive.¹ The Thor, as it was called, was not

¹Fran Maierhauser, "How to Have Happy Clothes or The Tale of A Tub," Rural Kentuckian Magazine, March 1972, p. 9.

immediately copied by the other hand powered washing machine companies. However, by about 1914, most of the competition had replaced the hand-powered lever with an electric motor, thus initiating the major electric appliance industry.

In 1922 the Maytag Company brought out a washer featuring an underwater agitator. It gained rapid acceptance because it was easy to operate and did a thorough job of washing. The next innovation to appeal to the market was the introduction of the agitator washer with a spin rather than a wringer-type dryer. This was introduced by the Easy Company in 1926.² After this, few changes were made to the washer until the late 1930s.

The automatic washer was placed on sale in 1939. It was developed by the Bendix Company who had the exclusive rights to the product until 1946 when it licensed Westinghouse to make a similar machine. Both of these early automatics were the basket-tumbler type which were used for a number of years by consumers. However, this machine met increasing customer resistance because the machine would overflow, spilling water and detergent on the floor. In 1950 the Whirlpool Corporation brought out the first successful agitator-type automatic. In the next few years other manufacturers entered the market with automatics of their own. In 1977 White-Westinghouse reintroduced the basket-tumbler type washer. The overflow problem has been solved with low sudsing detergents, and this washer is more

²Ibid., p. 11.

efficient and requires fewer moving parts--thus, a reduced need for service.

The Refrigerator

Initial experiments were started on the mechanical refrigerator for the home in 1914. Through the combined efforts of Edmund Copeland, Nathaniel B. Wales, an engineer, and Arnold G. Gross, a prominent Detroit industrialist, the first refrigerating mechanism for home installation was produced in Detroit in 1914. After a series of experimental models were produced, Gross and Copeland incorporated the Electro-Automatic Refrigerating Company, Inc. in 1916. Two months later, the name of the firm was changed to Kelvinator Company in honor of Lord Kelvin, the British scientist who discovered principles that were basic to refrigeration.

In 1915 a mechanical engineer named Alfred Mellows built the first Guardian refrigerator in Dayton, Ohio. In 1916 with the help of the Murray family (Murray Body Company) of Detroit, Mr. Mellows organized the Guardian Refrigerator Company in Detroit to manufacture and distribute his device. The first Guardian refrigerator had a solid oak cabinet, dried seaweed insulation, freezing space for the heavy zinc trays and nine cubic feet of storage. It was designed to sell for over \$750.

Between April 1, 1916 and February 20, 1918, Guardian built and sold 34 refrigerators. All of these were installed in Detroit homes and were serviced personally by Mellows every two or three

weeks.³ The Guardian Frigerator Company was purchased by Durant in June 1918 and then sold to General Motors in May 1919. In the process Durant changed the company name to Frigidaire.

The first mechanical refrigeration system consisted of a brine tank in the user's icebox with a separate compressor using ammonia as the refrigerant, usually installed in the basement. Early in the 1920s, sulphur dioxide was substituted for ammonia and the brine tank was eliminated.

The major factor holding down distribution of the product in these early years was the potential leakage of gas from the system. Because of this, hospitals could not use refrigerators and many consumers kept them on the back porch. In 1928 General Electric introduced the first hermetically-sealed compressor which virtually eliminated gas leaks. In addition, service was made easier because the compressor was mounted on the top of the refrigerator and could easily be removed and replaced. This was General Electric's famous "Monitor Top" refrigerator, and this concept was quickly adopted in the industry. Later, the development of Freon by Frigidaire and Kinetic Chemical, in about 1932, eliminated the problem altogether. Because Freon was odorless, non-toxic, and required much less power to compress, it became standard for the industry.

Up until 1925, the refrigerators were simply ice boxes with compressors. It was then that Kelvinator hung the first steel sides

³Alfred P. Sloan, Jr., My Years with General Motors (Garden City, NY: Doubleday and Company, 1963), p. 414.

on the refrigerator's wooden frame. In 1932 Frigidaire introduced the all-steel cabinet which became standard in the industry. This general construction is still used today with some improvements.

Other innovations added to the refrigerator include:

1933 Crosley introduces shelves in the door;

1939 Kelvinator makes a side-by-side refrigerator freezer; and

1954 Amana introduces a frost-free refrigerator.

The Range

The electric range was developed in 1903. The first range consisted of a platform on legs with the oven mounted above the surface units. There were no switches on the surface units. They were simply plugged in at either high, medium, or low heat, whichever the user wanted. Both the oven and surface units heated very slowly and burned out frequently. Early users of electric ranges accepted the disadvantages of slow heating and high operating costs because gas was not available in their areas and because they did not like coal or oil.

In 1907 the Hughes Company manufactured a range which looked a lot like the ranges people were used to. It resembled the wood-burning stove except the surface units consisted of coils of heating wire imbedded in porcelain bricks. The Hughes Company produced their first Hotpoint range in 1918. This company was bought out by General Electric who continued to make ranges under both the General Electric and Hotpoint brand names. These ranges used the Hughes' heating unit until Hotpoint developed the Calrod heating unit in the late 1920s.

The Calrod unit consisted of an electric coil imbedded in a steel tube. This increased both the speed of heating and the dependability of the unit. However, sales of electric ranges remained low until after World War II when lower electric rates, new automatic controls, and built-in ovens and ranges became available to the market. These features made electric ranges cheaper, easier to use, and added a new element of style to new homes.

Other appliances were developed over time. However, they have not had as significant an impact on the industry as the washer, refrigerator, and electric range. In addition to these three products, there are other factors which have had a significant impact on the distribution channels that have evolved in the major electric appliance industry. The manufacturers themselves, the market, and the very nature of the products have all contributed to the evolution of distribution channels.

Channel Determinants

Distribution channels in the major appliance industry have been affected by a number of factors. These can be grouped into: characteristics of demand, geographical concentration of manufacturers, and the concentration of sales volume in a few large firms.

Characteristics of Demand

A factor which plays a significant role in the determination of distribution channels is the characteristics of demand at all levels within the channel. Major appliances are consumer durable goods and

as such the sales of these appliances are highly sensitive to cyclical fluctuations in the economy. In addition, consumer demand is composed of both new and replacement demand. New demand includes consumers who are purchasing their first refrigerator, washer, range, compactor, etc. while replacement demand is made up of consumers who are replacing worn-out or outmoded appliances with new ones.

New demand is a function of the number of new family units, the construction of multiple or single-family living units, the growth in electrical service, the national income, the introduction of new appliances, and the saturation level of old ones. Replacement demand is basically a function of the saturation level and the age of the appliance. Saturation level is defined as the percentage of homes with electricity that have a particular appliance. As the saturation level increases, the amount of replacement demand increases. The saturation level for selected major appliances is presented in Table 3.

The saturation level for home appliances has been increasing year after year. Currently, the saturation level for refrigerators is 99 percent. Consequently, much of the demand for refrigerators is replacement demand. Many consumers are replacing their refrigerators in order to gain newer features even though their existing refrigerators are still usable. The same situation exists for washers. After the introduction of the automatic washer in 1937, consumers began to replace their existing wringer-type washers with the more convenient automatic, even though their wringer washers were still efficient. For other products like the trash compactor, introduced in 1969, almost 100 percent of the demand is new demand.

Table 3. Saturation Level of Selected Major Appliances

Year	Appliance				
	Refrigerator	Washer ^a	Ranges ^b	Dryers ^c	Freezers
1950	79.2	68.6	18.0	0.6	5.2
1955	92.4	81.3	27.0	6.6	15.1
1959	97.7	90.9	33.8	15.6	21.0
1966	98.3	62.9	42.9	40.5	25.8

Source: Merchandising Week and Kelvinator Corporate Records.

^aSaturation is for all washers until 1959; in 1966 only automatics are included.

^bFor electric ranges only.

^cIncludes both gas and electric dryers.

Replacement demand has been an important factor to dealers over the years. When demand exceeded supply, it mattered little whether or not demand was new or replacement. However, when there was a glut of appliances on the market, as there was in the late 1940s and early 1950s, then dealers were forced to accept trade-ins in order to sell slow moving merchandise. Trade-ins generally cause a reduction in dealer profits. This in turn has forced the poorly managed dealerships out of the market. This was particularly true in the early 1950s.

Sales fluctuations also play an important part in determining channel structure. The appliance market is faced with two types of fluctuations: those caused by changes in economic activity and seasonal fluctuations which are characteristic of the appliance industry.

Changes in the level of economic activity cause wide fluctuations in the sale of appliances. See Figure 12 for a history of the growth of appliance sales. During periods of recession, because consumers are cautious about future economic prospects, they are inclined to extend the life of existing appliances by repairing worn or broken parts and taking better care of them. Thus, sales decline even more than the overall economy as consumers put off replacement of appliances. When economic conditions improve, pent-up demand of the previous recession along with increased demand due to higher incomes cause sales to increase at a faster rate than economic conditions would warrant. Thus, the cyclical economic fluctuations cause even greater variations in the sale of appliances. However, this is not the only cause of fluctuations in appliance sales.

The seasonal fluctuations which are characteristic of the appliance industry also have an important influence on distribution channels. Sales of appliances are at their lowest point in the months of December, January, and February. This is due to reduced demand during the Christmas holidays and the dealer clearance sales following the end of the year. Appliance purchases, because they require a major resource commitment, are usually avoided when consumer finances are low prior to and immediately following the holidays. Sales of most appliances reach their peak in September, October, and November. However, refrigerators and freezers reach their peak sales during the hot summer months when they work the hardest and are most likely to fail. Table 4 illustrates the current fluctuations in appliance sales.

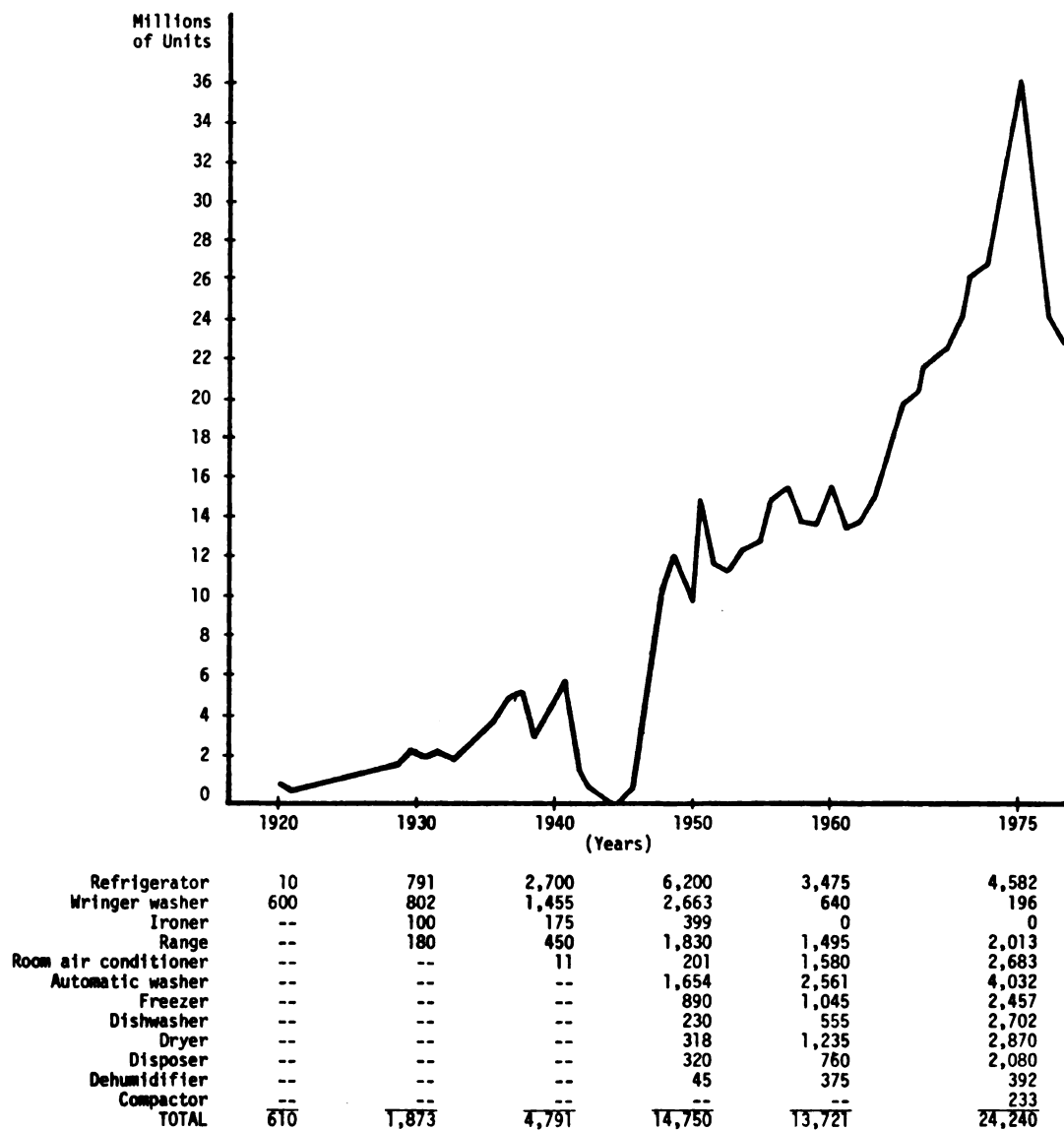


Figure 12. Industry growth.

Table 4. Percentage of Appliance Sales by Month

Month	Appliance						
	Refrigerators	Automatic Washers	Dryers	Freezers	Ranges	Dishwashers	Disposals
January	6.4 ^a	7.5	8.2	6.6	7.9	7.5	7.5
February	6.7	7.5	7.7	6.6	7.2	6.9	7.4
March	8.4	8.3	6.8	8.2	8.5	8.4	8.9
April	8.2	8.2	7.6	8.4	8.5	8.4	8.3
May	9.0	8.9	7.7	8.8	8.7	8.5	8.3
June	9.6	8.9	8.2	9.1	8.7	8.5	8.9
July	10.6	8.9	8.2	11.1	8.7	7.4	8.4
August	9.4	9.8	9.7	8.7	8.6	8.7	8.8
September	9.2	10.0	10.4	9.0	8.5	9.0	8.8
October	9.2	10.0	10.6	9.0	9.0	10.3	9.1
November	6.4	6.5	7.3	7.6	7.2	8.5	8.0
December	6.6	5.3	6.0	6.7	7.2	7.9	7.6

Source: Data supplied by Association of Home Appliance Manufacturers.

^aPercentage figure is an average of 1973-1975.

The fluctuations in appliance sales have moderated a great deal since appliances were first introduced. Refrigerator sales reached their peak during the summer months, while during the winter sales declined as there was little need in northern states for a device to keep food cold. In addition, washing machine sales in the early 1950s showed greater fluctuations than they do today. Then, the months of September, October, and November accounted for 39 percent of the yearly sales.⁴

These seasonal variations in sales cause problems for all the members of the distribution channel. First, manufacturers who have a limited line find it difficult to develop a strong dealer network. Dealers have little loyalty to a manufacturer whose product they might only sell for part of the year. Second, manufacturers need long production runs in order to maintain significant economies of scale. The fluctuations in sales at the dealer level cause even wider fluctuations in demand at the manufacturer level. This is due to the nature of the derived demand which faces the manufacturer. Dealers in their response to fluctuations in consumer demand order large quantities during certain months and then little or nothing in others. This causes sales to vary widely at the distributor and manufacturer level. Finally, the variations in sales increase the size and carrying costs of inventory in the channel. Some member of the channel must store units during the slow periods so that ample supply will be available during peak demand

⁴Anthony E. Cascino, "Household Washing Machines," Marketing Channels: Structure and Strategy (New York: McGraw-Hill, 1968), p. 182.

periods. This function is usually performed by the manufacturer, if factory branches are used, and by the distributor, if that channel is used.

Over the years, the introduction of new appliances has helped to flatten out the seasonal variation in sales. This is possible because different products may experience peak sales at different times, thus evening out the overall sales of the industry.

Geographic Concentration of Manufacturers

Characteristics which are common to all appliances include the location of plants and the concentration of sales volume in a few manufacturers. Practically all of the manufacturing facilities are located in the Middle West and East. Table 5 clearly demonstrates the location of manufacturing facilities in 1940 and 1972.

The economic justification for locating plants in this section of the country (Middle West and East) was that for many years the best market and source of the factors of production were here. It was in this section that both skilled workers and raw materials for production, such as the hardwoods necessary for early ice box and refrigerator production, were available.

In addition, the success of companies like Maytag in Iowa prompted employees, relatives, and business neighbors to enter the market with competing products. These individuals received a firsthand account of Maytag's sales growth and profitability and were encouraged to begin manufacturing and distribution of their own appliances. This geographical concentration of plants prompted the initial use of

Table 5. Manufacturing Locations of Selected Appliances

State	Product					
	Refrigerators		Washers		Ranges	
	1940	1972	1940	1972	1940	1972
New York	53	2	4	1	17	2
California	35	3	2	0	8	5
Illinois	31	2	10	3	25	10
Pennsylvania	28	0	1	0	6	3
Michigan	22	5	3	4	10	0
Ohio	17	1	6	5	18	3
Missouri	16	0	1	0	6	1
Minnesota	13	2	1	0	0	0
Indiana	12	4	3	0	7	0
Kentucky	0	2	0	2	0	2
Iowa	<u>2</u>	<u>1</u>	<u>8</u>	<u>5</u>	<u>0</u>	<u>0</u>
TOTAL	229	22	39	20	97	26

Source: U.S. Department of Commerce, Bureau of the Census, United States Census of Manufacturers.

direct-to-dealer channels in adjacent markets and the use of distributors in the less familiar distant markets.

Table 5 also demonstrates the consolidation that occurred in the industry between 1940 and 1972. The number of manufacturing facilities producing refrigerators in 1940 was 229. By 1972 this number was reduced to 22 even though sales of refrigerators had increased from 2,600,000 units to 6,315,000 units. During the same period, manufacturing facilities for washers were cut in half from 39 plants in 1940 to 20 in 1972. Facilities producing electric ranges declined from 97 in 1940 to 26 in 1972. As the industry moved to larger and larger manufacturing facilities, increasing pressure was placed on distribution channels. As manufacturing facilities move further away from the market, the link between producer and consumer becomes more important because the channel is longer, more complicated, and costly.

While production was being consolidated in fewer plants, sales were being concentrated in fewer manufacturers. The appliance industry has been characterized by the growth of large multiple line corporations.

Concentration of Sales Volume

Sales volume for some products has always been concentrated in a few manufacturers. From the very beginning, Kelvinator and Frigidaire divided the refrigerator market between them. Even after General Electric and Westinghouse entered the market in 1926 and 1930, respectively, concentration did not decrease much. Volume concentration exists in other products as well.

Maytag has always led in conventional washer sales while Bendix was the number one producer of automatic washers from 1939 to 1953. Bendix, along with Kenmore-Whirlpool, and Westinghouse sold about 57 percent of the automatic washers in 1952.⁵ This concentration has become even greater over the years. Table 6 demonstrates the level of volume concentration in the industry.

The top two manufacturers in each product account for 50 percent or more of sales except for gas and electric ranges. The top five manufacturers account for over 80 percent of the sales volume in every product with the exception of gas and electric ranges. Also, the industry itself is dominated by a few manufacturers.

General Electric and Whirlpool are either the largest or second largest manufacturer of every major appliance. In addition in five of the nine products, General Electric and Whirlpool are both first and second largest manufacturers in the industry. Table 7 lists the major manufacturers and how they rank in sales volume for each product.

This concentration exists primarily because some manufacturers have been forced out of the market by competitive pressures or because they have been merged into larger organizations. Companies that were forced out of the market by competitive pressure include: the Bendix and Crosley Divisions of AVCO, Borge Warner's Norge Division, Ford's Philco Division, Apex, and Landers, Frary, and Clark among others. Still other manufacturers have been merged into larger organizations.

⁵Ibid., pp. 175-176.

Table 6. Volume Concentration by Product, 1975

Product	Number of Manufacturers				
	One (%)	Two (%)	Three (%)	Four (%)	Five (%)
Refrigerators	28 ^a	50	68	78	85
Washers	40	58	71	80	87
Gas dryers	39	57	70	80	86
Electric dryers	40	60	71	82	88
Gas ranges	19	35	48	58	67
Electric ranges	33	45	55	65	74
Room air conditioners	26	49	58	66	70
Freezers	27	53	66	76	83
Dishwashers	35	58	76	82	87
Disposals	36	54	68	81	91

Source: Appliance Manufacturer, January 1976, p. 32.

^aAll figures are percentage of industry sales.

Table 7. Manufacturers' Ranking in Sales Volume by Product

Company	Product									
	Refrig- erator	Washer	Gas Dryer	Elec. Dryer	Gas Range	Elec. Range	Freezer	Dish- washer	Dis- posal	Com- pactor
General Electric	1	2	2	2	-	1	6	2	1	2
Whirlpool	2	1	1	1	-	8	2	5	-	1
White Consolidated Industries	3	4	4	3	-	2	1	6	-	-
Frigidaire	4	6	6	5	-	6	-	7	-	-
Maytag	-	3	3	4	0	0	0	4	0	0
Amana	7	-	-	-	-	-	5	-	-	-
Design Manufacturing	-	-	-	-	-	-	-	1	-	-
Magic Chef	-	-	-	-	1	3	-	-	-	-
Norge Fedders	-	5	5	6	-	-	-	-	-	-
In-Sink-Erator	-	-	-	-	-	-	-	-	2	-

Source: Appliance Manufacturer, January 1976, p. 32.

White Consolidated Industries merged with Gibson in 1967, Kelvinator in 1968, and the appliance division of Westinghouse in 1975. Whirlpool added the Seeger Refrigerator Company and RCA Estate Ranges in 1955, Servel, Inc., in 1958, and Warwick Electronics in 1966. Strong leadership in the distribution channel affects the methods of distribution by inducing the less successful companies to copy the methods developed by the leaders.⁶

Most of the successful companies in appliance manufacturing have multiple lines (Maytag being the notable exception). Because General Electric was a full line manufacturer and dominant force in the industry, other companies selected to copy them. Thus, diversification into different lines has been a part of the natural growth of the appliance business. Although Maytag has been able to maintain a direct-to-dealer system of distribution, multiple line manufacturers either employ an independent distributor, invest in a wholly owned factory branch, or a combination of the two.

The large multiple line manufacturer with abundant resources can have several advantages over single line manufacturers. These include: the development of a strong customer franchise in all areas of the market; maintenance of an adequate service and parts network for complex appliances; amortization, through national distribution, of the high cost of investment necessary to produce a product; and the opportunity for the appliance distributor to improve operations by dealing with a single manufacturer. This provides multiple line

⁶Ibid., p. 176.

manufacturers an advantage over single line competitors. However, it is possible for a single line manufacturer to compete in the market.

Single or limited line manufacturers generally distribute through independent distributors. The distributor's services are usually shared with a manufacturer of a complementary line. (A washer manufacturer could share a distributor with a refrigerator and range manufacturer.) However, should one of the manufacturers broaden his line to include products produced by the other manufacturers, then the distributor is forced to make a choice between the two manufacturers. (Historical industry practice has limited distributors to one brand of an appliance.) This could potentially leave a manufacturer without a distributor in a geographic area forcing him to accept a second rate distributor or institute a factory branch.

Thus far, the factors which affect the distribution of appliances have been analyzed in isolation. However, the decision to raise or lower price, to distribute through independent distributors or factory branches, or any other decisions made by any competitor affect the other members of the industry.

The Appliance Industry as an Oligopoly

Oligopoly was earlier defined as a situation of a few sellers. Few means few enough so that each can keep a watch on the actions of his rivals and must consider their reactions to what he may do. Any action taken by a member of the oligopoly can have a substantial effect

on the actions of other members in the market. Consequently, each member will watch the others and will copy or counteract their rivals' actions if possible. In addition, products in an oligopoly can be either differentiated or undifferentiated.

The appliance industry is dominated by a few large firms, and consequently, in an oligopoly, the market for appliances is large. However, the firms operating in the industry are also large. The top four companies in each product account for an average of 74.8 percent of the sales of that product. Two of the firms rank first or second in all but one product and are first and second in five of the ten major appliance categories. The appliance industry has always been characterized by the existence of a few manufacturers--that is, few enough so that each can and does watch the actions of the others. They then plan their strategy on the actions or expected actions of their competitors. However, the industry has not always been dominated by as few companies as it is currently. Over the years, a gradual weeding out process has taken place with the weaker competitors pulling out of the industry or being absorbed by larger firms.

Today, the industry is dominated by multiple line manufacturers, such as: General Electric, Whirlpool, White Consolidated Industries, and Frigidaire. However, several other firms have been able to compete in the market by gaining a strong foothold in a single market. These companies include: Maytag in laundry equipment; Design Manufacturing in dishwashers; Magic Chef in gas ranges; and In-Sink-Erator in disposals. Each of these companies ranks in the top three in sales of

its product. See Table 7 for the rankings of companies. Although the number of producers has changed greatly over the years, competition within the industry is still very intense.

In an oligopoly situation, competition can take several different forms. These include: (1) price, (2) product differentiation, and (3) a change in advertising or promotional expenditures. The firm operating in an oligopoly can utilize any or all of these forms of competition. In addition, because of the few numbers of sellers, each firm studies the competitive actions of its competitors.

Price

Throughout the history of the appliance industry, there has been a great deal of price competition. This competition has led to lower prices for almost all major appliances. For example, the first Guardian refrigerator sold for about \$750. Today, refrigerators are better constructed, more efficient, and can be produced for about \$200. In general, the same is true for the other major home appliances.

Economic theory suggests that price in an oligopoly will not fluctuate a great deal. This is due to the existence of the kinked demand curve (see Figure 4, p. 33) that faces a firm in an oligopoly situation. There are two assumptions that cause the kink in the demand curve. Economists assume that if the firm raises prices competition will not follow and sales of the firm that raised prices will decline as customers purchase competing products. On the other hand, if prices are lowered by one firm, the others will follow in order to maintain their market share. Consequently, no one gains market share. Because

there is nothing to be gained by a price reduction and a price increase leads to smaller revenue, the firm in an oligopoly situation generally avoids price competition. When prices do change, this is usually brought about by a firm that assumes the role of price leader.

A price leader is usually a large or influential firm in the industry that sets prices, and then the other firms adjust their prices accordingly. Each member of the oligopoly watches the price leader and takes its cue from the price leader's actions. In general, when the firm providing price leadership raises prices or lower prices, the other firms will follow. However, this is not always the case, and occasionally, other firms in the oligopoly will challenge the price leader and refuse to go along with the price change.⁷ Through competitive pressure, the appliance industry has been able to reduce the price of its products.

In the early years of the appliance industry, manufacturing innovations and an expanding market enabled manufacturers of appliances to continually reduce prices. Each year prices were generally lower than the last. This situation continued until the late 1930s.

In 1938 Kelvinator faced with stagnating sales and a seven million dollar loss took a dramatic step and reduced prices approximately 23 percent across the board. Its best selling refrigerator then sold for \$149.95. Kelvinator's price cut caught the rest of the

⁷Numerous examples can be found in the automobile, steel, and other industries. The challenge to price leadership usually occurs when one firm in the industry refuses to go along with a price increase.

industry by surprise. Until then, Kelvinator had been an "also ran" in the industry and in 1938 ranked a distant fourth. Because of the company's position in the market, the price cut was not expected, and it took the rest of the industry several months to meet the competition. Kelvinator, in the meantime, was well on its way to doubling its sales within the year. After World War II, price competition slacked off.

The pent-up demand that was created by the war caused a rush to purchase appliances in 1946, 1947, and 1948. Manufacturers had little trouble selling all they could produce, and so price competition was practically nonexistent. Many consumers were willing to pay anything just to get an appliance. However, by the early 1950s, price competition was again a reality.

In the early 1950s, the consumer demand of the postwar era had been satisfied, and price cutting was used to reduce unwanted inventories. All levels within the channel began to reduce prices 10 to 15 percent in an effort to attract customers and maintain market share. Since the early 1950s, the industry has been characterized by overproduction, and the result has been a strong downward pressure on prices with a reduction in profit margins for most channel members. During this period, several manufacturers have left the industry. There has, however, been one exception to this.

While many companies have decided to abandon the major appliance industry for more profitable areas, White Consolidated Industries (White) has been buying their cast-off appliance divisions. White has a different approach to pricing. Rather than meeting

competition and maintaining market share, even at a loss, White maintains that every product it sells should be profitable. Consequently, it has raised prices of late, and the rest of the industry has followed its leadership. White feels the industry has been mismanaged. This mismanagement has caused prices and profit margins for most producers to remain low. It feels that other manufacturers are reluctant to raise prices because of antitrust pressure from Washington and the potential loss of market share.

In general, the appliance industry has followed economic price theory. Prices and those things which affect prices, such as trade-ins, have been uniform within the industry; and price changes by one manufacturer have been copied by the rest of the industry. However, there have been instances where price leadership was provided by a firm that is not a dominant factor in the market. According to Chamberlin there are other competitive factors present in an oligopoly.

Product Differentiation

A general class of product is differentiated, Chamberlin states, "if any significant basis exists for distinguishing the goods (or services) of one seller from another."⁸ The differentiation may be based on characteristics of the product itself, such as: exclusive patented features; trademarks; trade names; peculiarities of the package or container; or singularity in quality, design, color, or style.

⁸Edward Chamberlin, The Theory of Monopolistic Competition (Cambridge, Mass.: Harvard University Press, 1933), p. 56.

Another possibility is for sellers to alter the terms of sale, service, credit, speed of delivery, convenience of the seller's location, general tone or character of the establishment, way of doing business, courtesy, efficiency, and all personal links which attach customers to the product or seller. To the extent that these factors vary from seller to seller, the product in each case is different because buyers take them into account and purchase them along with the commodity.

The product sold by the appliance industry is differentiated. In the early years of the industry, products were quite similar; however, within a short period of time, companies were adding porcelain finishes, manufacturing hermetically-sealed compressors, and much more. Over the years, manufacturers seeking a differential advantage over their competition have done the following: increased the size of the appliance, used porcelain finishes, offered credit, offered designer colors, built in the appliances, added new appliances, improved the quality and performance of the old appliances, provided factory service, provided quick delivery, improved dealers through sales training and management development, and promoted strong brand names and trademarks. The list of items that manufacturers in the industry have used to differentiate their product is endless, and it would be impossible to list all of them here. Manufacturers have vigorously attempted to gain a differential advantage over their competitors by differentiating their products. This process has been going on ever since the inception of the appliance industry. During this time, each manufacturer has been able to cultivate a segment of the market that has a preference for its product.

Product differentiation is a problem for the seller of appliances. The volume of sales and profits is dependent, in part, on the firm's ability to successfully differentiate its product. Firms which have failed in this respect are, in many cases, no longer a part of the industry. There is, however, another competitive factor which influences a firm's sales and profits.

Selling Costs

Selling costs are defined by Chamberlin as "costs incurred in order to alter the position or shape of the demand curve for a product." As such, they include "advertising of all types, salesmen's salaries, and the expenses of sales departments, margins granted to dealers (retail or wholesale) in order to increase their efforts in favor of particular goods, window displays, demonstrations of new goods, etc."⁹ In short, the manufacturer is faced with a dual promotional problem. He must promote his product to both the final consumer as well as the middleman. The manufacturer wishes to shift the consumer's demand curve to the right and to secure the desired aggressiveness of the middleman.

Promotion of the product to the final consumer usually takes the form of advertising or personal selling. The shift of the demand curve for a product is attributable to two factors: (1) imperfect knowledge and (2) the possibility of altering people's wants.

⁹Ibid., p. 117.

In the early years of the appliance industry, the main objective of promotion was to provide consumers with product knowledge. Lack of knowledge was a problem that faced most consumers. They were unaware or only vaguely familiar with the products the appliance industry was offering them. Promotional expenditures increased the sellers' market by disseminating information on the product. Manufacturers at this time relied on aggressive personal selling and information advertising to make as many consumers as possible aware of their products. Later, as consumers became more aware of major appliances, personal selling declined in importance. However, the manufacturer was still providing the consumer with information.

When department stores entered the business in the 1930s, some manufacturers set up display kitchens in the department store and staffed them with home economists to answer the consumer's questions and explain the use of the product. This further expanded the market and continued to alter people's wants. As successive new products were introduced, the consumer was first informed of their existence and over time the products met with increased acceptance.

Over the years, some companies have had a great deal of success in promoting their products to the consumer. Promotional activities allow the seller to reach more customers than those that might hear of the product by word of mouth. This generates the possibility of increased sales and reduced costs due to the economies of mass production and distribution. These reduced costs give the advertiser a cost advantage over firms with limited sales and distribution.

In addition, it is possible to build up a strong customer franchise which makes it easier to gain acceptance of new models and products. This, in turn, has probably contributed to the dominance of the appliance industry by some companies. There are, however, other promotional expenditures which the manufacturer must consider.

Chamberlin has suggested that middleman cooperation can be achieved by: (1) providing them with higher margins, (2) granting exclusive distribution territories, or (3) ownership by the manufacturer of the distribution outlets. In the early 1920s, it was difficult to find competent middlemen to carry the product. Appliance distributors and dealers did not exist, and so, to induce potential middlemen to carry appliances, manufacturers offered them exclusive franchises in their territories in addition to their profit margins. As acceptance of appliances grew, some manufacturers began to replace distributors with factory branches, and others offered sales training programs of distributor and dealer salesmen, cooperative advertising, floor planning for dealers and management assistance. In their competition for a differential advantage, manufacturers have thus chosen different techniques to reach the consumer.

The manufacturer is faced with a dual promotional problem. He must promote his product to the final consumer as well as secure the desired aggressiveness of the middleman. The former can generally be accomplished through good advertising, while the latter is accomplished by adjusting margins, offering exclusive distribution, providing incentives, or by the manufacturers' ownership of the distribution outlets.

Thus far, a general background of the appliance industry has been provided. The final sections of this chapter will provide a chronology of the appliance industry. This chronology has been divided into the following areas: Channels of Distribution to 1930; Channels of Distribution in the 1930s; and Channels of Distribution in the Post War Era. This division was chosen because of the significant changes that occurred in the industry about 1930 and again right after World War II.

About 1930 several major innovations took place in major appliances. These included: the development of the Calrod heating unit, the hermetically sealed compressor, and the development of freon. Each of these innovations would have a significant impact on the product and its market potential. In addition, Frigidaire began to sell appliances through a totally new type of dealer, the department store. Department stores would have a significant impact on appliance distribution not only because of their sales volume but because of the conflict that would emerge between the department store and the independent distributor.

During World War II, the appliance industry was nonexistent. However, after the war, the enormous demand for appliances caused an increase in the number of dealers, distributors, and manufacturers and their productive capacity. This sudden increase in the number of channel participants and the capacity of the industry had an effect on the industry that is still felt today. The next section provides a chronology of the appliance industry to 1930.

Channels of Distribution to 1930

Each of the topics discussed under the Channel Determinants section has had a significant effect on distribution channels in the appliance industry. In this and the following two sections of the chapter, other factors will be added which have shaped distribution channels. In addition, attention will be paid to the factors that were important in the decision-making process to alter the existing channel structure and policy.

During the initial stages in the life of the refrigerator, washer, and range, these products had little public acceptance, and brand recognition was limited to the area adjacent to the manufacturer's plant. The original Frigidaire and Kelvinator refrigerators were sold by company salesmen for cash, installed and serviced by the manufacturer. Because of all this, the Guardian Frigidaire Company had only sold forty refrigerators and lost \$34,162 in its first two years in the business.¹⁰

In 1919 when the company passed into the hands of General Motors, production was expanded greatly. To sell this increased volume, Frigidaire instituted sales and service offices in cities other than Detroit. They chose this channel because there were no appliance dealers or distributors available, because the management at General Motors likes to control the distribution channel, and because they had experience with this channel in the automobile

¹⁰ Sloan, "My Years With General Motors," pp. 414-415.

industry. However, even with this increased sales effort, the product was not durable enough for home use and so Frigidaire continued to lose money.

Finally, in 1921 the Frigidaire offices were moved from Detroit to Dayton and were merged with the newly acquired Domestic Engineering Company (later to be known as Delco-Light Company) and the Dayton Metal Products Company. Both Domestic Engineering and Dayton Metal Products had some background in appliances. In addition to this, Frigidaire gained a strong research department, a national sales force, and some unused productive capacity. In 1921 Frigidaire sold just over 1,000 refrigerators. However, by 1925, after the merger, this number had grown to 63,500. By that year, Frigidaire had established itself in the refrigerator market and had about 50 percent of the sales volume.

During this time the distribution pattern changed somewhat. Frigidaire had established their own direct distribution to the consumer in most areas. However, they began to add independent dealers of their refrigerators, and in markets outside the major metropolitan areas, they set up independent distributors. The independent distributors and dealers, like the automobile distributors and dealers, were exclusive. They carried only one manufacturer's product. When General Electric and Westinghouse entered the business, they set up their distribution along the same lines as Frigidaire. They had factory branches and dealers in urban markets with some independent distributors in rural markets. Kelvinator, however, was forced to take a different approach.

In the 1920s Kelvinator was the exception and distributed from the beginning through independent distributors. Kelvinator selected independents because they didn't have the funds necessary to establish their own distribution and/or dealer network. In some locations, they had factory branches. However, this was only because distributors were not available to carry their products.

The independent distributors and dealers of the 1920s should not be confused with the appliance distributors and dealers of today. At that time the appliance industry for all practical purposes did not exist, and so there were no specialty appliance middlemen. Manufacturers who used independents for distribution were forced to use distributors in remotely connected fields of electrical apparatus, hardware, farm implements, and even jobbers of general merchandise.¹¹ These distributors had space available and wholesale salesmen calling on dealers in their territory. These distributors were no match for a factory branch.

Both distributors and dealers carried only one appliance manufacturer's product. But because they were electrical or hardware distributors, they had other products to sell, and the appliance business might constitute only 5 percent of the total. In addition, appliance sales were difficult. A great deal of specialized door-to-door selling requiring a high degree of product knowledge was necessary to get customers to purchase the product. During this period, public utilities proved to be effective appliance dealers.

¹¹Cascino, "Household Washing Machines," p. 183.

The public utilities recognized early the advantages of selling appliances. Not only were appliances profitable on the initial sale, but they were profitable after the sale on a continuing basis as the utilities built up their residential load. In most cases, utilities acted as dealers; however, occasionally these dealers would also become distributors.

As the product improved and consumer acceptance increased, manufacturers expanded their sales territories and competition between manufacturers became inevitable. Additionally, the image of appliances as a rich man's luxury was beginning to fade. Many middle income consumers were beginning to enter the appliance market.

For most of these consumers, the purchase of an appliance constituted a major financial commitment which was exceeded only by the purchase of a house or an automobile. However, consumer financing for appliances was not provided by commercial banks, and there were only two sales finance companies, neither of which provided financing services to small dealers. This situation forced the Kelvinator management to take action. In 1926, following the lead of General Motors Acceptance Corporation (GMAC) in automobiles, Kelvinator initiated the Refrigerator Discount Corporation (REDISCO) to finance the sale of Kelvinator appliances for distributors, dealers, and their customers.

This action was brought on by the necessity of the situation. If Kelvinator hoped to continue to expand sales of their refrigerators, it must open up the market to middle income consumers who needed to purchase the product on time. In deciding to grant consumer credit,

Kelvinator was uncertain as to the profitability of this business. However, it was as a necessary adjunct to their appliance business. REDISCO's existence was predicated on its ability to help Kelvinator make a sale even if it meant losses for REDISCO. Originally, REDISCO only financed Kelvinator sales; however, after the profitability of the business had been demonstrated, financing for other manufacturers' appliances was added. This financing of appliance sales by the manufacturer was later copied by competition (Frigidaire shortly after and General Electric in 1932). During the 1930s, financing of appliances was a very important aspect of the business, and it enabled refrigerator manufacturers to expand sales even during the depression.

Channels of Distribution in the 1930s

Installment selling of refrigerators in the 1930s would do much to expand the size of the market and decrease the price of refrigerators. Terms of sale were generally quite liberal. The consumer could purchase a new refrigerator for nothing down and only pay 25¢ per day. At that price, it was easy to convince owners of ice boxes that a new refrigerator was actually cheaper (ice cost more than 25¢ per day). Consequently, installment contracts at REDISCO alone increased from \$6,000,000 in 1930 to over \$17,000,000 by 1940. In addition, refrigerator sales increased from 791,000 units in 1930 to 2,700,000 units by 1940. This increase in sales allowed manufacturers to mass produce refrigerators and thus reduce the price of the average refrigerator from \$292 in 1930 to \$164 by 1936.

By the early 1930s the traditional market for appliances, upper income customers, had become saturated. However, installment buying extended the market to other less affluent market segments. The saturation level of refrigerators was 73 percent for families with incomes of \$5,000 and over, while it was only 26 percent for families with incomes from \$1,000-\$2,000. Sixty-two percent of the families in the \$1,000-\$2,000 income level financed their purchases using an installment contract (see Table 8).

Table 8. Distribution of Refrigerator Owners by Income Class

Income	Percentage of Total Ownership	Percentage Using Finance Plan	Saturation (%)
\$5,000 and over	10.9	0.07	72.8
\$3,000-\$5,000	16.7	4.9	59.5
\$2,000-\$3,000	28.3	21.5	41.1
\$1,000-\$2,000	36.1	62.2	26.3
Less than \$1,000	8.0	10.7	8.1

The potential of the appliance market of the late 1920s and early 1930s attracted a great number of manufacturers. They developed primarily in the middle west where the success of the innovators could most easily be seen. However, as the market grew, competition between the industry leaders became more intense, and the smaller firms were forced out of the market. This was especially true after General Electric introduced the hermetically sealed compressor in the late 1920s. This device was a major competitive feature which the industry

bitterly fought. It allowed General Electric to guarantee its compressor for five years giving GE a strong competitive advantage. This forced existing and potential manufacturers to develop a sealed compressor and then to guarantee it for five years like General Electric. The cost of research and development and the extended warranty was too great a burden for the smaller firms, many of whom failed. In addition, it was difficult for new producers to establish efficient distribution systems as most of the effective distributors and dealers were already part of a channel system.

Distributors who recognized the importance of major appliances and devoted a major effort to their promotion were able to survive. In many cases, successful dealers were established as distributors. Although the specialty appliance distributor was beginning to develop, there were already pressures for change.

The appliance industry began with a price structure that allowed for the following gross profit: dealer, 25 percent; distributor, 25 percent. Within this, distributors were expected to spend a great deal of their income training the early salesmen in the industry. In these years it was common to keep a dealer's salesman in school for a couple of weeks before he attempted to sell new appliances to customers who had lived a lifetime without them. This discount structure remained unchanged as long as technical selling was needed at the dealer level. However by the mid-1930s it became evident that appliances could be sold in volume without as much training and assistance from the distributor. Consequently by 1935, the following

structure had generally been established: dealer, 35 percent; distributor, 16.6 percent. This pattern was held intact until 1940, when both dealer and distributor margins were again reduced. By 1940 the margins were: dealer, 33 percent; distributor, 12 percent.

During the 1930s the distributor's role in the distribution channel was changing. Although they still only represented a single manufacturer of a product, the market for appliances was changing rapidly and, consequently, so were distributor margins. Consumers were becoming increasingly sophisticated in terms of the potential and operation of appliances. In addition, new dealers, like the department store, seeing the potential profits in appliance sales had entered the market. Finally, some manufacturers, in order to keep pace with these changes, decided to convert some of their independent distributors to factory branches.

During the mid-1930s General Motors and General Electric began to replace their independent distributors with factory branches. The inability of the independent distributors to respond to a changing market and, in some cases, their refusal to deal with new dealers led to their replacement. Manufacturers eager to gain a larger share of the rapidly expanding market were unwilling to give up any dealers to competitors, especially the aggressive department stores. By the late 1930s, Kelvinator was the only major appliance manufacturer to distribute the bulk of its appliances through independent distributors.

By 1938, Kelvinator, the fourth largest manufacturer in the industry, found itself in financial trouble. Although the overall

market was increasing, Kelvinator sales were declining, and the company suffered a \$7 million loss in 1938. At that time 95 percent of its distribution was through independent distributors. Part of the problem was that the distributors were selling hardware, radios, furniture, etc., and Kelvinator represented a small part of their overall business. Under these circumstances, the manufacturer has very little control over the distributor. The Kelvinator management decided to restructure its distribution system making greater use of factory branches.

In the restructuring, the number of independent distributors was reduced from 120 to 52, and 13 factory branches were established in major metropolitan areas. In addition, the Kelvinator refrigerator line was reduced from 18 models to 6, and the price was reduced \$30 to \$60 on the entire line. These changes caused a rapid increase in appliance sales, and competitors quickly selected to meet the price competition by lowering prices. By 1941 Kelvinator's advantage was lost as appliance facilities were closed down or converted to war production.

At the dealer level of distribution, there were also numerous changes. Retail distribution of major appliances began with small businesses established to sell and service refrigerators and washing machines. Public utilities entered the business early to increase consumption of electricity, and distributors established their own dealer outlets. In the 1930s this structure was to change drastically.

By the early 1930s Frigidaire was able to convince department stores to carry major appliances. Department stores had many advantages over other dealers including: a strong customer franchise; strong local advertising; they organized outside selling crews much better than other dealers; and although they were a small number of accounts, they had a great market potential. Over 500 department stores entered the business between 1930 and 1936. So great was their impact on the market that by 1940 they accounted for 21 percent of the market. Their merchandising techniques were far superior to other dealers as they could offer better display, advertising, and sales promotion. In an attempt to gain maximum benefit from the large number of customers that patronized department stores, manufacturers established display kitchens staffed with a home economist. These display kitchens were placed in high traffic areas and provided an excellent opportunity for the manufacturer to introduce consumers to the convenience and ease of operation of new appliances. In addition, because of the department stores' strong market position, they were the first to break industry practice by selling competing lines of refrigerators, washers, or ranges.

Shortly thereafter, other major appliance dealers began to add radios to the lines of appliances they sold, and the appliance dealer as we know him today was instituted. By 1940 appliance dealers accounted for 32 percent of sales volume.

The public utilities, which were an important part of the dealer network in the 1920s, were beginning to diminish in importance. In 1930 the utilities accounted for 25 percent of dealer sales, but by

1940, this had declined to 10 percent. The public utilities abandoned the dealer business for two reasons: (1) other dealers had entered the market and (2) because of government pressure. In the early 1930s numerous other dealers had entered the industry and were providing increased competition for the utilities. During the 1930s, 500 department stores, 4,000 furniture stores, and a number of mail order houses had entered the market. These were aggressive dealers, and thus, there was little need for the utilities to sell appliances in an effort to increase the residential load. In addition, by 1932, Oklahoma and Kansas had passed, and other states were considering, laws which forbid the sale of appliances by utilities. With increased competition at the dealer level and government pressure, the utilities' market share slowly declined.

When the United States entered World War II, all appliance manufacturing would be halted until 1945. Upon the resumption of manufacturing after the war, many consumers who had postponed appliance purchases entered the market. This increased demand for appliances would cause repercussions in the industry that would be felt for years.

The Post-War Period

Immediately following the war, production of appliances resumed. Consumers, unable to satisfy their demands during the war years, began to demand appliances and tax the industry's capacity. In the five years following the war, sales of appliances increased from zero to almost 17 million units by 1950. Producers were selling every appliance produced

and could not satisfy the demand. Demand was so great that manufacturers were allocating products to dealers. Manufacturers would set list prices, and consumers were happy to pay them. In many cases consumers were even paying more than list for the right to purchase an appliance. Major appliances thus presented very lucrative profit possibilities. Consequently, distributors and dealers began to pay increasing attention to their appliance business. In addition, dealers were entering the market in an unprecedented scale. In one year after the war, over 50,000 dealers entered the market.¹² This situation continued until about 1950, when overproduction in the industry produced a glut of appliances.

After the war, manufacturers of major appliances continued the expansion of the product line. Full line distribution provided a differential advantage for both manufacturer and dealer. By purchasing from a full line manufacturer, the dealer could secure quantity discounts and reduce ordering costs by purchasing an assortment of products in carload lots. Dealers dealing with manufacturers of a single or limited line found it difficult to gain these quantity discounts. They had to purchase carload quantities of a single or few products to gain the full advantage enjoyed by the full line manufacturer's dealer. However, the single or limited line manufacturer, by using a distributor, could approximate full line distribution. The distributor combined several noncompeting lines of different manufacturers and then offered them to the dealer as a full line.

¹² "Thor Adopts Limited Distribution, Cuts Dealers from 20,000 to 7,000," Sales Management, 1 April 1950.

Prior to the war, many washing machine manufacturers shared distributors with manufacturers of refrigerators (who also had ranges and freezers) and manufacturers of televisions and/or radios. However, after the war when refrigerator manufacturers began to broaden their line to include automatic washers, problems occurred at the distributor level.

Industry practice limits independent distributors to only one brand of a particular product. When the refrigerator manufacturer introduced an automatic washer, the distributor was forced to decide between carrying the refrigerator manufacturer's washer and dropping the current washer line or dropping the refrigerator manufacturer brand. If the distributor chose the latter, then he would most likely lose the refrigerator manufacturer's other products which usually included refrigerators, ranges, and freezers. The decision was usually quite simple as economic considerations dictated that the distributor retain the profitable refrigerator line. Consequently, single line producers (they were predominately washing machine companies) stood a good chance of losing their best distributors as refrigerator manufacturers expanded into washer sales. The possibility existed for a single line manufacturer to be denied access to the market through independent distributors.¹³

To counteract this, single and limited line manufacturers began to introduce new products. By doing this, they became full line manufacturers and could offer distributors a franchise which covered

¹³Cascino, "Household Washing Machines," pp. 186-187.

several products. The major exception to this pattern was Maytag. Maytag concentrated on washer production and made only limited use of independent distributors. The bulk of Maytag's distribution was direct-to-dealer (60 percent) or through factory branches (17 percent).¹⁴

Prior to the war, General Electric, Westinghouse, and Kelvinator had all expanded their lines while Frigidaire continued to manufacture only refrigerators. Frigidaire had been very successful with its refrigerator line and never felt the need to expand the product line to gain sales or profits. However, prior to the war, Frigidaire sales had declined significantly, and so during the war, Frigidaire surveyed dealers in an attempt to define the problem facing the company. The dealers indicated that Frigidaire should introduce other major appliances beyond refrigerators in order to be competitive in the market. Immediately following the war, Frigidaire began to add other major appliances.

Following the war, Frigidaire, General Electric, Westinghouse, and Hotpoint added automatic washers to their lines. Nash-Kelvinator purchased Altorfer Brothers Company, a washing machine manufacturer; Bendix, an automatic washer producer; and added refrigerators, ranges, and freezers. Crosley introduced a washer line and Whirlpool Corporation, a washer manufacturer, added a complete line of products in the middle 1950s. Each was seeking the additional profits that a new product would offer them and/or at the same time trying to increase control of independent distributors and dealers.

¹⁴ Ibid., p. 189.

This expansion of product lines has continued ever since the end of the war. The result is that the industry is dominated by a few multi-product companies. The specialty appliance distributor has thus had a significant impact on the number of products offered by the manufacturers in the appliance industry.

The independent distributor has played an important part in the distribution of major appliances. This is due to his strategic position in the channel and his skill and importance in promotion of the product.

The appliance distributors were granted an exclusive franchise in a carefully defined territory under the condition that they would not sell competing brands. This was imposed by the manufacturers in order to: (1) increase their control over the distributors; (2) because of their belief that distributors could not do an effective job with, and be loyal to two brands; and (3) manufacturers felt that if distributors carried competing brands, competitive secrets would be impossible.

Within his franchise, a good distributor must build a strong dealer organization. This includes the right kind and number of dealers in each important market and then the training of the dealer's salesmen to sell and service the product. Competent dealers are vital to the distributor's success and good distributor-dealer relations are also important to the manufacturer's success.

An adequate inventory must be kept on hand by the distributor, and the dealer must be sold a sufficient supply of units by models.

The distributor must secure a good display location for the product on the dealer's floor and in display windows. Finally, the distributor must consistently expose the dealer to constant and effective sales promotion efforts.

Local promotion for the dealer is also a responsibility of the distributor. In many cases this means scheduling, writing, and participating in cooperative advertising programs. Other sales promotional literature must also be made available so the customer can continue to consider the product away from the dealer's showroom. Additionally, the distributor provides incentives to the dealer in the form of: trips for volume purchases, meetings, retail incentives to dealer salesmen, and other volume incentive programs which reduce the price the dealer must pay based on the volume the dealer sells.

Another important aspect of the distributor's job is financing. Because most consumers purchase their appliances on the installment basis, most dealers need help in financing their operations. Distributors then are expected to provide free floor planning¹⁵ by using financing from an outside institution. This has become a major part of the distributor's sales policy over the years. So much so that many distributors claim they sell terms rather than products.¹⁶

The relationship between a distributor and dealer is generally a close one. The distributor is intimately acquainted with the dealer's

¹⁵ Floor planning is the financing of dealer inventories by the distributor.

¹⁶ Cascino, "Household Washing Machines," p. 188.

problems and provides expert help whenever possible. This builds a high degree of trust and loyalty between distributor and dealer, and a good distributor is held in high esteem by his better dealers.

The importance of distributors in the distribution channel can be seen in the effect they had in the appliance business at AVCO. AVCO Manufacturing entered the appliance business in 1945 with the purchase of Crosley Corporation of Cincinnati, Ohio. Before the war, Crosley had marketed a successful line of refrigerators and radios. The refrigerators achieved a degree of fame because of their unique "Shelvador" construction which allowed for storage of food in the door of the refrigerator. In 1950, in an attempt to round out the company's line and compete with other full line companies, AVCO purchased Bendix Home Appliances. Bendix led the industry in the production of automatic washers, and Crosley was third in refrigerator sales. The combined companies made AVCO a significant factor in the appliance market.

Mindful of the trend to full line manufacturing and its increased profit potential, AVCO executives were determined to offer to their distributors a complete line of both Bendix and Crosley appliances. By 1952 AVCO had decided to introduce a Bendix refrigerator that was produced by Crosley. Because of this, many Bendix distributors were forced to choose between the Bendix refrigerator and the one they were currently carrying. As a result, 15 percent of the Bendix distributors discontinued the Bendix line, and AVCO was forced to find other, usually second rate, distributors. The same situation occurred again when Crosley introduced a line of washers manufactured by Bendix.

Because the two lines were exactly the same, except for nameplates, dealers were able to force distributors of the lines to reduce prices by playing one against the other. These problems in the distribution system induced management to consolidate the two lines under one management. In 1953 the combined line, including Crosley television sets, was offered to distributors on an all-or-nothing basis. Again, distributors were faced with a decision as to which lines they should carry. Many of the large Bendix distributors decided to drop the Bendix line and pick up another washer manufacturer, and AVCO had to again take second rate distributors. By 1956, after taking a 16.5 million dollar loss, AVCO discontinued the production of Crosley products and sold its inventory of Bendix washers to Philco for \$6 million dollars. In a period of less than six years, AVCO, one of the largest appliance manufacturers, had gone out of the business.¹⁷ AVCO sold its appliance division to Philco in 1956, and in August 1976 Philco-Ford discontinued the production and distribution of appliances. When Philco-Ford selected to discontinue appliance production, its distributors were forced to find another source of appliances.

Many of these independent distributors have selected to join a cooperative that would pool buying power and contract with manufacturers to produce appliances under the Crosley brand name. The 35 distributors will distribute the Crosley brand on a national basis

¹⁷ Spencer Klaw, "Why AVCO Quit Appliances, Fortune, February 1957, pp. 138-140.

to over 3,000 dealers.¹⁸ This marks the first time that a distributor private brand has been introduced to a national market. However, dealer private brands like Sear's Kenmore and Montgomery Ward's Signature have been in existence for a number of years.

The importance of the independent distributor was recognized by Whirlpool. In 1953 Whirlpool established its Distributor Advisory Council (DAC). The DAC is composed of 14 distributors and branches selected by Whirlpool management. The group's function is to provide feedback to Whirlpool for major channel decisions which affect the distributor. In addition, Whirlpool uses the DAC to presell concepts it intends to introduce to the distributors in two to five years.

During the war, as a continuation of a policy started in the early 1930s, Frigidaire and General Electric informed their independent distributors that they would be replaced by factory branches on the basis of attrition. Any time a distributor died or left the business, he would be replaced by a factory branch. The effects of this policy as well as the changes in distribution to the dealer can be seen in Table 9.

In 1952 30 percent of General Electric's distribution was through independents. Today it is 100 percent factory branches. Frigidaire reduced the percentage of independent distributors from 30 to 11 percent. Westinghouse has remained fairly constant in the percentage of sales going through the distributor although it

¹⁸ "Distributors Bring Back the Crosley Appliance," Business Week, 31 January 1977, pp. 92-93.

Table 9. Distribution Channels

Company	Independent Distributors		Factory Branches	
	1952 (%)	1976 (%)	1952 (%)	1976 (%)
General Electric	30	0	70	100
Frigidaire	30	11	70	89
Westinghouse (WCI)	25	22	75	78
Whirlpool	100	50	0	50
Kelvinator (WCI)	20	100	80	0
Gibson (WCI)	100	100	0	0

reorganized its distribution in August 1974. Whirlpool has changed significantly from 100 percent independent distribution to 50 percent factory branches. Kelvinator has headed in the opposite direction of the other appliance manufacturers. It has changed from 80 percent factory branches to 100 percent independent distributors--similar to the distribution system it had prior to the war. Gibson has remained 100 percent independent distribution.

The trend seems to favor factory branches. The factor branch combines selling, administration, and warehousing under one roof and operates in almost every respect as if it were an independent distributor. Despite this similarity, most manufacturers and dealers agree that a good distributor is better than a good factory branch.¹⁹

¹⁹Wallis E. Wood, "The Changing Pattern of Distribution," Merchandising Week, 20 December 1965, pp. 11-15.

However, there are additional factors which have caused a change in the independent distributor.

After the war more and more manufacturers developed full lines; one of the advantages of this was that the dealer could purchase directly from the manufacturer in mixed carloads. Manufacturers would grant a price reduction for those dealers that could purchase this way and would ship directly to the dealer avoiding the distributor level in the channel. Frigidaire started the practice after the war, Westinghouse followed in 1951, and General Electric in 1953. Hotpoint allowed dealers to pool their orders resulting in a savings of 4 percent in transportation and handling costs. Both of these practices reduce the functions provided by the distributor. The practice, as was pointed out earlier, gives the advantage to the full line producer and increases the manufacturer's control over the dealer.²⁰ The dealers, however, were beginning to increase their power in the market.

The period following the war was very profitable for the industry and its dealers. Attracted by the high profits of the existing dealers, thousands of new dealers entered the business immediately following the war. However, by 1949, the situation had changed. Consumer demand had leveled off, and customers were not longer standing in line eager to pay premium prices for appliances. Manufacturers had added capacity in the mistaken belief that the sales increases after the war would continue. This glut of appliances which appeared on the

²⁰ "Is the Wholesaler Losing Out," Business Week, 28 November 1953, pp. 41-42.

market in the early 1950s would have a significant effect on the distribution of major appliances.

As the consumer demand for appliances declined, dealers responded by cutting prices. This practice became widespread with most dealers selling at 10 to 20 percent below the manufacturer's list price. This price cutting was led by the discount houses which had come into prominence after the war. These establishments operated as low overhead, low margin, low status dealers and, in turn, offered their customers a low price. The established appliance dealer was very bitter about this intertype competition, however, grudgingly attempted to meet the discounter's price reductions. Lower prices and sales meant reduced profits, and many of the marginal appliance dealers went out of business. The specialty appliance dealer and the discount house (because of their willingness to reduce profit margins in favor of higher turnover) both gained in market share during this period. By 1950 the two accounted for over 42 percent of the market. The appliance dealer, however, had undergone some significant changes.

With the glut of appliances on the market, many appliance dealers found themselves in a somewhat desirable position. As consumer demand slowed, manufacturers (eager to increase sales) began to look for new dealers. The appliance dealers, who normally carried only one manufacturer's line, found their bargaining position vis-a-vis the manufacturer improving. Dealers who were unhappy with margins, advertising allowances, or dealer incentives simply switched manufacturers or began to carry two, three, four, or more lines.

Manufacturers then were forced to compete within every dealer's establishment for floor space or dealer emphasis while the dealers used their power to gain the best terms from the manufacturer.

As the number of lines the dealer carried expanded, it became increasingly more difficult to service them well and profitably. Manufacturers who felt that dealers did a poor job of servicing their products were even more convinced when dealers selected to service several manufacturer's appliances. For many dealers, the increase in parts inventory and decline in the productivity of their staff made the service business unprofitable. To alleviate these problems, several manufacturers went to a factory direct service system. This included either an independent franchised service facility or a manufacturer's service branch. As changes in the discount house and appliance dealer were taking place, other dealers were decreasing in importance. This can be seen in reduced shares of the market for both department stores and public utilities.

Department stores entered the appliance business rather late but became strong dealer outlets because of their position in the community which they served. However, department stores were in general quite demanding of the manufacturers whose products they carried. During the early fifties when dealer margins were shaved, many of the department stores refused to accept a margin less than 25 percent, and so they selected to drop or de-emphasize their appliance departments. The result was a decrease in their market share from about 21 percent in 1940 to 8 percent by 1960.

Public utilities, which began their decline in the 1930s, continued to become a less significant factor in the post-war era. Faced with the continuing increase in the number of dealers and adverse legislation, the public utilities continued to reduce their share of the market. By 1960 they accounted for only 3 percent of the appliance sales in the country. Other retailers who accounted for a major portion of appliance sales included furniture stores, auto and tire chain stores, department chain stores (Sears, Wards, etc.), and the builder business (home and apartment builders).

The retail appliance dealer has undergone some significant changes. The price competition brought on by the discount house and the glut of appliances on the market caused several alterations in the way products were distributed. Appliance dealers expanded lines and reduced margins while department stores and utilities abandoned the business. The retail appliance business is in a constant state of flux, and there can be little doubt that current dealers will continue to change and that new dealers will enter the market to replace older, less efficient ones.

Summary

Chapter IV attained the first research objective by providing a chronology of the growth of the appliance industry and the development of prevailing channel structures. The major appliance industry has been greatly affected by the development of three products: the refrigerator, the washer, and the range. This is especially true of the refrigerator.

These products and the way they were distributed in the first years of production has influenced the pattern of distribution greatly.

Other factors which have influenced distribution include: the characteristics of demand, the geographical concentration of manufacturers, and the concentration of sales volume in a few producers. The major manufacturers of appliances are primarily located in the middle west and east. Over the years, these companies have become increasingly more concentrated so that today the industry is dominated by four manufacturers. These manufacturers are: General Electric, Whirlpool, White Consolidated Industries, and Frigidaire. Finally, the distribution channel has been affected by consumer demand. This demand is composed of both replacement and new demand. Today, for most major appliances, the demand is primarily replacement. All of these factors have had a major impact on distribution, and this impact is outlined as distribution trends were traced from the beginning of the major appliance industry in the early part of this century.

During the 1920s distribution was quite limited as the products were generally viewed as luxuries. Factory branches and distributors from related lines of merchandise were used at the distributor level, while public utilities and distributor-owned dealers dominated the dealer level. In the 1930s the distributor and dealer level of distribution both changed. The specialty appliance distributor began to develop, and some manufacturers increased their use of factory branches--while the dealer level saw the introduction of a strong new competitor into the market, the department store.

Again, in the post World War II era, distribution patterns changed. Some appliance manufacturers either selected to withdraw or were forced from the industry, while others added to their product lines. Margins were reduced at all levels in the channel, and some functions were transferred from distributors and dealers to the manufacturer. The introduction of the discount house at the retail level of distribution had far-reaching effects on both the retail and wholesale levels in the channels.

Chapter V, Field Results, will present the results of interviews with executives at Frigidaire, Whirlpool, Westinghouse, Kelvinator, and Gibson. The manner in which these executives made decisions relative to vertical channel structure will be explored.

CHAPTER V

FIELD RESULTS

Chapter IV provided a historical perspective of distribution in the appliance industry. Attention was paid to the products, market characteristics, and manufacturer characteristics which have influenced distribution structure and policies. In addition, the major changes in the distribution structure were highlighted. Chapter V explores in more depth the decision-making process which led to these alterations in the distribution system. The purpose of this chapter is to satisfy the second research objective. The second objective was to isolate the manner in which vertical channel decisions relative to structure were made by executives holding representative roles within the major firms constituting the appliance industry.

The information relative to the decision-making process was secured from personal interviews with key individuals at: Kelvinator, Incorporated (a Division of White Consolidated Industries), White-Westinghouse Appliance Corporation (a Division of White Consolidated Industries, Incorporated), Frigidaire (a Division of General Motors Corporation), Whirlpool Corporation, and Gibson Products Corporation (a Division of White Consolidated Industries, Incorporated).

Chapter V details the major decisions that were made by these companies and identify the factors that were important in the

decision-making process. Because of the diversity of the circumstances surrounding these decisions, this chapter is organized according to companies. White Consolidated Industries and its divisions is the first discussed. Kelvinator, White-Westinghouse, and Gibson are dealt with separately. Second, the decision-making process at the Frigidaire Division of General Motors is outlined. Third, the Whirlpool Corporation's channel decisions are reported. Finally, by using published data rather than a personal interview, the General Electric Company's decisions are discussed.

Kelvinator

The distribution structure at Kelvinator Corporation has undergone many changes over the years. The company has vacillated between factory branches and independent distributors ever since it incorporated back in 1916. Initially, Kelvinator instituted some factory branches in markets that were close to Detroit, but as output expanded, it added independent distributors in distant markets. By 1939 the vast majority of its distribution was through independents. In that year the company made a complete switch to factory branches and shocked the entire industry. Again in 1968 the company abruptly switched back to all independent distribution. Currently, the possibility exists for the company to make yet another switch back to factory branches.

The company's initial move to institute factory branches was necessitated by the complexity of the product and the amount of service

necessary to keep it operating. Appliance distributors were nonexistent in the early years of the industry. Consequently, Kelvinator was forced to open its own factory sales branches in order to enlarge the distribution of its refrigerator beyond the local area. In addition, the product demanded specialized installation and service which was not available from middlemen. The early refrigerators could not merely be plugged in as they are today. The compressor was installed in the basement, and ammonia lines ran to the brine tank in the user's icebox. The system took technical expertise to install and also to maintain as the refrigerator frequently broke down or leaked--by its very nature it had to be serviced in the user's home. All of this required not only a technical sales staff but also high quality repairmen. Initially, due to the lack of competent middlemen, it was felt that these functions could best be performed by the factory; and so, Kelvinator instituted factory branches and even company-owned dealers. These early decisions were dictated by the necessity of the situation. There simply was no other way the product could be distributed.

As the market for refrigerators expanded, Kelvinator was forced by lack of funds to add independent distributors. These distributors carried related lines and in many cases had established a strong following with their dealers. This provided the manufacturer quick and easy entry into the market. By using independents, Kelvinator could establish itself quickly in a distant market and with a minimum of investment. In addition to distributors with related lines, Kelvinator also allowed successful dealers to become distributors.

These dealers knew the market for appliances and had already proved that they could do the job. Independent distribution provided some major advantages for Kelvinator. Besides providing a strong marketing force in distant markets, it also allowed for national distribution on a small budget. Kelvinator during its early years was generally short of funds. Because of this, it was almost impossible to establish factory branches across the country. The investment that was necessary in inventory, sales, and administrative expenses was more than the company could undertake. Even though factory branches may have been more advantageous, Kelvinator chose independent distributors as the least-cost means of providing a national distribution network. Without the independent distributor, it is doubtful whether or not Kelvinator could have existed in a market that by the middle 1930s was dominated by Frigidaire and General Electric with Westinghouse in third place.

Kelvinator's position in the market was greatly enhanced by its decision to provide financing of retail purchases of refrigerators through its Refrigeration Discount Corporation (REDISCO). Banks and consumer loan companies were reluctant to finance the purchase of appliances and so the financing function was originally performed by the consumer. The high cost of refrigerators made it imperative that some type of consumer financing be found. To the Kelvinator management, it did not seem feasible that distributors, dealers, or banks would perform this function. Consequently, in 1926 Kelvinator formed REDISCO to finance the retail purchase of refrigerators. At that time there was no way of forecasting what REDISCO's sale would

be or whether or not the financing of refrigerators would be profitable. The objective in establishing REDISCO was to provide market support for the Kelvinator sales effort, yet no apparent studies were conducted to determine the effect of consumer financing on sales or what its eventual cost might be.

REDISCO, in its effort to provide sales support to Kelvinator, at first only financed sales of Kelvinator appliances. In its attempt to increase Kelvinator's sales, REDISCO was supposed to provide support--no matter what the cost. It would be several years before REDISCO would realize the potential profitability of consumer finance and increase the scope of its operations to include the financing of other manufacturers' appliances.

The financing of retail appliance purchases was so successful that REDISCO provided the impetus for Kelvinator to increase its sales all during the depression. However, by the late 1930s sales had declined sharply to a point where Kelvinator was only selling about 100,000 refrigerators per year. Because of declining sales, Kelvinator lost about \$7 million in 1938. Kelvinator's management realized that if they could not reverse this trend that Kelvinator was destined to become one of the casualties of the industry. At the time, Kelvinator was plagued with excess productive capacity, due to declining sales, and a product line consisting of 18 to 20 models. Management identified a task force of executives and assigned them the problem of analyzing the company's situation and making recommendations for the future.

The task force was headed up by a man named Whorley. Under his guidance, they redefined Kelvinator's marketing strategy and reorganized upper management. The task force quickly moved to solve the management problem by raiding one of the best managed companies in the industry, Frigidaire. Kelvinator hired two people from Frigidaire who would have a significant impact on the company's marketing strategy.¹

During the 1930s Frigidaire had been cancelling many of their independent distributors in favor of factory branches. Independent distributors had in many cases refused to deal with department stores because they were more demanding than other dealers. However, these department stores played an important role in Frigidaire's overall strategy.

In addition to reorganizing top management, the task force also attempted to reduce costs. It worked under the assumption that cost and price would be lowered if the product was more standardized and if sales volume increased. To this end, it recommended the reduction in the number of models from about 18 to 6, a reduction in price, and the institution of a national advertising campaign. In addition, the task force felt that if the new models and pricing structure were going to be successful a quick response from distributors and dealers was essential.

¹Frank P. Pierce was hired as General Sales Manager of Kelvinator in August of 1939. Charles T. Lawson was hired as the Sales Manager of Household Appliances in October of 1939 prior to the announced changes in the distribution system.

At that time, Kelvinator was about 95 percent independent distribution. The company had discovered that in many cases distributors were indifferent to Kelvinator's problems. The independent distributors' appliance sales accounted for only a small percentage of his entire sales, and so he could not afford to spend much time on this business. The task force came to the conclusion that in order to institute this dramatic new program a great deal of control over distributors would be needed. It wanted a group of people in the field that would "jump" when Detroit (home office) said, "Jump!" The task force felt this could not be accomplished with the current independent distributors. Thus, Kelvinator management decided to replace its independent distributors with factory branches because the current system was ineffective, and management wanted to increase control over the distribution of its product.

Thus, in 1938 the company began to cancel independent distributors. However, the cancellations were conducted on a selective basis. The independent distributors cancelled were almost entirely in major markets. Kelvinator left intact the distribution through public utilities and retained small distributors in markets like Burlington, Vermont, or Gastonia, North Carolina. However, in markets like Chicago, New York, San Francisco, Los Angeles, Detroit, etc., the company instituted factory branches. It was expected that 80 percent of company sales would be generated by factory branches.

The independent distributors that were retained were selected very carefully. The Kelvinator distributor and dealer organizations

had developed over a period of years with little pruning or rearrangement of territories. As a result, many distributors had insufficient potential to justify giving the Kelvinator line the attention it needed. Consequently, when the new distribution system was established, this was kept in mind. Distributors were selected based on (1) good sales management and (2) good dealer contact. It was not necessary that they were the largest distributors around; they just had to be willing to put forth some effort to sell in a territory with a good potential.²

By the middle fifties, the market for appliances was considerably tighter than it was before or after the war. The glut of appliances in the channel caused power to shift toward the dealer, and so the distributor and factory branch margins began to shrink. As margins shrank, so did profitability. Kelvinator management was concerned with this trend and considered reverting back to independent distributors several times. However, management was of the opinion that this would affect sales volume so adversely that more would be lost than gained by this action.

Kelvinator was acquired by White Consolidated Industries in 1968. White management immediately reversed Kelvinator's pattern of distribution by going entirely to independent distributors. White did not want to maintain the investment in the factory branches and was concerned about the potential reduction in sales volume. Its main concern was the reduction of costs. Whether White built one

²"Kelvinator Shakes Up Production, Distribution, Rolls Out More Sales," Sales Management, 1 April 1940, pp. 22-23.

hundred thousand appliances or five hundred thousand, the company's intent was making each appliance profitable. Management at White, headed by their Chairman, Reddig, is manufacturing and accounting oriented. White's management works hard to reduce costs; consequently, its decision to revert back to independent distributors was based solely on which channel provided the lowest cost method of distribution.

The factors that entered into this decision were: (1) a change in the demand which reduced distributor margins, (2) increasing power of the dealer, (3) independent distributors were in the lowest cost distribution, and (4) a new group of top management with a different philosophy had taken control. Currently, it is entirely possible that within the next few years Kelvinator may move back toward factory branches.

Westinghouse

The Westinghouse Appliance Corporation has for many years been a company that distributes primarily through factory branches. This pattern has persisted throughout Westinghouse's history in the major appliance business and is basically an extension of its practices in other fields. In the early years of the company, other products were distributed through factory branches, and so it was natural for them to follow the same distribution pattern in major appliances.

In August 1974 the major appliance division of Westinghouse undertook a major reorganization of the appliance distribution system. This reorganization was the result of the realization on the part of

Westinghouse management that the industry was changing while Westinghouse was static. Specifically, management came to the conclusions that: (1) multiline manufacturers were becoming the dominant force in the industry; (2) the small dealer, except for secondary and rural markets, was being replaced by large dealers or consolidated into buying groups; (3) there was increasing pressure to find methods to reduce the cost of distribution; (4) there was increasing losses accruing to the appliance division; and (5) normal cost reduction programs were having no effect. Each of these factors created pressure on Westinghouse management to do something about its current distribution system.

At the time, Westinghouse had 36 factory branches and 24 independent distributors. The factory branches were located in major markets and had the major share of market potential and sales. Each branch had a sales office with a district manager and his staff--a sales manager and any number of salesmen. These people, in turn, required a good deal of support staff. Originally, this network was needed because customers were numerous and small. However, over the years the dealers had grown in size and many of them felt that they could get the best deal by negotiating price and terms directly with the people at the company's main office. Quite often the local Westinghouse sales manager became the representative of the customer in negotiations with headquarters.

In an effort to solve these problems, a group was formed to study the distribution system with the overall goal of reducing

marketing costs but maintaining the customer service level. The group's initial assumption was that it would distribute appliances as if it was going to start in business all over again. The group theoretically closed all 36 locations and began to restructure around what was called a super-region concept. In each of six regions, a sales office was included which consisted of: (1) a region general manager and his staff, (2) a controller, (3) a sales promotion and training manager, (4) order entry and processing, and (5) inventory control and credit manager. In essence, all of the functions of the independent distributor would be performed by the factory branches. In addition, the super region concept allowed for the reduction of many costs.

By selecting the super region concept, many costs were reduced. Overhead of sales display areas, leases, internal operations people, and even a layer of management were eliminated by the plan. The reduction in costs was necessary to insure the long-term survival of the organization. However, while costs were being reduced, management was not wanting to reduce the customer service level. The larger dealers still expected good customer service including: good sales contact by a professional salesman who could train the dealer's people, help with merchandising, buying, and in general, serve as the dealer's partner. In order to maintain this customer service level, Westinghouse, in their super-region concept, maintained the same number of salesmen.

The super-region concept resulted in a reduction in the cost of distribution primarily due to the reduction in overhead and administrative costs. The regions were reduced from 36 to 6 including Eastern, South-Eastern, Central, Mid-Western, South-Western, and Western with a headquarter city in each region. The headquarter cities include: New York, Atlanta, Columbus, Kansas City, Houston, and San Francisco. The independent distributors are located in Montana; El Paso, Texas; and Salt Lake City, Utah. They cover approximately 40 percent of the geographical area but account for only 22 percent of sales. The warehousing to support the regional system consists of a regional depot system in which each region has a large mixing warehouse shipping direct to dealers. Service is factory direct to all locations or independent service in rural areas.

In attempting to determine whether or not to use a factory branch or an independent distributor, Westinghouse management utilizes several criteria. These criteria include: (1) cost of distribution, (2) the competitive nature of the market, (3) geographic market coverage, (4) control of the independent distributor in the builder market, and (5) legal considerations.

It is the feeling of Westinghouse management that they can do a better job of distributing products in major metropolitan areas than an independent distributor can, while in rural markets the independent distributor has an advantage. This is true from a cost as well as a control standpoint. Factory-direct distribution in major markets is less expensive than independent distributors because the factory

operates on a smaller margin, due to a reduction in administrative costs such as order entry and billing, etc. However, the cost of coverage of rural markets is high for factory branches. The independent distributor has a larger sales staff, a smaller sales territory, more frequent contact with dealers, and carries other lines (i.e., radios, television, and small appliances) which help to offset expenses. Thus in some markets the factory branch has a cost advantage while in others it has a cost disadvantage.

The competitive nature of the market can have a varying effect on the selection of an independent distributor. In general, due to their potential, the major metropolitan markets are the most competitive, and consequently, they are serviced by factory branches. Factory branches do a better job of promoting Westinghouse appliances to dealers than an independent distributor can. In rural markets, however, the independent distributor may have an edge. Some of the factors which give independents the edge at Westinghouse are: (1) social factors (i.e., church affiliations), (2) the distributors stature in the community, and (3) the independent brings continuity to the territory that is not present with a factory branch (i.e., factory branch salesmen and managers are often transferred to other territories and thus have little allegiance to their customers). These competitive factors would lead Westinghouse management to select an independent distributor over a factory branch.

Another consideration is the geographic coverage of the market. The national market needs coverage, and so a distributor, factory branch,

or combination system must be developed to effectively cover the entire United States market. Isolated markets are particularly suited to the use of an independent distributor. Problems can occur when an independent distributor refuses to sell to a dealer that another distributor or factory branch is selling to in its territory. Westinghouse feels it cannot force an independent to sell to a particular dealer and then at the same time hold them responsible for a certain market share. Consequently, isolated territories where there is little or no overlap of dealers are well suited to the use of an independent distributor.

This lack of control over the independent distributor can be a significant factor when selecting a distribution channel. As was just pointed out, it can cause problems with dealers who sell in two territories. In addition, independent distributors have a reluctance to sell to the builder market. In general, they feel this market segment is not as profitable as other segments and, consequently, are reluctant to sell to builders. Westinghouse, on the other hand, wants to participate in this market, and consequently, this situation is a potential source of conflict between the manufacturer and the distributor. Thus, in markets where the builder business is significant, a factory branch would be preferred.

Finally, legal considerations play a part in the manufacturers decision on distribution channels. The Federal Trade Commission (FTC) requires manufacturers to be fair to all customers. This may be difficult to guarantee if Westinghouse uses independent distributors. Westinghouse, in order to gain some degree of control over independent

distributors, holds them responsible for a particular market share in their territory. Consequently, Westinghouse is reluctant to pressure distributors to sell to certain dealers because this may disrupt the distributors' marketing strategy.

After the reorganization of the major appliance division, Westinghouse sold it to White Consolidated Industries on March 1, 1975. Prior to this time, White had purchased Gibson Products Corporation in 1967 and Kelvinator in 1968. Gibson had always distributed through independent distributors and Kelvinator had vacillated back and forth between company distributors and independent distributors. After Kelvinator's purchase, White immediately converted Kelvinator's distribution system to independent distribution. Westinghouse, however, has not had to alter its distribution system. There has been no pressure to adopt an independent distributor system, and in fact, Westinghouse has one fewer independent distributor than when it was acquired by White. Currently, within White Consolidated Industries, the appliance companies distribute their product in different ways. Some distribute entirely by independent distributors while others use a combination of factory branches and independent distributors. Although it seems that a consolidation of the different systems is possible, no plans are being made at present to accomplish this, and it is difficult to tell in which direction the company might go. Another one of the White Consolidated Industries is the Gibson Products Corporation.

Gibson Products Corporation

Gibson Products Corporation is 100 percent independent distribution and has always distributed its appliances in that manner. Over the years the biggest change in its distribution to the dealer has been the addition or deletion of one independent distributor for another.

The management maintains the independent distributor system because it feels: (1) it is the least cost way to distribute the product; (2) the independent distributor is more sensitive to market demand; (3) Gibson is not trapped by their current distribution system; and (4) if the independent is not committed enough, he can be replaced. Currently, Gibson shares its independents with other manufacturers like Zenith, Sylvania, and Motorola.

Gibson feels in terms of total cost the least cost way for it to distribute is through independent distributors. The independent distributor spreads the cost of distribution among several brands, thus reducing the cost of distributing any single brand. Gibson has considered other alternatives such as: factory branches with a limited investment in sales offices and public warehouses; use of manufacturers' representatives and public warehouses; or use of the facilities of White-Westinghouse which are already in place. However, the best arrangement at this time is the independent distributor. In addition to having a cost advantage, the independent is closer to the market and consequently, more sensitive to its needs.

Because the independent distributor is in closer contact with dealers, seeing them more frequently and over a longer period of time, the distributor knows what the dealer's wants and needs are. In addition, having been a member of the business community for years, the distributor knows the market and its competitors. Unfortunately, these independents usually ignore the builder market. However, this market is not part of Gibson's strategy as its product is not suitable for the builder market. In general, Gibson's product is high quality and heavily featured. Consequently, it fails to meet the needs of the builder's customer. In addition, by distributing through independents, some control over the product is given up by Gibson. However, management feels this may improve the company's market position by allowing the independent distributor more flexibility in dealing with competition, and at the same time the manufacturer maintains some control by promoting the product in the channel. Another advantage of the independent distributor system is Gibson's ability to make changes in its distribution system.

Gibson management maintains control of its independent distributors by monitoring its market share. If an independent is not attaining the market share that Gibson feels it should, then the distributor can be replaced. Unfortunately, it would appear that good independent distributors are getting harder and harder to find. Because of low profitability of independent distributors, few people are attracted to the business. To counter this trend, Gibson has provided some independents with inventory financing and some up-front

advertising money to establish them in the market. Should the profitability return to the industry, it is likely that more capable distributors would be attracted to the industry.

At the present time, new distributors are selected on the basis of: (1) their financial strength and stability; (2) their experience in the market; (3) their knowledge of the appliance industry; and (4) the size of their physical plant. Each of these factors is used in the evaluation of potential distributors.

Gibson's management feels that it currently has the best independent distributors in the market. Management feels its distributors can perform the job better and at a lower cost than factory branches. However, the possibility of a future consolidation of the Gibson and White-Westinghouse distribution system is a possibility. If this were to occur, it seems likely that Gibson would shift to a combination of independent distributors and factory branches.

Frigidaire

Frigidaire quickly went to a factory-direct, sales and service operation following its purchase of the Guardian Refrigerator Company. This was done to bring appliance distribution practices in line with the distribution policies followed in the automotive area and because of the lack of specialized distributors to handle appliances. During the 1920s, Frigidaire added some independent distributors as they became available. This was done in distant and primarily rural markets. However, the bulk of Frigidaire's distribution was still conducted by factory branches.

During the 1930s, Frigidaire began to replace many of its independent distributors with factory branches. The inability of the independent distributors to respond to a changing market and in some cases, their refusal to deal with department stores (a dealer segment Frigidaire had instituted) led to their replacement. The distribution system remained relatively stable with factory branches in major metropolitan areas and some independents in rural areas until the 1960s.

In 1965 a new chief executive assumed the reins at Frigidaire. Terrell, a General Motors executive from outside Frigidaire, was appointed as General Manager of Frigidaire and Vice-President of General Motors.³ Shortly after his arrival at Frigidaire, changes were made in the distribution system. Frigidaire once again began to add independent distributors. This persisted for several years until a new general manager of the division took over.

The only apparent reason for the addition of these independents was Terrell's feeling that these particular independent distributors could perform better than the current factory branches. Terrell, as well as the new distributors, had been associated with the automotive divisions of General Motors. It would appear that the decision to add the independent distributors was made on the basis of one man's influential position, rather than careful analysis and planning. (Terrell is currently Vice-Chairman of the Board of Directors of General Motors.) In 1968 when Campbell,⁴ a long-time employee,

³Richard L. Terrell became General Manager of Frigidaire in 1965.

⁴Harold W. Campbell became General Manager in 1968.

replaced Terrell as General Manager, Frigidaire shifted back to its policy of reducing independent distributors.

Another significant change in the distribution system occurred as a result of research originating in 1967. For years, Frigidaire had been an unprofitable division of General Motors. Because of this unprofitability and shifting dealer requirements, an extensive study was undertaken. Its goal was to determine the changes in the market place and to outline Frigidaire's response to these changes. The study revealed that there was a significant shift in the responsibility for inventory. Storage of inventory was shifting away from the dealer and toward the manufacturer. The dealer was becoming more demanding in this requirement to meet changes in consumer demand.

The shifting responsibility for inventory led the Frigidaire management to restructure its warehousing system. Prior to the study, Frigidaire had 88 field warehouses from which products could be shipped to dealers in quantities from one to five units and six units and up. To meet dealer demands, five regional distribution centers were added to the one already in existence in Clearfield, Utah. In addition, over 40 strategic warehouses are located around the country. The net result is that the number of warehouses were cut from 88 to 46, and the vast majority of dealers are within 24 to 36 hours transit time from a warehouse. To further speed delivery, a rapid ordering system was installed to handle orders on a real-time basis. The computerized

system allows dealers to place orders and receive immediate confirmation that the appliance is in stock and will be shipped.⁵

The major objective of the entire system was to maintain a high customer service level. The regional distribution warehouse network was established to insure a customer service level of 48 hour delivery and to do this at the lowest cost. Frigidaire did not attempt to minimize the total cost of distribution. General Motors seeks to control the distribution of appliances in the same way it controls the distribution of automobiles. Consequently, it distributes factory direct.

In addition to the customer service level, legal questions and problems are important to Frigidaire management. Even though an alternative might be cheaper, it may not be selected because of the anti-trust implications. In addition, independent distributors were not considered in the plan. Although 11 percent of sales are through independent distributors, Frigidaire is reluctant to distribute through them. The reason for this is that Frigidaire management does not want to relinquish the distributor's profit margin. By adding independent distributors, Frigidaire feels it could cost cut itself right out of business. So, Frigidaire continues to distribute primarily through factory branches.

Like all other appliance manufacturers, Frigidaire allows transportation companies to provide this function, and it does franchise

⁵For a brief description of how Frigidaire's FRONTIER System works see "A Logistics Approach Speeds the Flow," Appliance, January 1971, pp. 36-37.

service to independent service companies. Finally, when developing the regional distribution center, it looked for investors to finance the construction of the building because it did not want to invest the capital.

Throughout the years Frigidaire has favored a direct-to-dealer distribution system. The company wants to be able to control distribution and offer a high level of customer service at the least possible cost. Independent distributors, management feels, are not the means for attaining these goals, and so Frigidaire minimizes the number and importance of independent distributors in its distribution system. The major variance to this policy occurred under the guidance of a general manager who was perhaps an outsider to the appliance industry. Finally, Frigidaire avoids any potential conflict with anti-trust law even if it means higher costs. Whereas Frigidaire seems to view independent distributors as necessary in some markets, other manufacturers view the independent as a strong force in the market and an integral part of their distribution system.

Whirlpool

For years, the 1900 Corporation (Whirlpool) had been a successful manufacturer of private brand washing machines. Just prior to World War II, Whirlpool produced 17 different private label brands (its major customer was Sears). This was to change during the war.

Before the war Whirlpool had developed the first agitator-type automatic washer; however, it was never introduced. When production

was shut down during the war, Gray,⁶ Whirlpool's Chairman, became concerned about the company's ability to compete effectively after the war. In 1937 when Bendix introduced the automatic washer, Whirlpool and the rest of the industry selected to follow this innovation.⁷ Engineering and tooling on the Whirlpool automatic had been very costly, and Gray became concerned that the Sears' sales alone would not provide Whirlpool sufficient sales volume to survive in the post-war industry. He wanted to introduce a Whirlpool brand washer so that tooling costs could be spread over a hoped-for larger volume. In other words, Gray wanted dual distribution--that is, to sell washers both through Sears, under the Kenmore brand name, and through independent dealers, under the Whirlpool brand name.

The war provided ample time to test and perfect the new washer. In 1947 both the Sears' Kenmore and the Whirlpool automatic washers were introduced. At first, the Whirlpool brand ran into resistance at the dealer level. Many dealers resented selling a washer that was so similar to the Kenmore brand. However, consumer demand eventually broke down their resistance and sales began to increase rapidly. The new dual distribution system was beginning to work.

However, the giants in the industry began to broaden their product lines. General Electric, Frigidaire, Kelvinator, etc., entered the 1950s offering full lines, and this trend scared the Whirlpool management. In 1952 Kelvinator, a company with whom Whirlpool shared

⁶Elisha ("Bud") Gray began his career with Whirlpool in 1938.

⁷Judson Sayer was the man most responsible for the success of the Bendix washer.

independent distributors, bought out a washing machine company.⁸ Because of this, many of the shared distributors dropped the Whirlpool washer. In January of 1954 Philco bought Dexter Company, a maker of laundry equipment. The result was that Whirlpool lost the 12 distributors it shared with Philco. In addition, there were rumors that RCA, with whom Whirlpool shared 14 distributors, was looking for a white goods line to go along with its brown goods.⁹ In the scramble over full lines, over 1,000 distributorships changed lines between 1953 and 1955.¹⁰ The prospects of Whirlpool's losing any more of its 70 independent distributorships was not good.

In 1954 RCA came close to buying the Norge Division of Borg Warner. Instead, it decided to purchase room air conditioners from Fedders and buy Estate ranges. RCA, however, was still looking for a manufacturer of laundry equipment while Whirlpool wanted to expand its product line. The end result was the formation of the RCA-Whirlpool line in 1955 which included all major appliances.¹¹ The next problem facing the Whirlpool management was how to organize the distribution system.

⁸Kelvinator purchased Altofer Brothers Company (ABC) in 1952.

⁹White goods include washers, dryers, refrigerators, ranges, etc., while brown goods include televisions, radios, etc.

¹⁰"Whirlpool Corporation," Forbes, 1 February 1963, p. 19.

¹¹The agreement between RCA and Whirlpool also involved the Seeger Refrigerator Company which was the supplier of the Sears Coldspot Refrigerator.

At times the decisions of other manufacturers help to create a company's destiny. For Whirlpool this was the case with its independent distributors. In July 1953 the Crosley and Bendix Divisions of AVCO were merged into a single line. This continued line was then offered to their independent distributors on an all or nothing basis. Distributors were faced with the decision to sell the combined line or look for another manufacturer. Consequently, many of the key Bendix distributors in major markets severed their connections with AVCO and began searching for a washing machine line to replace Bendix. Whirlpool promptly seized the opportunity and added most of the old Bendix distributors to the Whirlpool distribution system. Thus, in spite of everything, Whirlpool had a strong distributor network prior to the RCA agreement.

One of the provisions of the 1955 RCA agreement was that Whirlpool would, as soon as possible, move to combine the two distribution systems. A base for the new system was found in the 14 independent distributors that the two companies shared. To this was added a very few of the RCA distributors. The rest of the system was made up of the old Whirlpool distributors. In five markets, where good distributors could not be found, Whirlpool opened factory branches. This caused a number of the independents to feel that they might also be replaced by factory branches; however, this was not to be the case. Within a short period of time Whirlpool was able to put together what it felt was one of the strongest distribution systems in the industry.

In 1953, in an effort to improve manufacturer-distributor relations, Whirlpool instituted its Distributor Advisory Council (DAC) which is still functioning. The group of 14 representatives of distributors and company branches meet a minimum of once every year to: (1) consider the effect major company decisions will have on distributor margins, pricing, profits, and product lines and (2) to serve as a sounding board and sales format for Whirlpool ideas. Since its inception the DAC has been very successful in providing feedback from the field and smoothing the way for changes which have an effect on distributors. In addition, the DAC is credited with helping to keep manufacturer-distributor conflict to a minimum.

The decision to change independent distributors was dictated by opportunity. Whirlpool had, in the case of AVCO and RCA, an opportunity to add better distributors to its distribution network. The new distributors, Whirlpool hoped, would give it greater market share and penetration. Factory branches were only added because there were no good independent distributors in the market. Since then, Whirlpool has continued to add factory branches and to replace independent distributors whenever they could not deliver the share of market Whirlpool wanted. Currently, the company has 15 factory branches, and in every case, the factory branch has increased the company's penetration in the market. The factory branches have 50 percent of the potential and 50 percent of the sales, and the 30 independent distributors have 50 percent of potential and sales. Whirlpool management feels that the 30 independent distributors that it currently has are the best available,

and consequently, there is no reason to replace them with another independent. If the independent failed to deliver an adequate share of the market, he would be replaced by a factory branch.

Neither cost nor distributor margin enter into the decision to replace the independent distributor. Whirlpool feels that costs to operate a factory branch are the same as that for an independent distributor. In addition, Whirlpool would not take over distribution to gain the profit margin of the independent distributor because it generates the same profit in either channel.

Whirlpool, over the years, has been forced by the conditions of the market to alter its distribution system. After the war, it went to dual distribution because of increasing market pressure. Again in the 1950s, Whirlpool developed a full line because of market pressure, and finally, the absence of good distributors who can deliver a reasonable share of the market led Whirlpool to establish factory branches. Although Whirlpool has been successful with its system, other companies have taken a different approach to distribution. General Electric, for instance, has followed a distribution pattern similar to Frigidaire's.

General Electric

Over the years General Electric has distributed its major appliances primarily through factory branches and, at times, has used a combination of factory branches and independent distributors. Like Frigidaire and Westinghouse, General Electric had some independent

distributors during the 1920s. However, when department stores made their entrance into the market in the 1930s, distribution systems began to change. The department store was an important dealer outlet, and General Electric considered it a vital portion of its marketing strategy. Department stores offered good advertising, a strong sales force, prime location, and a good customer list. General Electric provided the department store with strong merchandising help in the form of display kitchens set up in the department store and staffed by a home economist to explain the operation of the appliances. Although General Electric wanted to sell to this market, many independent distributors would not deal with department stores because they demanded high levels of service and a low price. Consequently, in the 1930s General Electric decided to begin cancelling its independent distributors and shift toward factory branches. This continued during the war as the remaining independent distributors were notified that they would be replaced by a factory branch on an attrition basis.

The war also led to a study of the overall goals of General Electric and, in particular, the major appliances division. For years General Electric had problems with its major appliance business. Sometimes the company would win leadership in a product only to lose it because engineers had neglected styling. Sometimes the parts were manufactured in plants so outmoded that low cost production was impossible.¹² This led to the restructuring of the company management

¹²William B. Harris, "The Overhaul of General Electric," Fortune, December 1955, p. 237.

and the construction of Appliance Park, a massive facility planned specifically for the production of major appliances.

The reorganization of the company led to decentralized decision-making which allowed managers at lower levels to make decisions which affected their division's sales. This enabled the company to respond more quickly to changing market conditions. At the same time General Electric, in an effort to adjust to the wide fluctuations in the sales of different appliances and improve efficiency, established Appliance Park.¹³

General Electric had several plants that were old and inefficient. In addition, General Electric was trying to reduce the impact of fluctuations in appliance sales at the manufacturer's level. This caused increases in costs because it meant that equipment lay idle or needed to be converted to the production of other appliances. In either case it added to cost. Thus, the existing facilities were replaced by modern plants designed to produce appliances as efficiently as possible. Following the establishment of Appliance Park, General Electric made other efforts to reduce distribution costs.

In March 1954 General Electric again made an attempt to solve the problem of the cyclical fluctuations in demand. This time a Consumer Goods Distribution Study Project was initiated to analyze the problem. There was a growing realization at General Electric that the problem stemmed from a faulty distribution system rather

¹³Appliance Park is General Electric's manufacturing and administrative headquarters just outside Louisville, Kentucky.

than variations in consumer demand. Observation indicated that although consumer sales were fairly constant manufacturer sales were jerky and wide swinging.¹⁴

Pressure to analyze the distribution system was due to increased price competition facing appliance manufacturers. This competition was the result of the glut of appliances that began in the early 1950s. This price competition resulted in lower margins and reduced profits for manufacturers. At General Electric everything possible in manufacturing was done to offset these reduced margins. Consequently, the distribution system became the next target of the cost cutters. The project was organized to study: (1) consumer purchase motivation; (2) distribution methods in the automobile, hardware, tire, and food products industries; (3) the functions of the distributor and dealer; (4) whether distributors and dealers were performing those functions; and (5) if the distributor's job and dealer's job matched what the customer wants.¹⁵ Exactly what the results of the study were is hard to say. However, following the study, some changes were made in the distribution system.

In 1955 Cordiner¹⁶ of General Electric stated that service was an even more important factor than price when selling appliances. It was his feeling that the public bought from discounters because it was

¹⁴ "G.E. Seeks the Answers in its Distribution System," Business Week, 2 October 1954, p. 68.

¹⁵ Ibid., p. 70.

¹⁶ Ralph Cordiner was President of General Electric.

getting nothing in the way of service or credit from the dealers. For many dealers, service had become a not too profitable chore. He suggested that General Electric extend factory-owned warehouses and service centers to pick up the slack left by the dealers.¹⁷ In addition, Cordiner suggested that General Electric increase the number of factory branches in urban areas. He felt that the combination of factory branches and additional field warehouses would eventually relieve the dealer of carrying any inventory.

By 1963 General Electric, as well as other manufacturers, was trying out a different physical distribution channel. Instead of the manufacturer or distributor delivering goods to the dealer for delivery to the customer, the manufacturer or distributor inventoried the merchandise for the dealer and made deliveries from the distributor's inventory to the dealer's customer. This relieved the poorly financed dealer of the expensive inventory function and shifted another function to the manufacturer. Over the years, the job of selling appliances and performing all the traditional functions had become too big for all but the strongest dealers.¹⁸ In addition to providing the inventory function for some of its dealers, General Electric also provided dealers with a display of merchandise.

Under this plan General Electric provided dealers with a display of appliances. This way the dealers had appliances that they

¹⁷ "Appliance: Service Means More," Business Week, 16 May 1955, p. 41.

¹⁸ "Building a Faster Track from Factory to Home," Business Week, 16 February 1963, p. 45.

never could afford to carry. The dealer didn't pay for the appliances until they were sold. This is an extension of the floor planning that was prevalent in the industry. However, under this plan, the dealer did not take title to the goods. They were financed and owned by the manufacturer.

The goal of this plan was to cut distribution costs and to step up sales by getting more merchandise out onto the dealer's floor where the customer could see it.¹⁹ The thrust of the General Electric plan was a response to lower margins dictated by an increase in competition in the industry after the war. The increased competition, along with lower margins, caused emphasis to be placed on distribution costs. In addition, the dealers' response to lower margins was to cut back on the functions they performed and thus reduce cost. This, in turn, led General Electric as well as other manufacturers to assume the performance of these functions. However, in an oligopoly like the appliance industry, the actions of one manufacturer affect the actions of the others.

Summary

This chapter has attained the second research objective by describing the manner in which vertical channel decisions relative to structure were made by executives holding representative roles within the major firms constituting the appliance industry. Through personal interviews with current and past company executives, the

¹⁹ Ibid., p. 45.

factors which were considered important to the decision-making process were discussed. The chapter outlined the important decisions that were made at the following appliance manufacturers: Kelvinator, White-Westinghouse, Gibson, Frigidaire, Whirlpool, and General Electric. The next chapter will integrate this decision-making process with the marketing theory that is relevant to distribution channels.

CHAPTER VI

BEHAVIORAL INTERPRETATION

The preceding chapter, Field Results, provided an understanding of the manner in which vertical channel decisions relative to structure were made by executives in the major appliance industry. The sixth chapter directs itself to the third research objective which was: To interpret which if any behavioral and/or economic theories of channel formulation and change can predict or explain what actually occurred in the appliance industry. Within this chapter, the economic and behavioral theories developed in the Literature Review will be analyzed in the context of the conceptual framework developed in Chapter III. In order to attain the third research objective, this chapter is organized in the following manner: macroeconomic environment; microeconomic environment; power; and conflict.

Macroeconomic Environment

Macroeconomic theories of channel evolution and change concentrate on the manufacturer's competitive relations with other manufacturers and the effect of overall conditions in the market. In this section, attention is paid to: (1) factors in the market; (2) cycle theory; (3) dialectic processes; (4) the nature of a

differentiated oligopoly; (5) the theory of a "normative channel"; and (6) postponement-speculation.

The Market

There are several market factors which affect the structure and policies in the distribution of appliances. Included among them are: the density of population; improved transportation facilities; the affluence of consumers; institutional voids in the market; changes at other levels in the channel; and government regulation and industry policy.

Density of population. The variation in population density across the country has affected the distribution of appliances. One of the major reasons for the location of manufacturing facilities in the midwest and east was the proximity to the large urban markets of this region. In addition, population density has played a role in the selection of independent distributors or factory branches. White-Westinghouse, Kelvinator, and Frigidaire have relied at various times on distribution systems that were dependent upon the use of independent distributors in areas where population density and, consequently, sales potential were low. Manufacturers felt that their distribution system was usually more efficient if independent distributors could be used in rural areas. Aligned closely with the density of population is the improvement in transportation infrastructure.

Transportation infrastructure. The improvement of the transportation infrastructure since the inception of the appliance industry has affected the concentration found in the industry. In the 1920s

manufacturers limited their sales to local markets because of the high cost of an inefficient transportation system. The further the appliance had to be shipped from the point of manufacture to the point of consumption the higher the transportation costs. This placed manufacturers at a cost disadvantage and made it difficult to compete in distant markets. As transportation facilities improved, the relative cost of transportation declined and competition between manufacturers increased. With the improvements in transportation, it became possible to competitively ship appliances further away from the point of manufacture. This led to increased sales and increased use of larger, more efficient manufacturing facilities. As manufacturing facilities increased in size, the economies of scale made possible the further reduction in the price of appliances and a corresponding increase in sales as less affluent consumers entered the market.

Consumer affluence. Throughout the history of the appliance industry, the real income of consumers has increased. As consumers became more affluent, increasing numbers selected to purchase appliances. The expanded market hastened the growth of even larger enterprises. Increasing demand enabled manufacturers to increase the size and efficiency of manufacturing facilities. The resulting economies of scale, made possible by larger, more efficient production facilities, reduced both the unit cost and price of appliances. These economies of scale fostered the increasing concentration of the industry as smaller appliance manufacturers found it increasingly difficult to compete with their larger, more efficient competitors.

Institutional voids. It is possible that as consumer needs change that these needs may go unheeded by some channel participants. This is caused by the commitments channel members make to specific ways of doing business. When change occurs, some participants may fail to adapt causing a void in the institutional coverage of the market. This presents opportunities for other firms to gain market position by satisfying consumer needs and filling these voids. Alderson suggests that these voids will be filled by both established and nonestablished firms. In his core-fringe concept, he postulates that an enterprise establishes a market niche from which it makes thrusts into the market and to which it retreats when attacked.¹

The establishment of factory branches by Frigidaire, General Electric, and Westinghouse at the inception of the appliance industry was an attempt to satisfy consumer needs. At the time, independent appliance distributors did not exist. If appliances were to be made available to consumers then a distribution channel was necessary. Consequently, these producers selected to fill this institutional void themselves.

Kelvinator's decision to institute REDISCO was a result of the void of consumer financing in the market. Commercial banks and consumer finance companies at that time wanted no part in financing consumer purchases of appliances. Kelvinator, seeing this void in institutional coverage of the market, selected to satisfy the need

¹Wroe Alderson, Marketing Behavior and Executive Action (Homewood, Ill.: Richard D. Irwin, Inc., 1957), p. 56.

for consumer finance and made a strategic thrust into the market, thus extending its fringe and increasing the protection for its core market. Kelvinator was thus able to successfully differentiate its product until other major appliance manufacturers introduced consumer financing.

Later, in 1938, Kelvinator reorganized its distribution system. After a year in which the company lost several million dollars and its core market was threatened, Kelvinator decided to consolidate its product line, reduce prices, and institute factory branches. This strategic thrust into the market was intended to expand sales and thus increase the protection of the core market.

In the 1920s, public utilities entered the market and became successful dealers primarily because of the paucity of appliance dealers. Utilities selected to fill this void and extend their fringe markets and build up residential loads. The expanded load increased revenue and further protected the core market. In the 1930s and 1940s, utilities began to withdraw from the market. This was caused by the emergence of new dealers and the passage of legislation in some states which restricted the sale of appliances by public utilities.

During the 1930s the emergence of the department store as an appliance distributor and the independent distributors' refusal to deal with it led Frigidaire and General Electric to choose factory branches over their current distributors. These independent distributors, by their refusal to deal with department stores had caused an institutional void in the market. Kelvinator, on the other hand, was

not greatly affected by the independent distributors' decision because a number of its larger distributors and dealers were public utilities. However, by the late 1930s, these utilities were leaving the market; and Kelvinator was incurring losses. Because of these losses, management reorganized its distribution system and instituted several factory branches to fill the void left by the departing utilities.

The proliferation of appliances and the tendency of manufacturers to produce full lines can be seen as strategic thrusts by the manufacturer. Manufacturers tended to specialize in the production of a single appliance. Broadening the product line made it more difficult for competitors to enter the market because they were forced to develop a complete line. Thus, existing manufacturers were able to make their core market less vulnerable. However, the increased width of the manufacturer's line produced an increasing burden on the dealer. Until that time, product service had been the responsibility of the dealer; however, dealers were reluctant take on the added service requirements of the new products and lines. To solve this dilemma, manufacturers opted to provide product service direct from the factory or through franchised service agencies. This afforded an opportunity for franchised service agencies to develop and allowed manufacturers to extend their fringe market. Now potential competitors not only had to produce and distribute a full line but also provide product service.

Response to change. Some channel decisions have been in response to changes at other levels in the channel. Change at one level has a ripple effect on other levels in the channel. After the

war, increased levels of demand caused numerous distributors and dealers to enter the market. However, in the late 1940s and early 1950s, many of these dealers went out of business when consumer demand declined. During this time the remaining dealers, because of their strong market position vis-à-vis manufacturers, were able to expand their lines and carry products of competing manufacturers. The introduction of discount houses into the appliance industry with their emphasis on low prices and few services caused substantial price competition among dealers and influenced manufacturers to provide factory direct service. Again in the mid 1950s, numerous marginal dealers were forced out of the industry when General Electric elected to discontinue fair trading its appliances. Finally, the RCA and Whirlpool merger forced many independent distributors to look for another appliance line when their services were no longer required by RCA-Whirlpool.

Legal restraints. In some instances, legal considerations have played a role in channel decisions. The legal restrictions placed on appliance sales by public utilities caused the most successful dealer until that time to withdraw from the market. In the 1950s and 1960s, fear of prosecution by the Justice Department under antitrust law affected the appliance manufacturers' decision not to increase price along with increasing costs. Finally, the industry trade practice of not allowing independent distributors to carry competing lines was instrumental in AVCO's decision to discontinue the production of appliances. This industry policy makes it difficult for smaller

manufacturers to increase their product line and limits the introduction of any new product line.

Instead of being well planned strategic decisions, many of the examples cited are a response to factors in the market over which the channel decision maker had little control. Channel managers seem content with the existing marketing strategy and occasionally make strategic thrusts into voids in the market in an effort to increase the protection of the core market. Finally, the decisions made at one level of the channel have a ripple effect causing other participants on different levels to respond.

Cycle Theory

Cycle theories of institutional change are based on the premise that a rhythm of change is present in the evolution of channel institutions.² The institutional life cycle assumes that institutions move through a life cycle similar to the familiar product life cycle concept. The institutional life cycle has four stages: (1) innovation; (2) accelerated development; (3) maturity; and (4) decline.³

The innovation stage is characterized by rapidly increasing sales. However, profits lag behind because of start-up expenditures

²M. P. McNair, "Significant Trends and Developments in the Postwar Period," ed. A. B. Smith, Competitive Distribution in a Free, High-Level Economy and Its Implications for the University (Pittsburgh: University of Pittsburgh Press, 1958), pp. 17-18.

³William R. Davidson, Albert D. Bates, and Stephen J. Bass, "The Retail Life Cycle," Harvard Business Review, November-December 1976, pp. 89-96.

and/or the problems of achieving economies of scale. This stage began in the 1920s for manufacturers, distributors, and dealers. Sales were beginning to increase; however, profitability increased slowly because of high promotion costs, research and development expenditures, and the lack of economies of scale. Profit margins for channel participants are difficult to establish because of the variety of firms in the industry and the mix of products those firms offered. Consequently, this and the subsequent analysis of the life cycle is based on general information secured in the interviews.

The second stage of the institutional life cycle is accelerated development. During this stage, participants experience rapid sales growth and high profits. This stage began about 1930 for manufacturers, distributors, and dealers and ended in 1950 for manufacturers and dealers and in 1935 for distributors. Because of the strong demand in the 1930s, manufacturers, distributors, and dealers experienced rapidly increasing sales and profits. This continued until 1950 for manufacturers and dealers when the postwar demand became a glut of appliances; however, distributors' sales and profits began to decline when they were replaced by manufacturers' branches starting in about 1935. Consequently, the third stage of the institutional life cycle began earlier for the independent distributor than it did for either manufacturers or dealers.

The third stage, maturity, is characterized by moderate to slow sales growth and low profitability. For the independent distributor, this period began about 1935. About that time, General

Electric, Frigidaire, and later on, Kelvinator began to replace their independent distributors. As this occurred, the remaining independent distributors found themselves faced with increasing competition from manufacturers' branches and other distributors anxious to add major appliances. Although there were some periods when new distributors were attracted to the industry (for example, after World War II until 1950), the distributor's overall profitability and sales continued to decline.

Manufacturers entered the maturity stage in about 1950. Numerous competitors had entered the industry after the war. When demand leveled off in the face of increasing capacity, the resulting overcapacity forced many competitors out of the business and reduced the profits of those that remained. This situation has continued throughout the 1960s and 1970s. Westinghouse, Frigidaire, Gibson, and Kelvinator have all been unprofitable operations for much of this time, in spite of rapidly increasing sales. At present, it is difficult to determine if these developments are an indication that manufacturers have entered the decline stage of the cycle or if this is an aberration from a still positive trend. Some of what is described above is characteristic of the decline stage of the institutional life cycle; however, future industry prospects look brighter than the recent past.

Dealers entered the maturity stage in 1950 and, after an initial period where inefficient dealers were forced out of the business, both profit and increasing sales have returned. This period saw the development of the specialty appliance store, the

discount house, and mass merchandisers as appliance dealers. At present, there are numerous appliance dealers who are generally profitable as industry sales continue to increase.

The independent distributor entered the decline stage in about 1960. The distributor's share of the market, as well as profitability, has declined significantly. This, in turn, has caused a reduction in the number of distributors. However, recently a group of Philco distributors have attempted to reintroduce the Crosley brand of appliances. This may signal the development of a new form of independent distributor in the market and the beginning of another life cycle for this dying institution.

Appliance dealers as a group are currently in the maturity stage of the cycle. However, throughout the development of the industry, specific types of appliance dealers have completed the institutional life cycle. Public utilities, department stores, and furniture stores appear to have gone through the introduction, accelerated development, and maturity stages. Currently, each is in the decline stage having been replaced by the discount house, mass merchandisers, and specialty appliance dealers.

Dialectic Process

It is possible to view institutional change in the channel as a dialectic process in which there is a thesis (the established institution), an antithesis (an innovative institution), and a

synthesis (a new form drawing its attributes from the other two).⁴

The emergence of the appliance dealer in the 1930s can be viewed as a dialectic process of change which starts with a thesis and an antithesis and produces a synthesis of the two. The thesis, or established institution, is the public utility dealer while the antithesis is the department store dealer and the synthesis is the appliance dealer of the middle 1930s. Public utilities had the following general characteristics: (1) downtown location; (2) extensive service; (3) strong door-to-door selling; (4) variable margin; and (5) narrow line--while the department store had: (1) downtown location; (2) extensive service; (3) in-store as well as outside selling; (4) high margin; and (5) broad line. The appliance dealer of this period is a combination of the characteristics of these two dealers. The appliance dealer stressed: (1) extensive service (i.e., department store and public utility); (2) high margin (i.e., department store); (3) narrow line (i.e., public utility); and (4) in-store sales (i.e., department store). Thus, the appliance dealer adopted the characteristics of the two most successful dealers of the time.

In addition to the above example, the dialectic process can be seen in the changes that later occurred in the appliance dealer. The appliance dealer serves as the thesis while the discount house provides the antithesis. In the early 1950s, the appliance dealer's mix typically included: extensive product service, a narrow line, and

⁴Ronald Gist, Marketing and Society (New York: Holt, Rinehart and Winston, Inc., 1971), pp. 370-372.

a relatively high margin. The discount house of this period offered few services, a broad line, and operated on a low margin. Over the years, the specialty appliance dealer has lowered margins, broadened the line, and reduced the level of service. In general, the appliance dealer, the thesis, has moved closer to the discount house, the anti-thesis, to form the specialty appliance dealer, the synthesis. The specialty appliance dealer is thus the result of the coalescing of these two prominent dealers.

Oligopoly

The economic theory of a differentiated oligopoly suggests that oligopolists take into consideration the reactions of competitors when they make their decisions and, in addition, that the oligopolist constantly monitors the decisions competitors make. These decisions can be divided into two areas: price and product differentiation.

Price. Price in an oligopoly is assumed to be relatively fixed with pricing leadership provided by a large influential enterprise normally called a price leader. On at least two occasions, someone other than the price leader has led a price increase or decrease. However, both of these instances still conform to the oligopolistic model. In 1938, when Kelvinator reorganized its distribution system, product line, and pricing, it was the fourth largest manufacturer; yet, the industry followed its price leadership. Again, in the 1970s, White Consolidated Industries, the third largest producer and newcomer to the industry, raised prices and the industry followed.

In the first example, Kelvinator lowered prices and increased sales dramatically. This action prompted other firms to take action to protect their core market; and consequently, they also reduced price. However, in the 1970s, White Consolidated Industries raised prices and selected to take a smaller share of the market. In this case, the leading companies in the industry for years had been reluctant to increase price because of the fear of antitrust violations. Because of this fear, price increases trailed increases in cost, and consequently, profits were below what was considered normal. Thus, when White Consolidated Industries increased price, its leadership was enthusiastically followed by the rest of the industry. In addition, the reluctance of producers to change price can be explained by the kinked demand curve in the economic model of an oligopoly. The kink causes a vertical break in the marginal revenue curve of the firm. Thus, marginal costs may rise or fall over a substantial range before a price change occurs. Costs had been increasing for a number of years with little or no change in price. Because of the vertical break in MR the MR was still equal to MC. Finally, $MR \neq MC$ and prices increased to reflect the increased cost.

Product differentiation. Manufacturers may attempt to differentiate their product by altering the objectives of the distribution system. In terms of order processing and transit time, for example, some manufacturers place major emphasis on the speed with which they can process an order from either a distributor or a factory branch and ship direct to the dealer. Frigidaire's FRONTIER System is an example.

Others, although concerned with order processing time, give equal weight to the cost of distribution. For example, Whirlpool with its WHAMOL System attempts to minimize cost and still maintain a high customer service level. Still others ship by the lowest cost method and are unconcerned about order processing and transit time. Gibson and Kelvinator ship by lowest cost transportation method and expressed little concern about transit time.

In addition to the physical distribution functions, manufacturers have also varied other aspects of the mix. These have included: the selling of appliances on open account rather than sight draft; floor planning for smaller dealers; games; sales contests; advertising and promotional allowances; and cash incentives paid to dealer salesmen. Finally, manufacturers have attempted to gain a differential advantage over competitors by differentiating the product to the final consumer. This has involved: (1) factory-direct service; (2) new products; (3) new exclusive features on old products; (4) extension of warranties; (5) improved durability; and (6) styling. Although manufacturers' decisions in terms of price and various methods used to differentiate products conform to the normative oligopolistic model, other channel decisions do not.

Several manufacturers have selected to retain independent distributors despite the fact that a more effective distribution system could have been utilized. Whirlpool retains the current independent distributors despite its ability through the use of factory branches to increase sales at the same cost with the same level of service. In one

case in particular, the decision to retain a distributor is based on close personal ties. Frigidaire also added independent distributors in spite of the factory branches' ability to perform the job as well or better at a lower cost. Here again, the decision was based on a personal friendship with the independent distributors. These decisions were made primarily on the basis of personal considerations rather than any economic justification.

Normative Channel

Bucklin has suggested that channels of distribution, under reasonably competitive circumstances and low barriers to entry, will evolve in the long run toward what he calls the normative channel.⁵ The normative channel is defined as the group of channel institutions that generates the greatest level of consumer satisfaction and profits to the participants per dollar of cost. In order to determine what the normative channel might be, it is necessary to determine what economic conditions are expected to prevail in the future. The existing channel, or extant channel as Bucklin called it, then changes over time to conform to the normative channel.

It is apparent that the distribution channel for appliances has changed over the years. Significant changes in the number and types of participants as well as distribution policies have occurred. The concept of the normative channel may be useful in explaining or predicting

⁵Louis P. Bucklin, "The Economic Structure of Channels of Distribution," ed. Bruce E. Mallen, The Marketing Channel A Conceptual Viewpoint (New York: John Wiley and Sons, Inc., 1967), pp. 63-66.

some of this channel change. For example, the realities of the appliance industry indicate that both manufacturers and dealers have and are continuing to increase in size. Some time in the future, the industry will be more concentrated at both the manufacturer and dealer levels of the channel. Consequently, one would expect direct-to-dealer shipments to increase, thus reducing the need for distributor inventories. In addition, as dealers become oligopsonists and more demanding, the situation favors the establishment of a factory branch. With these assumptions of future economic conditions in the appliance industry, it is possible to predict the demise of the independent distributor as he currently functions.

With the same type of analysis, it would have been possible to anticipate the need for specialized product service in the 1950s. The astute observer identifying the change in the width of dealer lines and the increasing demand for service by a more affluent consumer could have forecasted the development of factory direct service. In a like manner, the increasing size of dealers in the 1950s would lead to the prediction of direct-to-dealer delivery. The early expansion of appliance manufacturers in the 1920s produced a gap between the extant and normative channel. This gap was later filled by several middlemen. The development of the discount house as an appliance dealer in the 1950s can be traced to the failure of many appliance dealers to meet the needs of their customers. These appliance dealers offered little service but still charged a high price. Although the concept of the normative channel is useful, it would not have predicted the demise of the public

utility as a dealer. This change in channel structure was based on a legal decision. Nor could it have been predicted that Frigidaire would add independent distributors in the mid-1960s. This decision was based to a great extent on personal friendships.

Concept of Postponement-Speculation

The way in which channels are structured depends to a great extent on where inventories should be held in order to provide appropriate levels of customer service. The concept of postponement-speculation provides a framework for anticipating where and if speculative inventories will be found in the channel. The model consists of three sets of flows including: (1) the cost of a shipment to a speculative inventory and then on to the buyer; (2) the cost of a direct shipment from point of production to the buyer; and (3) the cost to the buyer of holding inventory.⁶ The relationship of these three flows helps in the determination of the existence of speculative inventories. The concept states that a speculative inventory will appear in the channel when its costs are less than the net savings to both buyer and seller from postponement.

Although the general pattern in the industry favors the existence of speculative inventories, dealers have been able to postpone purchase of inventory, shifting the burden to the manufacturer or distributor. In the early 1950s, dealers were able to increase the

⁶Louis P. Bucklin, "Postponement, Speculation, and the Structure of Distribution Channels," ed. Bruce E. Mallen, The Marketing Channel A Conceptual Viewpoint (New York: John Wiley and Sons, Inc., 1967), pp. 67-74.

number of manufacturers they represented while at the same time manufacturers were increasing the width of their lines. As a result, the dealer assumed an even wider line of appliances and increased inventory requirements. The increased cost and risk associated with the inventory for this wide line led dealers to depend upon manufacturers and distributors to assume the cost and risk of inventory. As inventory carrying costs increased, the least cost point of the system shifted indicating a shorter delivery time. Consequently, by the early 1960s, manufacturers were shipping mixed carloads from a mixing warehouse direct to dealers, and some companies provide two-day delivery to most locations in the country. This provides dealers the opportunity to reduce the size of their inventories as well as their costs and risks. In addition, they can postpone purchase of the product until it has actually been sold.

Microeconomic Environment

Microeconomic theories of channel change concentrate on the enterprise's internal operations. Included in this section will be an analysis of: (1) functional cost minimization; (2) total cost minimization; (3) increased sales and/or profits; and (4) corporate policies.

Functional Cost

The emphasis here is on the identification and analysis of the costs associated with the performance of various functions within the

enterprise. Channel managers must determine the average cost curve for each of the functions they perform and then an attempt is made to minimize the cost of distribution by shifting unwanted functions to more cost-efficient middlemen.

Appliance manufacturers consider the cost of performing some functions. This is especially true for the physical distribution functions of transportation and storage. For example, manufacturers spin off the transportation function to existing common carriers and local delivery services. In addition, product service is also contracted out to independent service specialists in many areas. Public warehousing is often used to supplement manufacturers' or distributors' warehouse capacity. In the Chicago market, manufacturers have spun off the parts service function to a specialist. The use of independent distributors in rural markets is an attempt to reduce the cost of providing the distributor functions to that geographic territory. Decisions in all of these functional areas are based primarily on a cost factor. It is simply less expensive to spin off these functions to available middlemen than it is to perform them in-house.

In many areas of the country, good middlemen willing to take over functions are not always available. Credit, for example, was initially made available to the consumer by the manufacturer. This occurred because in the first years of the industry, banks and consumer finance companies would not perform this function. Additionally, manufacturers tend to think of the functions the distributor performs as an integrated whole. No attempt is made to cost out each of the

functions to determine if another participant could perform it more cheaply. Manufacturers find it difficult if not impossible to identify these individual functions and determine their cost. In addition, manufacturers have concluded that this analysis serves no useful purpose. When deciding to integrate the channel, the manufacturer either performs all of the distributor's functions or none of them. Manufacturers view the distributor's job as an integrated whole rather than a group of functions which can be divided up among a number of middlemen.

Total Cost

The total cost approach is similar to functional cost analysis. The objective of the total cost approach to distribution is to determine the average cost curves for the various functions that are performed and then to aggregate these functional average cost curves into an average cost curve for distribution. The prudent manager would then design the distribution system to operate at the minimum point on this cost curve. This approach seems both simple and logical. All the channel manager needs to do is to identify the minimum point on the total average cost curve, where costs are minimized, and then design the distribution system to meet these constraints.

Cost is a factor in many decisions made by manufacturers. Whirlpool has developed a computer simulation (WHAMOL) specifically to reduce the total physical distribution cost. Gibson utilizes independent distributors because they are the least expensive means

of distribution. White-Westinghouse reorganized its distribution system in 1974 in an effort to reduce total cost. When Kelvinator was purchased by White Consolidated industries, the distribution system shifted from factory branches to independent distributions in order to reduce total costs. Cost as a basis for decision making is of course interrelated with sales and profits.

Increased Sales and/or Profits

The potential for increased sales volume and/or profit that the sales volume can generate is a primary motive for channel decision makers. Every manager in the course of the interview mentioned that decisions were based on this factor. Alternative channel structures and policies were evaluated on the basis of their effect on the company's sales and/or profits.

For example, Whirlpool and the other manufacturers who utilize independent distributors will only replace an independent distributor if the distributor fails to provide the manufacturer with the desired market penetration. Frigidaire utilizes factory branches because of the profit available at that level of distribution. Kelvinator selected to integrate the channel after heavy losses accrued from distributing through independent distributors. Later when Kelvinator was purchased by White, a distribution system utilizing 100 percent independent distributors was instituted because of sagging profits and sales. White-Westinghouse selected to reorganize its distribution system after suffering sustained losses. Frigidaire and General Electric added department stores as dealers to increase sales. Many of these

decisions led to increased levels of expenditure. This, however, was insignificant in relation to the additional sales and profits the expenditures would generate.

Corporate Policies

In some cases, channel decisions were affected by corporate policies. Manufacturers, especially the smaller ones like Gibson and Kelvinator, are constrained to some extent by the resources and objectives of White Consolidated Industries. The White Consolidated Industries management has a reputation of cutting costs to make its divisions profitable. Consequently, there is pressure on both Gibson and Kelvinator to maintain a low cost distribution system. Thus, they are constrained to a distribution system composed solely of independent distributors which provides a low customer service level. As of now, however, this pressure to reduce costs by utilizing independent distributors and to provide a lower level of customer service has not been brought to bear on White-Westinghouse.

In another instance, the Board of Directors of Whirlpool has restricted the authority of the channel manager to make some decisions regarding the channel structure. Before an independent distributor can be replaced by a factory branch, three members of the Whirlpool Board of Directors must approve such a decision. Consequently, this limits the range over which the channel manager has decision-making authority. In addition to the factors mentioned above, some recent models have suggested that many channel decisions are the result of a struggle for power among channel participants.

Power

Power in the distribution channel can be an important factor which influences decisions on channel structure and policies. Several bases of power have been identified including: (1) reward power; (2) coercive power; (3) expert power; (4) legitimacy; and (5) identification. Channel participants use these bases to increase their power vis-à-vis other channel members. The channel participant with the greatest relative amount of power is in the position to control to some extent the activities of other channel members.

Throughout the history of appliance distribution, power has been shifted between participants in the channel. Manufacturers quickly attempted to gain power vis-à-vis distributors and dealers by granting them exclusive franchises. This power was based on both reward and legitimacy and provided the manufacturer with some control over distributors and dealers. However, manufacturers were dependent upon the independent distributors and dealers for distribution of their unknown products. In many cases, the appliance manufacturer's product constituted a small percentage of the distributors sales; and consequently, some distributors were not responsive to the manufacturers demands. Distributors at times failed to promote the product adequately and/or gain a satisfactory share of the market. Finally, some distributors refused to deal with the aggressive department stores. These factors led to the decision by General Electric, Frigidaire, and Kelvinator to vertically integrate the channel and expand the number of factory branches. This use of coercive power impressed upon the

remaining distributors what their fate would be if they didn't comply with the manufacturer's request.

When department stores began to merchandise appliances, they were so aggressive and close to the customer that power began to shift toward them. This increased power made it possible for them to demand and receive higher margins from the manufacturer. Manufacturers then attempted to increase their control over dealers. Display kitchens staffed by home economists were placed in high traffic areas of department stores. This investment in promotional expenses by the manufacturer increased the dealer's dependence on the producer. Dealers were aware that if they wished to share in the rewards that they must cooperate with the producers. Finally, manufacturers were able to differentiate their products through advertising, consumer financing, and product innovations, and some had developed a strong customer franchise; the overall effect was to increase the dealer's dependence on the producer. This restricted the dealer's alternatives and erected barriers to entry which reinforced the manufacturer's power. During this time period, the industry was generally experiencing a growth in sales; and consequently, the increase in power of the manufacturers was accepted by the dealers because they were allowed to share in the rewards of the channel.

Throughout the latter part of the 1930s and the war years, manufacturers continued to replace distributors with factory branches. General Electric, Frigidaire, and Kelvinator wanted to be able to institute new marketing strategies quickly in order to gain the maximum

market impact. This, they felt, could only be done if the manufacturer increased his power by controlling distribution through ownership of factory branches. Consequently, they instituted factory branches in major markets and retained some independent distributors in rural markets. For some distributors, the actions of the manufacturers were of little consequence as appliance sales constituted a small percentage of total sales. However, for others, it served as a veiled threat that they would be next if they did not perform.

After the war, the market situation was changed drastically. The strong consumer demand gave manufacturers an opportunity to further increase their power vis-à-vis distributors and dealers. Manufacturers allocated products to an ever-expanding number of dealers while at the same time widening the manufacturer's line to include more models of an increasing variety of appliances. Shortly thereafter, pool orders were instituted which bypassed the distributor at least in the physical distribution sense and allowed the dealer to buy directly from the manufacturer. This use of reward and legitimate power increased the manufacturer's control over distribution and dealers. As long as the market continued to expand, channel participants were content.

Several factors in the early 1950s had a dramatic effect on the power relationships in the channel. The emergence and growth of the discount house has had far-reaching effects on the appliance industry. The discount house acts as a powerful oligopsonist in the market. The tremendous sales volume and large purchases permitted the discount house to gain significant power vis-à-vis manufacturers.

As demand decreased in the early fifties, there was increasing downward pressure on dealer and distributor margins. This placed a severe burden on the smaller, less efficient dealers. Because discount houses competed on price, smaller dealers felt they would be pushed out of the market.

The introduction of built-in appliances and appliance colors created even more discord among small appliance dealers. The built-in appliances were sold direct to builders by manufacturer branches or independent distributors thus reducing dealer sales while the addition of colored appliances increased the cost of dealer inventories. This increased the manufacturer's power and strained relationships between dealers and the manufacturer, thus increasing the level of conflict in the channel.

Unlike other manufacturers, General Electric attempted to protect dealer margins during this period. General Electric fair traded its major appliances and thus maintained a good deal of power over dealers. However, by 1954, General Electric had abandoned this policy letting prices fall to the market level. This provided the final impetus pushing many inefficient dealers out of business. Finally, General Electric as well as other producers attempted to integrate the channel even further by opening dealer outlets. Although few, if any, of these outlets were successful, it served as a threat to existing dealers. The message seemed clear to many--conform to the manufacturer's strategies or compete with a manufacturer's dealer branch. In addition, the manufacturer's dealer branches served as a testing ground for new concepts that were later to be sold to dealers.

While manufacturers were increasing their power during the early 1950s, many dealers had also taken steps to counteract the manufacturer's power and maintain their profit levels. As dealer margins were reduced with demand, they began to add competing lines in an effort to maintain profit levels. Consequently, a customer in the dealer's showroom had four, five, or more refrigerator brands to choose from. This expanded the dealer's power by: increasing his sales; reducing his dependence on a single manufacturer; and he could play one manufacturer against the other and thus negotiate better terms.

The expansion of dealer lines afforded the manufacturer an opportunity to countervail the power of the dealer. Prior to this time, manufacturers were dissatisfied with the level of product service provided by many dealers. After the addition of several more lines, it became more difficult for dealers to affectively and efficiently provide customer service. Manufacturers then began to establish a factory-direct service system. This tended to increase the average level of service provided the customer and to increase the manufacturer's power and control of the dealer. By doing this, the manufacturer had removed a potential dimension upon which the dealer could differentiate his products. In addition, it made the dealer and his customers more dependent on the manufacturer.

Over the years, manufacturers have used several methods to increase their power. Some of these include: (1) cash payments to dealer salesmen; (2) management training sessions for distributors and dealers; (3) sales training; (4) product service training; (5) Whirlpool

has used its Distributor Advisory Council; (6) granting exclusive franchises; (7) instituting factory branches; (8) allocating products; (9) developing full lines; (10) providing service; (11) carrying inventories; (12) resale price maintenance; (13) promotional allowances; (14) implied threats; and (15) dealer and distributor margins.

Finally, the oligopoly situation provides manufacturers with power.

This is because (1) there are a few producers and other channel participants have limited alternatives and (2) product differentiation in conjunction with the large size of the producer provides effective barriers to entry.

Dealers, on the other hand, have been able to countervail the manufacturers power by: (1) increasing their size; (2) aggressively merchandising the product; (3) adopting multiple lines; and (4) because of their proximity to the customer. The independent distributors, however, have not generally been able to countervail the power of other channel participants; and consequently, distributors are not as significant a factor in the market as they once were. Recently, the effort by Philco distributors to revive the Crosley brand name can be viewed as an attempt to increase the distributor's ability to countervail the power of manufacturers and dealers. The concept of countervailing power⁷ appears to be useful in explaining decisions which affect the structure of distribution and the policies of channel participants.

⁷John K. Galbraith, "The Concept of Countervailing Power," American Capitalism, rev. ed. (Boston: Houghton Mifflin Co., 1956).

Bucklin⁸ and El-Ansary and Robicheaux⁹ have provided models which attempt to predict and explain channel change. These models seek to measure the manufacturer's and/or the middleman's payoff and tolerance functions and then to define the area where bargaining will occur as well as where channel disintegration is likely. The operation of these models is demonstrated in the negotiation that occurs between manufacturer and independent distributor. The manufacturer sets sales quotas for the distributor each year. When there is disagreement between the two participants, discussion takes place. The manufacturer typically uses persuasion, then authority, and finally, when all else fails, coercion to impose his will on the independent distributor.

Conflict

Conflict between participants in the appliance channel has been present since the inception of the industry. This conflict has taken many forms including: vertical, horizontal, and intertype conflict. Vertical conflict, between manufacturer and distributor or dealer, had the most significance for this study.

Vertical Conflict

Instances of vertical conflict have occurred throughout the entire history of the channel. In the 1920s, manufacturers had

⁸Louis P. Bucklin, "A Theory of Channel Control," Journal of Marketing 38 (January 1973): 29-37.

⁹Adel I. El-Ansary and Robert A. Robicheaux, "A Theory of Channel Control: Revisited," Journal of Marketing 38 (January 1974): 2-7.

difficulty in adding dealers and distributors; and once they carried the product, it was often hard to get them to promote it adequately. Dealers and distributors have in many cases been coerced into accepting manufacturer quotas. Through the years, manufacturers have forced the industry policy of noncompeting brands on both distributors and dealers. It wasn't until the early 1950s that dealers began to carry competing brands, and the distributors still carry only one brand.

The establishment of distributor quotas has always offered the potential for conflict. Quotas were set by the manufacturer and then forced on the distributor. Most distributors accepted them because they had nowhere else to go to get the product. These quotas are then used to control the distributor. If they fail to make the quota and their share of market, they may be replaced by the manufacturer which leads to even more conflict. In addition, throughout most of the 1930s the major producers were replacing their independent distributors with factory branches.

In the late 1940s, manufacturers established an allocation program for appliances. This program had few supporters among distributors and dealers who were anxious to sell as many appliances as they could. Then when demand declined, manufacturers began to force different models and colors on both distributors and dealers.

In the 1950s, manufacturers who sold to discount houses came in conflict with other dealers who could not compete with the discount house on price. Later, factory direct service upset many dealers who felt service was profitable and used it to help differentiate their

product. Finally, conflict again arose over pricing when manufacturers generally refused to lower prices or provide price protection for their dealers when oversupply caused severe price competition at the dealer level.

Horizontal Conflict

Horizontal conflict between participants on the same level in the channel has been present. Manufacturers have historically tried to outsell their competitors by altering price, advertising, or differentiating the product in some way. In the 1950s, the rush to broaden lines was an example of this type of conflict. Manufacturers, whether or not they wanted to expand their lines, were forced into it by their competitors. Similar situations have occurred when manufacturers have added improved features to their products. General Electric's introduction of the sealed compressor was an innovation that was bitterly fought by its competitors. In addition, manufacturers have fought for good distributors, and distributors have competed for the best manufacturer's brand, and most important, dealers. Dealers in turn have competed for the best manufacturer's brand, and the most customers. In attempting to attract customers, dealers have used price, service, their location, and numerous other factors to differentiate their product.

Intertype Conflict

Intertype conflict has been prevalent at the dealer level of the channel. The discount house, specialty appliance dealer, department store, and public utilities have all vigorously competed for the consumer's appliance dollar. Conflict has occurred over pricing, promotion, and other aspects of the mix. Dealers in the 1950s for example were particularly upset by the discount houses' failure to provide service while selling at a low price.

Crisis Change Model

The crisis change model describes the enterprise's reaction to a crisis situation. The model predicts the enterprise faced with a crisis situation will go through four stages. The stages of the model are: (1) shock, (2) defensive retreat, (3) acknowledgment, and (4) adoption and change.¹⁰ The reaction of several companies to crisis situations has followed this pattern.

The 1938 decision by Kelvinator to reorganize its distribution conforms to the model. The shock phase involved a sustained loss from the appliance operation. Over several periods, the company attempted to reduce costs (defensive retreat); however, it failed to correct the situation. Finally, a task force was established (acknowledgment) to deal with the problem. The task force's goal was to develop some original ideas to prevent the continuing losses. Finally, a plan

¹⁰ Stephen L. Fink, Joel Beak, and Kenneth Taddeo, "Organizational Crisis and Change," Journal of Applied Behavioral Science 7 (January-February, 1971): 15-37.

was formulated to reduce the product line (adoption and change) and reorganize the distribution system around factory branches.

Westinghouse had sustained losses for several years (shock phase) in the late 1960s and early 1970s. They had also attempted to eliminate excess cost by reducing budgets (defensive retreat); however, these normal cost reduction techniques proved to be of little use. Next, they established a task force (acknowledgment phase) to help in the reorganization of the distribution system. Finally, a new plan was adopted and put into action (adoption and change).

Decisions of other companies like the 1945 decision of General Electric to locate its production facilities in Louisville to reduce distribution costs; the 1970s decision by White Consolidated Industries to cancel Kelvinator's factory branches; and the 1960s reorganization of Frigidaire's distribution system all follow the same pattern. It would appear that the crisis change model could have described and possibly predicted the pattern of management decision making.

Summary

This chapter has directed itself to the third research question which was to interpret which if any behavioral and/or economic theories of channel formulation and change could have predicted or explained what actually occurred in the appliance industry. This chapter was organized to reflect four broad areas of theory development. Those areas included: macroeconomic, microeconomic, power, and conflict. Several theories in each of those areas were interpreted in light of the occurrences in the appliance channel.

CHAPTER VII

SUMMARY AND CONCLUSIONS

The precedent chapter interpreted the behavior of the major participants in the channel of distribution for appliances. This chapter provides the summary and conclusions of this research. It synthesizes the three objectives of the research which were reported in Chapters IV, V, and VI. In addition to summarizing the objectives of the research, conclusions are drawn as to which economic and/or behavioral theories could have explained or predicted what actually occurred in the appliance channel. Finally, recommendations for future research are provided.

Summary

The study of the decision-making process in the distribution channel provided a deeper understanding of both existing and potential channel relationships. This research developed an understanding of the development of the appliance industry and the decisions which affected the formulation and change of appliance channels. The present channel structure has evolved from the decisions made by numerous channel participants. In order to integrate channel theory with practice in the appliance industry and provide a perspective for the analysis of channel decisions, this summary charts the development of the appliance industry

from inception to present. In order to maintain continuity with previous chapters and because of the significant occurrences in the early 1930s and again after the Second World War, the Summary is divided into three areas. They include Appliance Distribution Pre 1930, Appliance Distribution 1930-1945, and Appliance Distribution 1945 to Present. Within each of these sections, the most important events in the period are highlighted. Consequently, because these events vary considerably, the sections do not follow a prescribed order.

Appliance Distribution Pre 1930

There are several important events which have characterized appliance distribution in the pre 1930 era. One of the most significant developments of this time was the development of the first major home appliances and the emergence of the manufacturers. Because appliances were in the introductory stage of the life cycle, consumer acceptance was low and early distribution was limited. However, by the early 1920s, distribution patterns were beginning to evolve. The evolution in distribution can be seen most readily in the changes occurring at Frigidaire. Finally, by the end of the 1920s, several major developments, including the hermetically sealed compressor, the calrod heating unit, and installment financing, had a significant impact on appliance sales.

The growth of the major appliance industry has been greatly affected by the development of three products: the refrigerator, the washer, and the range. Of these, the refrigerator has had the greatest

impact. Manufacturers who currently dominate the industry had strong market positions in at least one and in some cases all three products. Innovations in these products, as well as their dominant position as industry sales leaders, and the way they were distributed in the first few years of the industry have influenced the pattern of distribution greatly. Early distribution was direct to the consumer while later the channel became longer and included more intermediaries.

As the products were new so too was the industry. Manufacturers, distributors, and dealers were in the innovation stage of the institutional life cycle up until 1930. Although sales continued to increase throughout this period, profits lagged behind. The promotional cost of establishing the product in conjunction with research and development cost kept profits low and at times negative. Frigidaire, for instance, continued to lose money for several years.

Development of the washer. During the initial stages in the product life cycle, the refrigerator, washer, and range had little public acceptance; and brand recognition was limited to the area adjacent to the manufacturer's plant. For example, the washer had been in existence since the Civil War. However, early models were made of wood and driven by ineffective mechanical power which was no better and often more dangerous than doing the job by hand. The first major product innovation occurred when the Hurley Machine Company developed an electric washer with a chain drive. This innovation which initiated the electric washer was not immediately copied by competitors. It wasn't until 1914 that most washer manufacturers

had replaced the hand powered lever with the electric motor. It was not until 1922 when the Maytag Company introduced a washer featuring an underwater agitator that consumer acceptance began to grow. The Maytag machine was easy to use and was the first to do an effective job of washing.

Development of the range. Likewise the development of the electric range followed a similar pattern. Early ranges, the first was developed in 1903, consisted of a platform on legs with the oven mounted above the surface unit. The temperature of the surface unit was selected by simply plugging them in at either high, medium, or low heat. Both the oven and the surface units heated slowly and burned out frequently. Early users accepted these disadvantages because either gas was not available or they disliked coal or oil. Electric ranges, thus, were the last choice of most consumers. The product was not improved greatly until Hotpoint developed the Calrod heating unit in the late 1920s.

Development of the refrigerator. Finally, the mechanical refrigerator, which began to replace the icebox in 1915, was also plagued with mechanical problems which limited its market. The first refrigeration systems consisted of a brine tank in the user's icebox with a separate compressor using ammonia as the refrigerant, usually installed in the basement. The early refrigeration systems were noisy, bulky, and often leaked the strong smelling gas into the consumer's home. Because of this, hospitals could not use refrigeration, and many customers kept them on the back porch. It was not

until 1928 when General Electric introduced the hermetically sealed compressor that the problem of gas leaks was solved.

The major competitors. In addition to the products themselves, the producers also had a significant impact on distribution channels. The major producers in the appliance industry have, with one exception, been a part of the appliance industry since its earliest years. General Electric entered the major appliance industry by producing ranges in 1906, while Westinghouse influenced by General Electric's decision began to produce ranges in 1908. Kelvinator, Frigidaire, and Gibson initiated production of refrigerators in 1916, 1918, and 1933, respectively. Finally, Whirlpool has been a successful producer of washing machines since 1898. The single exception among the companies studied is White Consolidated Industries. Although White has had ties to the major appliance industry (it has produced sewing machines since 1876), it did not directly participate in the industry until it purchased Franklin Appliance from the Studebaker Corporation in 1967. Each of these companies has had differing reasons for entering the electric appliance industry.

Several concepts including Alderson's Core-Fringe Concept,¹ the potential for increased sales or profits, and economic theory, offer a useful framework for analyzing a firm's decision to enter the appliance industry. For companies like General Electric and Westinghouse, the entry into major appliance production was the natural

¹Wroe Alderson, Marketing Behavior and Executive Action (Homewood, Ill.: Richard D. Irwin, Inc., 1957), p. 56.

extension of their work in small appliances and other electrical apparatus. The addition of major appliances extended these companies into new fringe markets where they had little experience and helped to protect and insulate their core market. In addition, the venture into major appliances helped to diversify product lines and increase sales and profits.

The decision by General Motors to purchase the Frigidaire Company from William Durant can be viewed as an attempt to extend the company's fringe market and protect the core market. The purchase of Frigidaire provided General Motors with its entry into the major appliance industry. This put General Motors in a position where it was competing in an unknown market. However, it extended the fringe market for the company and had the potential for increased sales and profits, by doing this it helped insulate the firm's major market in automobiles.

Similarly, Gibson began production of refrigerators in an attempt to protect its core market. Gibson had been a producer of iceboxes for several years prior to its introduction of the refrigerator. As its core market in iceboxes was threatened by the refrigerator, the company broadened its product line to include refrigerator production. This shift to a growing segment of the market additionally offered the possibility of increasing sales and profits.

Finally, each organization's decision to enter the major electrical appliance industry would be the expected behavior under the normative economic model. The objectives in entering the industry to increase sales, increase profits, protect the firm's core market,

meet competitive pressure, and insure the long run survival of the organization are all compatible with the economic model of the firm.

Pioneering of consumer demand. Manufacturers of the early appliances faced an uphill battle in gaining consumer and middleman acceptance of their product. The new appliances were in the introduction stage of the product life cycle and had little or no consumer acceptance. In general, electrical appliances were poor substitutes for previous methods. They were low in product quality, expensive (early refrigerators cost \$750), and difficult to use, install, and maintain. Finally, consumer demand was restricted to the homes that were wired for electricity. In 1903, approximately one million homes were wired for electricity; however, that number grew to 8.7 million by 1920. Because of this, refrigerator manufacturers like Kelvinator and Frigidaire, electric range manufacturers like Westinghouse and General Electric, and washer manufacturers like Whirlpool and Maytag faced a limited market for their products. In an attempt to expand the market, producers began to distribute in distant markets.

Distribution 1900-1920. The lack of consumer acceptance and other forces affected the distribution of major appliances. Early channels of distribution were direct from producer to consumer. This was necessitated by several factors. First, appliances are purchased infrequently and thus the need for numerous dealers did not exist. Second, they required a high level of technical competence to sell, install, and service. The refrigerator, for example, required:

- (1) technical salesman to aggressively promote the product, (2) a

custom installation, and (3) repair in the home. Alfred Mellows, Founder of the Guardian Refrigerator Company (Frigidaire), installed the refrigerators himself and then serviced them every two weeks. With these technical problems, a short channel of distribution is most appropriate as it is unrealistic to assume that middlemen will be able to service the product. Third, the market for appliances was concentrated in close proximity to the producer's facilities; thus, middlemen were not needed to reach the market. Fourth, appliances were not standardized. In the introduction stage of the product life cycle, producers of appliances introduced many different designs in an attempt to find the right combination that would satisfy the consumer. Fifth, as already noted, the refrigerator required a custom installation. Because of this, refrigerator manufacturers were able to postpone the final characteristics of the product until it was sold, thus reducing the risk associated with its ownership. The long delivery time of the appliance was tolerated by the consumer because the refrigerator was updating the existing icebox. Sixth, no specialized appliance distributors or dealers were available in the market; and those in related lines could not be expected to perform sales training, installation, and servicing on a product that accounted for a small percent of sales. Finally, the distribution of appliances was affected by the distribution patterns that producers had used for other products. Companies like General Electric, Westinghouse, and later, Frigidaire carried many of the trade practices and relationships in industries with which they were familiar into the major appliance industry. Through this channel

of distribution, sales of major appliances reached 610,000 units by 1920. Wringer washers accounted for 600,000 of this, refrigerators 10,000, and electric ranges sales were insignificant.

The potential market for electrical appliances of all types had grown by over 800 percent since 1903, as more and more homes added the convenience of electrical service. By 1920, 8.7 million homes were wired for electricity and that number would continue to increase at a rapid pace throughout the 1920s.

Distribution 1920-1930. In the 1920s, distribution patterns began to shift. In addition to the direct to consumer channel, producers began to establish independent distributors, factory branches, and independent dealers. The variety of channels utilized in this period can be outlined by contrasting distribution at Frigidaire and Kelvinator.

Distribution at Frigidaire. In 1919, Frigidaire was sold to General Motors. Shortly thereafter, an attempt was made to increase sales and profits, thus production was expanded greatly. To sell this increased volume, Frigidaire instituted sales and service offices in cities other than its Detroit home. Frigidaire chose this channel for several reasons including: (1) the paucity of appliance dealers and distributors; (2) the desire to control the distribution channel; and (3) because of experience with a similar channel in the automobile industry. However, even with this increased sales effort, the product was not reliable enough for home use and so Frigidaire remained unprofitable.

In an attempt to increase its profitability and sales, in 1921 Frigidaire moved its offices from Detroit to Dayton and merged with the newly acquired Domestic Engineering Company (later to be known as Delco-Light Company) and the Dayton Metal Products Company. Both Domestic Engineering and Dayton Metal Products had backgrounds in appliances. In addition, Frigidaire gained a strong research department, a national sales force that would sell direct to consumers, and some unused productive capacity. By 1925, Frigidaire sales had increased to 63,500 units and had established itself in the refrigerator market with about 50 percent of the sales volume. This increase in sales can be attributed to a number of factors including: (1) increasing reliability of the product; (2) the use of sulphur dioxide as a refrigerant in 1921, which eliminated the brine tank in the refrigerator and made more room available for storage; (3) the increasing electrification of American homes; and (4) the aggressive door-to-door selling of salesmen in a wide geographic market.

As Frigidaire and other producers attempted to distribute appliances in distant markets, a gap materialized between the normative and the extant channels. The cost of a speculative inventory had become less than the net savings to both the buyer and seller from postponement. The extant channel was factory direct to the consumer in local markets. However, with the continued concentration of manufacturing in the middle west and the increasing geographical distribution of the market, a change in distribution patterns became inevitable. As the physical distance between producer and consumer increased, the need for some

type of market intermediary developed. The extant channel (direct to consumers) needed to be adjusted to the economic realities of the normative channel (the new channel would include some type of middleman).

During the early 1920s, the distribution pattern began to change. Originally, Frigidaire had established its own direct distribution to the consumer. However, shortly thereafter, Frigidaire began to spin off the selling, inventory, and related functions to independent dealers in major metropolitan areas. In rural markets, it established independent distributors and dealers. In doing so, Frigidaire was able to reduce the cost of distribution in rural markets and at the same time increase sales and hopefully profits. Spinning off various functions to either distributors or dealers provided national market coverage at a cost that was less than factory branches.

Distribution at Kelvinator. Frigidaire's major competitor, Kelvinator, was forced to take a different approach. In the 1920s, Kelvinator was the exception and distributed almost from the beginning solely through independent distributors. Kelvinator selected to spin off functions to independents because it didn't have the financial resources necessary to establish its own distribution and/or dealer network. Kelvinator found this was the least expensive method of achieving wide scale distribution and rapidly increasing sales. In some locations, however, Kelvinator was forced to use factory branches where independent distributors were not available.

Early middlemen. The independent distributors and dealers of the 1920s should not be confused with the appliance distributors and dealers of today. At that time, the appliance industry for all practical purposes did not exist; and so, there were no specialty appliance middlemen. Manufacturers who used independents for distribution were forced to use distributors in remotely connected fields of electrical apparatus, hardware, farm implements, and even jobbers of general merchandise.² These distributors had space available and wholesale salesmen calling on dealers in their territory. The addition of appliance sales was an opportunity for these middlemen to expand their product line into new markets and with this diversification increase the protection provided to their core market.

However, in spite of this incentive, it was not easy for manufacturers to induce distributors and dealers to carry appliances and do an adequate job of promotion. Middlemen occupied a powerful position in the market because they provided manufacturers access to the consumer market. Without this access, manufacturers would have a difficult time competing in some market segments. This is especially true for the small producers. In addition, appliances were untested in the market, generally unreliable, experienced wide fluctuations in sales (refrigerators did not sell well in the winter) which increased the cost of inventory, and required aggressive selling. Each of these factors made it more difficult for manufacturers to sell appliances to

²Anthony E. Cascino, "Household Washing Machines," Marketing Channels: Structure and Strategy (New York: McGraw-Hill, 1968), p. 183.

competent middlemen. Because of this middleman power, manufacturers copied existing practices in the automobile industry and established exclusive territories for distributors and dealers.

The exclusive selling arrangement increased the manufacturer's power by encouraging the independent distributor to cooperate with the producer in developing the territory (usually a county) to its fullest potential. Thus, the independent distributor's power was increased because he was assured of a monopoly in a given territory while the manufacturer gained a measure of control over this important middleman. However, in spite of the cooperation that existed in the channel, conflict often erupted over the determination of territories, the level of penetration expected by the manufacturer, ordering and payment policies, and the amount of sales effort put forth by the distributor.

Both distributors and dealers were limited by an industry policy to carry a single appliance manufacturer's refrigerator, range, washer, etc. For example, a middleman might carry a Frigidaire refrigerator and Maytag washer but never would carry both Frigidaire and Kelvinator refrigerators. So appliance middlemen normally carried several different manufacturers' products. In addition to appliances, they had other products to sell; and a single appliance manufacturer's business might constitute only 5 percent of the total sales. Appliance sales were difficult to make, normally requiring a great deal of specialized door-to-door selling and a high degree of product knowledge to convince customers to purchase the product. Consequently, many middlemen failed to provide the effort the appliance business required.

During this period, public utilities proved to be one of the most effective appliance dealers.

Public utilities recognized early the advantages of selling appliances. In entering the appliance market, utilities in most cases expanded beyond their core into a fringe area where they had little experience. This fringe area would provide protection to the core by expanding the demand for electrical service.

The success of the public utility dealer can be attributed to a number of different factors. First, unlike other dealers at the time, the utilities carried a very narrow line and specialized in the sale of appliances. Thus, they could provide expert technical advice and service to their customers. Second, they were generally well-respected in their community and offered prime downtown locations to their customers. This was especially important in dealing with a product that had limited customer acceptance. The good reputation of the utility provided a halo effect for appliances. Third, they were able to organize aggressive door-to-door selling campaigns. Finally, they operated on a variable margin. At times, utilities would sell appliances at a loss just to increase the residential electric load. This practice of selling appliances at a loss would generate intertype conflict with other dealers and lead to legal steps which would prevent utilities from selling appliances. Thus, utilities found that appliances could be profitable on the initial sale, as well as after the sale on a continuing basis as the residential electrical load was increased. Normally, utilities acted as dealers; however, occasionally these dealers also became distributors.

In 1926, General Electric began production of refrigerators and two years later announced an innovation that would do much to increase the size of the refrigeration market. The hermetically sealed compressor introduced in 1928 caused horizontal conflict with other manufacturers in the industry. The compressor eliminated gas leaks, a common problem with early refrigerators, and made it possible to reduce greatly the amount of in-home service (the compressor, guaranteed for five years, could be replaced rather than repaired on the spot). This increased the reliability of the appliance and made it possible for marginal dealers, those who were unable or unwilling to service the old refrigerators, to enter the business. Although the hermetically sealed compressor was originally fought by other manufacturers, they quickly adopted the innovation when General Electric extended its guarantee to five years.

Besides expanding the market, the compressor would also limit the number of producers in the industry. The small competitors who had entered the market in the mid-1920s now needed large amounts of capital to produce refrigerator compressors and then to guarantee their compressors for five years. In 1916, the refrigerator industry was a monopoly; by 1918, it was a duopoly; by the mid-1920s, the industry was composed of two large manufacturers and numerous smaller ones. In the late 1920s, the number of manufacturers in the industry began to decline as competition provided increased pressure on smaller producers. The trend toward fewer manufacturers which began in the late 1920s has continued ever since.

General Electric's Hotpoint Division in the late 1920s introduced another innovation, the Calrod heating unit for electric ranges. The Calrod unit consisted of an electric coil imbedded in a steel tube. This innovation increased both the speed of heating and the dependability of the unit. However, sales of electric ranges remained low until after World War II when lower electric rates, new automatic controls, and built-in ovens and ranges became available to the consumer. These features made electric ranges less expensive to operate, easier to use, and added a new element of style to the consumer's home.

Consumer credit. As product quality improved and consumer acceptance increased, manufacturers expanded their sales territories, and competition between manufacturers became inevitable. Additionally, the image of appliances as a rich man's luxury was beginning to fade. Many middle income consumers were beginning to enter the appliance market. This meant a shift in the location of dealers into less affluent areas and a revision of sales quotas for all middlemen. Both of these led to conflict between the manufacturer and the middleman and an increase in power for the manufacturer. Generally, middlemen acquiesced to the manufacturer because of the increasing sales they were enjoying.

For most consumers, the purchase of an appliance constituted a major financial commitment which was exceeded only by the purchase of a house or an automobile. The purchase was made more difficult as consumer financing for appliances was not provided by commercial banks or sales finance companies. This void in the institutional coverage of

the market led the Kelvinator management to take action. In 1926, following the lead of General Motors Acceptance Corporation (G.M.A.C.) in automobiles, Kelvinator initiated the Refrigerator Discount Corporation (REDISCO) to finance the sale of Kelvinator appliances for distributors, dealers, and their customers. Kelvinator's venture into this fringe area of its business was designed to protect and expand its core market in refrigerators.

This action was precipitated by the necessity of the situation and the desire to increase Kelvinator sales and profits. If Kelvinator hoped to continue to expand sales of its refrigerators, it felt it must open up the market to middle income consumers who needed to spread the purchase of the product over time. In deciding to grant consumer credit, Kelvinator was uncertain as to the profitability of this business. However, management viewed it as a necessary adjunct to their appliance business. REDISCO provided Kelvinator with a differential advantage in the market as its existence was predicated on its ability to help Kelvinator make a sale even if it meant losses for REDISCO. Originally, REDISCO only financed Kelvinator sales; however, after the profitability of the business has been demonstrated, financing for other manufacturers' appliances was added. The success of REDISCO was later copied by competition (Frigidaire shortly after and General Electric in 1932). During the 1930s, financing of appliances was a very important aspect of the business; and it enabled refrigerator manufacturers to expand sales even during the depression.

Appliance Distribution 1930-1945

The period of 1930-1945 is characterized by change in all levels of the channel of distribution. As sales expanded and economies of scale reduced the price of appliances, demand shifted to the less affluent market segments which made increasing use of consumer credit to purchase appliances. Other major changes which occurred during this period include: (1) the shift of the sales training function from distributors to dealers; (2) the entry of department stores into the market; (3) the decline in importance of public utility dealers; (4) the shift toward increased use of factory branches by the major manufacturers; and (5) the reorganization at Kelvinator.

The period of the 1930s began the accelerated development stage of the institutional life cycle for manufacturers, distributors, and dealers. During this stage, participants experienced a combination of rapid sales growth and high profits. The increasing consumer acceptance of appliances and aggressive door-to-door selling helped increase sales dramatically, and increased investment at all levels in the channel was undertaken to keep pace with the increasing sales. The increasing demand for appliances was due to a number of factors. One of the major factors leading to increasing sales was the expansion of consumer financing of appliances.

Economies of scale. Installment selling of refrigerators in the 1930s would do much to expand the size of the market and decrease the price of refrigerators. Terms of sales were generally quite liberal. The consumer could purchase a new refrigerator for nothing

down and only 25 cents per day. At that price, it was easy to convince owners of iceboxes that a new refrigerator was actually cheaper (ice cost more than 25 cents per day). Consequently, installment contracts at REDISCO alone increased almost 200 percent from \$6,000,000 in 1930, to over \$17,000,000 by 1940. During this period, refrigerator sales increased from 791,000 units to 2,700,000 units. This increase in sales allowed manufacturers to mass produce refrigerators, gaining the cost advantages of mass production.

The reduction of production costs led manufacturers to decrease selling prices. When prices were lowered by one competitor, they were quickly copied by the others. This created a good deal of horizontal conflict in the industry as competition increased. Because of this, the average price of a refrigerator declined from \$292 in 1930 to \$164 by 1936. These price reductions provided still further barriers to entry for small manufacturers. Now besides promotional expenditures for introducing a new brand and the development and guaranteeing of a compressor, new competitors had to be able to produce at a cost low enough to meet the price competition. In addition, new entrants into the market were forced by industry trade practices to utilize inferior distributors and dealers. Because distributors and dealers already had exclusive franchises with other manufacturers, new producers had to use less efficient middlemen. Thus, the trend toward fewer manufacturers which started in the late 1920s would continue through the 1930s.

Change in consumer demand. The 1930s saw some significant changes in the appliance market. The traditional market for appliances, upper income consumers, had become saturated. The saturation level of refrigerators was 73 percent for families with incomes of \$5,000 and over. However, installment buying extended the market to other less affluent market segments. For example, the saturation level was only 26 percent for families with incomes from \$1,000 to \$2,000. However, 62 percent of these families who bought an appliance financed their purchase using an installment contract. The shift in demand caused a change in the channel.

Because of shifting consumer demand, the normative channel was once again different from the extant channel. Dealers who had selected their locations because of their proximity to the high income market suddenly found this was inappropriate. The resulting horizontal conflict between dealers and vertical conflict between dealers and manufacturers over territories and levels of market penetration finally led to the realignment of the normative and extant channels to more accurately reflect the existing geographic distribution of the market.

The changes occurring in the channel had increased the manufacturers' power vis-à-vis distributors and dealers. The increasing consumer acceptance of appliances induced numerous dealers to enter the market. Manufacturers with strong customer franchises were better able to select dealers and control their activities. Manufacturers were also able to increase their power by increasing or decreasing distributor and dealer margins. Changes in margins, however, frequently led to channel conflict.

Shifts in the distributor's level. During the 1930s, the distributor's role in the distribution channel was changing. Although they still only represented a single manufacturer of a product, the market for appliances was changing rapidly, and consequently, so were distributor margins. Consumers were becoming increasingly sophisticated in terms of the potential and operation of appliances, while technological improvements made appliances more efficient and dependable. In addition, new dealers, like the department store, seeing the potential profits in appliance sales had entered the market. Finally, some manufacturers, in order to keep pace with these changes, decided to convert several of their independent distributors to factory branches.

The appliance industry began with a price structure that allowed for the following gross profit: distributor, 25 percent; dealer, 25 percent. With this margin, distributors were expected to spend a great deal of their time training the early salesmen in the industry. Because of the technical nature of the product, it was common to keep a dealer's salesman in school for a couple of weeks before he attempted to sell new appliances to customers who had lived for years without them. This discount structure remained unchanged as long as technical selling was needed at the dealer level. However, by the mid-1930s, it became evident that appliances could be sold in volume without as much training and assistance from the distributor. Consequently, by 1935, the following margins had generally been established: dealer, 35 percent; distributor, 16.6 percent. The new margins increased the level of conflict between manufacturer and distributor.

Distributors, however, had no choice but to accept the new margins if they wanted to continue as appliance middlemen. Dealers were, of course, pleased by the new margins. At this time, manufacturers were able to increase their control over distributors by using coercive power and over dealers through the use of reward power. These margins were held intact until 1940, when both dealer and distributor margins were again reduced. By 1940, the margins were: dealer 33 percent; distributor 12 percent.

Shifts at the dealer level. The realignment in margins can also be attributed to changes at the dealer level of the channel. Retail distribution of major appliances began with small businesses established to sell and service refrigerators and washing machines. Public utilities entered the business early to increase consumption of electricity, and distributors often established their own dealer outlets. In the 1930s, this structure was to change drastically.

By the early 1930s, Frigidaire was able to convince several department stores to carry major appliances. Department stores were willing to add this fringe market to their core market of clothing and other products because of the potential sales and profits that appliances would generate. In addition, appliances would help to further diversify the department stores' lines adding stability to the organization and increasing the protection for the core market.

Department stores also enjoyed a differential advantage over other dealers including: (1) a strong customer franchise; (2) strong local advertising; (3) they organized outside selling crews much better

than other dealers; and (4) although they constituted a small number of accounts, they had a great market potential. Their merchandising techniques were far superior to other dealers as they offered better display, advertising, and sales promotion. Department stores also enjoyed prime downtown locations, offered extensive service, and carried a broad line of products which attracted a variety of customers.

In an attempt to gain maximum benefit from the large number of customers that patronized department stores, manufacturers established display kitchens and staffed them with a home economist. These display kitchens were placed in high traffic areas and provided an excellent opportunity for the manufacturer to introduce consumers to the convenience and ease of operation of new appliances. Leads established in the store were then normally followed up with a sales presentation and closing in the home. Because of the aggressive department stores and recent technological advancements, appliance sales began to change. Department stores were now able to presell appliances making the salesman's job much easier, thus reducing the need for a highly technical sales force. This reduction in the need for technical selling, as was mentioned before, was a factor leading to a change in margins. In addition, because of their strong market position, department stores also affected other areas of the channel.

Over 500 department stores entered the business between 1930 and 1936. So great was their impact on the market that by 1940 they accounted for 21 percent of industry sales. The aggressiveness of department stores initiated conflict between several channel

participants. Intertype conflict situations arose between department stores and other less aggressive dealers. The increasing share of the market which department stores were able to gain came from the existing dealers market share. In addition, independent distributors were reluctant to deal with department stores because: (1) independent distributors were reasonably content with the status quo, and department stores were not a market they had initiated; (2) department stores were very demanding; (3) the other dealers which constituted the bulk of the distributors sales would be hurt if the distributor sold to department stores (vertical conflict); and (4) if the manufacturer was going to hold the distributor accountable for a certain level of market penetration then he wanted to manage the market as he saw fit.

Finally, the department stores were in conflict with manufacturers. Because of their strong market position, department stores were able to countervail the power of the large manufacturer. Consequently, dealer margins were adjusted upward to reflect the political and economic reality of the channel. As the department store became more powerful another dealer began to diminish in importance.

The public utility dealers, which were an important part of the channel in the 1920s, were beginning to lose stature in the market. In 1930, the utilities accounted for 25 percent of dealer sales; but by 1940, this had declined to 10 percent. Public utilities abandoned this fringe market to protect themselves from attack by smaller competitors and government. In the early 1930s, numerous other dealers had entered the industry and were providing increased competition for

the utilities. During the 1930s, 500 department stores, 4,000 furniture stores, and a number of mail order houses had entered the appliance market. These were aggressive dealers; and thus, there was little need for the utilities to continue to sell appliances to build up their residential load. Finally, the aggressive pricing policies followed by some utilities (at times they sold appliances for less than cost) fostered intertype conflict between public utility dealers and small appliance dealers. The small dealers could not compete with the larger, more diversified and regulated utility. Consequently, they began to push for government regulation of the utilities' appliance business. The result was the passage of two state laws (in Oklahoma and Kansas) in 1932 which forbade utilities from selling appliances. In addition, other states were considering similar laws which would restrict appliance sales. Because of these laws and the increased number of appliance dealers, utilities slowly began to withdraw from the market. One of the dealers that was to replace the public utility dealer was the specialty appliance dealer.

In the mid-1930s, many appliance dealers began to add radios and other small appliances; and the appliance dealer as we know him today was born. The emergence of this dealer can be viewed as a dialectic process of change which starts with a thesis and an anti-thesis and produces a synthesis of the two. The thesis, or established institution, is the public utility dealer while the antithesis is the department store dealer and the synthesis is the appliance dealer of the middle 1930s. The public utilities had the following general

characteristics: (1) downtown location; (2) extensive service; (3) strong door-to-door selling; (4) variable margin; and (5) narrow line--while the department store had: (1) downtown location; (2) extensive service; (3) in-store as well as outside selling; (4) high margin; and (5) broad line. The appliance dealer is a combination of the characteristics of these two dealers. The appliance dealer stressed: (1) extensive service (department store and public utility); (2) high margin (department store); (3) narrow line (public utility); and (4) in-store sales (department store). Thus, the appliance dealer of this time adopted characteristics of the two most successful dealers up to that time. These appliance dealers experienced a rapid growth in sales; and by 1940, they accounted for 32 percent of sales volume.

Manufacturers cancel distributors. The changes occurring at the dealer level of the channel would have an impact on all the other channel levels. By the mid-1930s, both Frigidaire and General Electric would become disenchanted with the independent distributors they used. The emergence of the department store as an appliance dealer was met with strong reseller solidarity. Independent distributors refused to trade with department stores for fear that it would jeopardize their relations with other dealers. The growth oriented manufacturers, on the other hand, were anxious to enlist the aggressive department store as a dealer. Manufacturers felt that the department store could do much to help them increase both sales and profits. Even though they were few in number, they represented a tremendous market potential that General Electric and Frigidaire did not want to forego.

The resulting conflict between independent distributors and manufacturers led the manufacturers to begin replacement of their distributors with factory branches. The use of this coercive power by manufacturers increased their power relative to independent distributors and dealers. In addition, it emphasized that there is a level of distributor control in the channel that these manufacturers would not tolerate. Their tolerance for distributor control was reduced when it became apparent that the current level of distributor control would lead to slower growth in both sales and profits. Thus, by instituting factory branches, manufacturers were able to increase their control over the channel of distribution and increase the potential sales and profits.

As the larger manufacturers replaced independent distributors, the distributors entered the maturity stage of the institutional life cycle. Their overall growth was slowed because the larger, more successful appliance manufacturers were replacing them. Those that remained typically had rural territories where sales volume and profits were low. Thus, the institutional rigidity displayed by the independent distributor in dealing with the changing structure of the channel led to their decline. In addition, as dealers became larger, the cost advantage of distributing through independent distributors was reduced. It became more economical and effective for manufacturers to sell directly to department stores and other large dealers. Here, again, the separation between normative and extant channels needed to be narrowed. This trend toward larger dealers that began with department

stores would continue to affect the distribution channel for a number of years. Thus, beginning in the early 1930s manufacturers began to eliminate their independent distributors in favor of factory branches. Although smaller appliance manufacturers continued to use independent distributors as the least cost method of distributing their products. By the late 1930s, Kelvinator was the only major appliance manufacturer that distributed the bulk of its appliances through independent distributors.

Kelvinator in crisis. By 1938, Kelvinator found itself in a crisis situation. Kelvinator management had blinded itself to changes that were occurring in the appliance industry. In spite of the increasing importance of department stores, the diminishing importance of public utility dealers, and the need for increased control of the channel by the manufacturer, Kelvinator continued to utilize its independent distributors. Finally, Kelvinator's management recognized its plight and took steps to correct the situation. The Crisis Change Model provides a useful framework for analyzing the changes that occurred at Kelvinator.

The first stage of the Crisis Change Model is shock. This phase is characterized by the realization that a critical aspect of the organization is threatened. In 1938, Kelvinator, the fourth largest manufacturer in the industry found itself in financial trouble. Although the overall market for appliances was increasing, Kelvinator sales were declining and the company suffered a \$7 million loss. Management viewed this as a substantial threat to their core market

and were afraid if something wasn't done that Kelvinator would become just another casualty of the industry.

The second phase is defensive retreat. In this phase, the organization attempts to reduce the threat by instituting controls. During this phase, Kelvinator management began to reduce costs wherever possible; however, these attempts to reduce costs proved futile. Losses continued to mount, and it became clear that some major reorganization was needed.

The third phase of the Crisis Change Model is acknowledgment. In this phase, the management of the organization begins to question existing practices. In order to solve its problems, Kelvinator identified a task force of executives and assigned them the problem of analyzing the company's situation and making recommendations for the future. The task force was able to identify several major problem areas. Since Kelvinator began distribution of refrigerators in 1916, it had always used independent distributors because: (1) they were the least cost method of distribution; (2) Kelvinator's limited financial resources precluded it from establishing factor branches; and (3) it provided a national distribution network for its product.

In 1938, 95 percent of Kelvinator's distribution was still through independent distributors. Most of these distributors sold hardware, radios, furniture, etc., and paid little attention to appliances as they were usually a small portion of sales and profits. In addition, these independent distributors were reluctant to deal with one of the fastest growing dealer segments, department stores. At the

same time that department stores were increasing in importance, another dealer segment which had always been important to Kelvinator was declining. As department stores entered the introduction stage of the institutional life cycle, public utilities entered the sales decline stage. This was important to Kelvinator because public utilities had always been the mainstay of its distribution network.

In addition, over the years Kelvinator had attempted to differentiate its product by adding new models to its refrigerator line. By 1938, the refrigerator line consisted of 18-20 models that were different sizes and offered different features. This wide variety of models meant increased production and inventory costs for Kelvinator and increased inventory costs for distributors and dealers.

The final stage of the Crisis Change Model is adoption and change. Here dysfunctional behavior is disposed of as the organization takes steps to realign itself with its environment. At Kelvinator, one of the first steps taken by the task force was to hire top managers from outside the company. It selected two Frigidaire managers to become General Sales Manager and Sales Manager of Household Appliances. Further, working under the assumption that cost and price could be reduced if the product were more standardized, it recommended a reduction in the number of models from 18 to 6. To increase sales, the price of an appliance was reduced substantially and a national advertising campaign was initiated. Finally, the task force concluded that if the new strategy was going to succeed, then a quick response from distributors and dealers was essential. It wanted a group of

managers in the field that would jump when Detroit (home office) said, "Jump!" Kelvinator management like Frigidaire and General Electric could no longer tolerate the level of distributor control that existed in the market. Distributors were in many cases indifferent to the problems of the manufacturer and simply wanted to run their own businesses.

Thus, in 1938, Kelvinator began to cancel independent distributors and replace them with factory branches. Kelvinator ventured into this fringe area of its business in order to protect its core market. The manufacturers' branches would increase the control in the market and increase the sales of appliances. The cancellation of independent distributors was done on a selective basis. The independent distributors cancelled were in high potential urban markets where the cost for Kelvinator to contact a customer was lowest. In rural markets where potential was low and cost per customer was high to Kelvinator, the company selected to continue spinning off the distribution function to cost efficient middlemen (these middlemen could spread the cost of a sales call over a wide range of products rather than just appliances).

The independent distributors that were retained were selected very carefully. Two major criteria were used to evaluate distributors these were: (1) good sales management and (2) good dealer contact. In addition, each distributor and factory branch was assigned a territory with a potential large enough to induce distributors to increase their selling effort. This use of reward power increased

Kelvinator's position vis-à-vis the remaining distributors by increasing their dependence on Kelvinator and at the same time warning them that if they didn't perform they might be replaced by a factory branch.

The results of the strategy were significant. The number of independent distributors was reduced from 120 to 52, and 13 factory branches were established in major urban markets. The product line was reduced from 18 to 6, and price was reduced between \$30 and \$60 across the entire line. These changes caused a rapid increase in appliance sales. Other manufacturers fearing that their market share and profitability would be eroded selected to follow Kelvinator's price leadership.

The Kelvinator decision to reorganize was not the only occurrence of the late 1930s that would change the distribution channel. In 1939, Bendix introduced the automatic washer. This simplified washing clothes and took much of the drudgery out of the job. When Bendix, an outsider to the appliance business, introduced its washer, the company was expanding into a fringe market where they had little expertise. However, this fringe market proved to be profitable and increased the protection of its core market through product diversification.

The advantages gained by Bendix and Kelvinator were not long lived. Shortly after their decisions, the United States entered World War II and all appliance manufacturing was halted. The war provided some manufacturers with an opportunity to improve their product, redesign their distribution system, and in general prepare their marketing strategies.

Appliance Distribution 1945 to Present

The period following World War II until the present was characterized by several major occurrences in the appliance industry. These include: (1) heavy demand after the war; (2) a glut of appliances in the early 1950s; (3) the emergence of the discount house as an appliance dealer; (4) price cutting on appliances; (5) trend toward full line distribution at the manufacturer's level; and (6) the development of factory direct service and delivery. In addition to these topics, this section of the chapter will also summarize the distribution strategies of the major manufacturers.

Immediately following the war, production of appliances resumed. Manufacturers of major appliances continued the expansion of the product line, a trend which had emerged in the late 1930s. For example, Frigidaire and Kelvinator had added ranges in 1937 and 1939, respectively; and General Electric and Westinghouse had produced refrigerators and ranges for a number of years. After the war, other appliances were added to manufacturers' lines including automatic washers, freezers, room air conditioners, dishwashers, and dryers. The most significant of these, because of sales volume and its effect on distribution, was the automatic washer. Westinghouse added an automatic washer in 1946 followed by Whirlpool and Frigidaire, while General Electric and Kelvinator added this product in the early 1950s.

Full line distribution provided a differential advantage for both manufacturer and dealers. By purchasing from a full line manufacturer, the dealer could secure quantity discounts and reduce

ordering costs by purchasing an assortment of products in carload lots. On the other hand, dealers purchasing from manufacturers of a single or limited line found it difficult to gain these quantity discounts. They had to purchase carload quantities of a single or few products to gain the full advantage enjoyed by the full line manufacturer's dealer.

By granting carload discounts, manufacturers were able to increase their control over dealers by providing them with incentives for purchasing in larger quantities. Thus, the manufacturer was able to reward the larger dealer (reward power) and also to encourage the smaller dealer to sell more aggressively so he too could enjoy the advantages of buying in carload lots. In addition to providing the manufacturer with increased control over dealers, it also diversified the manufacturer's line making them less dependent on the core market.

However, the single or limited line manufacturer, by using a distributor, could approximate full line distribution. The distributor combined several noncompeting lines of different manufacturers and then offered them to the dealer as a full line. To the limited line manufacturer, the independent distributor was the least cost way to effectively distribute the manufacturer's appliance.

The independent distributor. Independent distributors have played an important role in the distribution of major appliances. This is due to their strategic position as they control the manufacturer's access to some dealers. In addition, their skill and importance in promotion of the product (normally, they are well

respected by others in local area) have been indispensable to the smaller or single line manufacturer.

Appliance distributors have always been granted an exclusive franchise in a carefully defined territory under the condition that they would not sell competing brands. This limitation was imposed by the manufacturers because: (1) it increased their control over the distributors; (2) it reduced the chance of conflict between independent distributors and other distributors or factory branches over sales territories; (3) of their belief that distributors could not do an effective job with, and be loyal to competing brands; and (4) manufacturers felt that if distributors carried competing brands competitive secrets would be impossible.

Within his franchise, a good distributor must build a strong dealer organization. In order to accomplish this, he must take a systems perspective and elicit cooperation from both dealers and manufacturers. Some of his duties include the selection of the right kind and number of dealers in each market segment and then the training of the dealer's salesmen to sell and service the product. Competent dealers are vital to the distributor's success and good distributor-dealer relations are also important to the manufacturer's success.

An adequate inventory must be kept on hand by the distributor, and the dealer must be sold a sufficient supply of units by models. The distributor must secure a good display location for the product on the dealer's floor and in display windows. Finally, the distributor must consistently expose the dealer to constant and effective sales promotion efforts.

Local promotion for the dealer is also a responsibility of the distributor. In many cases, this means scheduling, writing, and participating in cooperative advertising programs. Other sales promotional literature must also be made available so the customer can continue to consider the product away from the dealer's showroom. Additionally, the distributor provides incentives to the dealer in the form of: trips for volume purchases, meetings, retail incentives to dealer salesmen, and other volume incentive programs which reduce the price the dealer must pay based on the volume the dealer sells.

Another important aspect of the distributor's job is financing. Because most consumers purchase their appliances on the installment basis, most dealers need help in financing their operations. Distributors then are expected to provide free floor planning³ by using financing from an outside institution. This has become a major part of the distributor's sales policy over the years. So much so that many distributors claim they sell terms rather than products.⁴

The relationship between a distributor and dealer is generally a close one. The distributor is intimately acquainted with the dealer's problems and provides expert advice whenever possible. This builds a high degree of trust and loyalty between distributor and dealer, and increases the control the distributor has over the dealer. The distributor uses reward, expert, legitimate, and coercive

³Floor planning is the financing of dealer inventories by the distributor.

⁴Cascino, "Household Washing Machines," p. 188.

power to increase the control over dealers. This control over dealers makes the independent distributor invaluable to the single line manufacturer.

The independent distributor performs a wide variety of functions for the appliance manufacturer. Any manufacturer that wants to eliminate the independent distributor must be willing to perform all these functions. Therefore, the manufacturer needs both the financial and human resources of the independent distributor when establishing a factory branch. Thus, to producers who lack these resources, the independent distributor is an indispensable aspect of the distribution system and without this access to the dealer market these producers might cease to exist. Other manufacturers who possess the necessary resources can perform these functions through a factory branch system. Shortly after the war, the expansion of the manufacturer's product lines posed a problem for manufacturers who utilized independent distributors.

Prior to the war, many washing machine manufacturers shared distributors with manufacturers of refrigerators (who also produced ranges and freezers) and manufacturers of televisions and/or radios. However, after the war when refrigerator manufacturers like Frigidaire, Westinghouse, General Electric, and Kelvinator began to broaden their line to include automatic washers, problems occurred at the distributor level.

As noted earlier, industry practice limits independent distributors to only one brand of a particular product. When the

refrigerator manufacturer introduced an automatic washer, a vertical conflict situation occurred between manufacturer and distributor. The distributor was forced by industry practice to decide between carrying the refrigerator manufacturer's washer and dropping the current washer line or dropping the refrigerator manufacturer brands. Choosing the latter, the distributor would most likely lose the refrigerator manufacturer's other products including refrigerators, ranges, and freezers. Thus, the decision was usually quite simple as economic considerations dictated that the distributor retain the more profitable refrigerator line. Consequently, single line producers (they were predominately washing machine companies) stood a good chance of losing their best distributors as refrigerator manufacturers expanded into washer sales. Consequently, the possibility existed for a single line manufacturer to be denied access to the market through independent distributors.⁵ Thus the independent distributor controlled the channel of the small washer manufacturers and exerted great power over them.

As refrigerator manufacturers became full line producers, they gained power over the distributor through their ability to offer distributors a franchise which covered several products. This expansion of product lines has continued ever since the end of the war. The result is that the industry is currently dominated by a few multi-product companies. The specialty appliance distributor has thus had

⁵Ibid, pp. 186-187.

a significant impact on the number of products offered by the manufacturers in the appliance industry.

The industry policy which forces independent distributors to carry only one manufacturer's product has affected the increasing concentration of the industry by inducing manufacturers to merge with other producers and establishing barriers to entry which thwart the entry of new competitors. A new competitor in the industry must be willing and both financially and managerially able to develop a full line of products as well as a manufacturer's branch system of distribution.

Expansion of market sales. Consumers, unable to satisfy their demands during the war years, were anxious to add appliances to their homes. In the five years following the war, sales of appliances increased from zero to almost 17 million units by 1950. Manufacturers were producing at plant capacity, yet consumer demand could not be satisfied. Demand was so great that manufacturers allocated products to distributors and dealers. Prices began to escalate to higher levels and consumer demand continued strong. In many cases, consumers paid in excess of list price for the right to purchase an appliance. Major appliances thus presented very lucrative profit possibilities to manufacturers, distributors, and dealers alike. Consequently, existing distributors and dealers began to pay increasing attention to their appliance business. In addition, new dealers were entering the market in an unprecedented scale. In a

single year after the war, over 50,000 new dealers selected to sell appliances.⁶

This situation increased the manufacturer's power vis-à-vis distributors and dealers. The reward power possessed by manufacturers is demonstrated by their ability to reward successful dealers and distributors with higher allocations. This, in turn, helped to determine distributor and dealer profit. In addition, manufacturers who limited the number of dealers they used could increase the allocation to existing dealers. Finally, because the product was highly profitable, middlemen would accept higher levels of manufacturer control. The individual middleman no longer provided the only access to the consumer market. Manufacturers could now pick and choose between a number of middlemen willing to adequately promote the product. This situation continued until about 1950, when overproduction in the industry produced a glut of appliances.

After the war, manufacturers had added capacity in the mistaken belief that the sales increases would continue. However, by 1950, consumer demand had leveled off, and customers were no longer standing in line eager to pay premium prices for appliances. Dealers responded to the situation by cutting prices and offering trade-ins. These practices became widespread and most dealers sold at 10 and 20 percent below the manufacturer's list price.

⁶"Thor Adopts Limited Distribution Cuts Dealers from 20,000 to 7,000," Sales Management, April 1, 1950.

Discount houses enter market. This price cutting was led by the discount houses which had come into prominence after the war. These establishments being outsiders to the industry challenged accepted practices and operated as low overhead, low margin, low status dealers and, in turn, offered their customers a low price, no service, and in-store selling. Because of the success of the discount house in the late 1940s and early 1950s, other dealers selected to meet this competition. The established appliance dealer, however, was very bitter about this intertype competition. With little or no support from the manufacturer, the other dealers grudgingly attempted to meet the discounter's price reductions. Lower prices and sales meant reduced dealer profits, and many of the marginal appliance dealers went out of business. The specialty appliance dealer and the discount house, because of their willingness to reduce profit margins in favor of higher turnover, both gained in market share during this period.

The horizontal conflict (between similar dealers) and intertype conflict (between discount houses and appliance dealers) which emerged in this period eventually led to vertical conflict (between manufacturers and dealers). While dealers were reducing prices to generate sales and protect their core market from the strategic thrusts of the discount houses, manufacturers generally did little price cutting. General Electric alone attempted to maintain the retail price of its appliances by utilizing the fair trade laws. General Electric fair traded its major appliances until about 1954. Its fair trade policy increased General Electric's power and control over its middlemen.

These middlemen were willing to accept this increased level of manufacturer control because they anticipated it would lead to a higher payoff in the form of increased profits. Other manufacturers under increasing pressure from dealers, distributors, and their own profit margins slowly began to reduce prices.

With the glut of appliances on the market, other appliance dealers found themselves in a somewhat desirable position. As consumer demand slowed, manufacturers (eager to increase sales) began to look for new dealers. The appliance dealers, who normally carried only one manufacturer's line, found their bargaining position and power vis-à-vis the manufacturer improving. Dealers who were unhappy with margins, advertising allowances, or dealer incentives simply switched manufacturers or began to carry two, three, or more manufacturers' lines. The resulting horizontal conflict pitted manufacturer against manufacturer as they were forced to compete within every dealer's establishment for floor space or dealer emphasis while the dealers used their power to improve the terms granted by the manufacturer.

Beginnings of the maturity stage of the life cycle. The glut of appliances coupled with the decreasing demand led manufacturers and dealers into the maturity stage of the institutional life cycle. For manufacturers and most dealers, this stage has been characterized by slow growth in sales and lower profit levels than existed in the accelerated development stage. Between 1950 and 1960, sales of all appliances actually declined from approximately 14.75 million units to 13.72 million. Although sales generally increased from 1960 until

present, the high levels of profit prevalent in the late 1940s have not returned to the industry. Between 1930 and 1950, appliance sales increased by more than seven times; while from 1950 to 1975, a longer period, appliance sales only doubled. Much of the increase since the 1950s has been in new products while the mainstays of the industry, refrigerators and ranges, have declined or remained constant in unit sales.

Finally, although dealers in general entered the maturity stage in 1950, some dealers (for example, the discount house) had just entered the innovation stage of the institutional life cycle. Other dealers, however, like department stores, were already declining and for the most part public utilities had been in the decline stage for a number of years.

Department stores entered the appliance business rather late but became strong dealer outlets because of their stature in the community which they served. However, department stores were in general quite demanding of the manufacturers whose products they carried. During the early fifties when dealer margins were reduced, many of the department stores refused to accept a margin of less than 25 percent; and so they selected to drop or de-emphasize their appliance departments. It should also be noted that the advantages they enjoyed in the 1930s, such as a downtown location, were now a detriment as consumers moved to the suburbs. The result was a decrease in their market share from about 21 percent in 1940 to 8 percent by 1960.

Public utilities, which began their decline in the 1930s, continued to become a less significant factor in the post-war era. Faced with the continuing increase in the number of dealers and adverse legislation, the public utilities continued to reduce their share of the market. By 1960, they accounted for only 3 percent of the appliance sales in the country. Other retailers who accounted for a major portion of appliance sales included furniture stores (15 percent), auto and tire chain stores (5 percent), department chain stores (Sears, Wards, etc.) (12 percent), the builder business (home and apartment builders) (15 percent), and appliance dealers and discount houses which had increased their share of the market from 32 percent in 1940 to 42 percent in 1960.

Shifts in the service function. As the number of lines the dealer carried expanded, the economics of the channel began to change. The normative channel once again did not correspond to the extant channel and change became inevitable. Over time, dealers found it increasingly more difficult to service effectively and profitably the wide range of products and brands they handled. For many dealers, the increase in parts inventory and decline in the productivity of their staff made the service business unprofitable. Manufacturers who felt that dealers already did a poor job of servicing their products were even more convinced when dealers selected to service several manufacturer's appliances. To alleviate these problems, in about 1955 several manufacturers including General Electric, Frigidaire, and Westinghouse decided to bypass the dealer and retake the service function by

providing a factory direct service system. This included either an independent franchised service facility serving several manufacturers or a manufacturer's service branch. The service function was spun off to independents in areas where it was too expensive to establish a manufacturer's branch (rural areas where population and, thus, appliance density were low were likely areas for an independent).

The shift of the service function increased the manufacturer's power because it alleviated many dealers of an unwanted drain on their profits. These dealers were then better able to compete on the same basis with discount houses who offered no service. However, this also led manufacturers into a vertical conflict situation with other dealers. Those dealers that had differentiated their products on the basis of the high quality service that they offered the customer, now found themselves at a disadvantage. They were upset with the manufacturer for providing service because in many cases it was profitable and could be used as a strong competitive weapon. Because of these changes a new type of dealer was beginning to emerge.

The specialty appliance dealer of today is a result of the economic changes in the channel. Additionally, this change can be viewed as a dialectic process of change which incorporates some of the elements of the old appliance dealer (thesis) and the newer discount house (antithesis) to formulate the specialty appliance dealer (synthesis). In the late 1940s, the appliance dealer's mix typically included: extensive service, high margin, reliance on in-store selling, and a narrow line--while the discount house offered

few services: a broad line, low margins, and in-store selling. Over the years as the specialty appliance dealer has developed, it has adopted some of the characteristics of both of these dealers. Today, the specialty appliance dealer has a low margin, relies on factory direct service, has a wider line than the old appliance dealer (but narrower than the discount house), and relies on in-store selling. In general, the appliance dealer has moved closer to its major competitor, the innovative discount house, to form the specialty appliance dealer. In this process, the service function has been spun off creating the need for new types of marketing institutions in the channel; the independent franchise service center, and the manufacturer's service branch.

The result was to increase the manufacturers' control over middlemen by increasing their dependence on the manufacturer. In addition, manufacturers could then differentiate their product lines from one another on the basis of service. Manufacturers could now stress that service was fast, available everywhere, and courteous, thus, increasing the strength of their customer franchise and their power over the dealer.

The retail appliance dealer has undergone some significant changes. The price competition brought on by the discount house and the glut of appliances on the market caused several alterations in the way products were distributed. Appliance dealers expanded lines and reduced margins while department stores and utilities abandoned the business. The retail appliance business has been in a constant state

of flux, and there can be little doubt that current dealers will continue to change and that new dealers will enter the market to replace older less efficient ones. Besides the changes that were occurring at the distributor and dealer levels of the channel, the manufacturer's level of the channel was also undergoing some change.

General Electric. The break in appliance production during the war led General Electric to study the overall goals of the major appliance division. For years, General Electric had problems with its major appliance business (shock phase of Crisis Change Model). Sometimes the company would win leadership in a product only to lose it because engineers had neglected styling. Sometimes the parts were manufactured in plants so outmoded that low cost production was impossible.⁷ Numerous attempts had been made to increase the efficiency of this operation but they had failed (defensive retreat). Finally, a group of executives were assigned the task of studying the industry and making recommendations for the future (acknowledgment phase of model). This study led to the restructuring of the company management and the construction of Appliance Park, a massive facility planned specifically for the production of major appliances (adaptation and change phase of model).

In an effort to adjust to the wide fluctuations in the sales of different appliances and improve efficiency, General Electric

⁷William B. Harris, "The Overhaul of General Electric," Fortune, December 1955, p. 237.

established Appliance Park.⁸ It had several plants that were old and inefficient. In addition, the company was trying to reduce the impact of fluctuations in appliance sales at the manufacturer's level. These fluctuations caused increases in costs because equipment lay idle or needed to be converted to the production of other appliances. In either case, total cost increased. To reduce costs, the existing facilities were replaced by modern plants designed to produce appliances as efficiently as possible. However, the establishment of Appliance Park did not have as great an effect as General Electric had hoped and so other efforts to reduce distribution costs were undertaken.

Because the problem had not been solved, General Electric reverted back to the acknowledgment phase and once again began a period of self-examination questioning the way in which appliances were distributed. There was a growing realization at General Electric that the problem stemmed from a faulty distribution system rather than variations in consumer demand. Observation had indicated that although consumer sales were fairly constant, manufacturer sales were uneven with wide fluctuations.⁹

In the early 1950s, increased pressure to analyze the distribution system was brought on by the higher levels of price competition which was facing appliance manufacturers. At General Electric,

⁸Appliance Park is General Electric's manufacturing and administrative headquarters just outside Louisville, Kentucky.

⁹"G. E. Seeks the Answers in Its Distribution System," Business Week, 2 October 1954, p. 68.

everything possible in manufacturing had already been done to offset these reduced margins (defensive retreat). Consequently, the distribution system became the next target of the cost cutters. In March 1954, the Consumer Goods Distribution Study Project was organized to study: (1) consumer purchase motivation; (2) distribution methods in the automobile, hardware, tire, and food products industries; (3) the functions of the distributor and dealer; (4) whether distributors and dealers were performing those functions; and (5) if the distributor's job and dealer's job matched what the customer wants (acknowledgment phase of the Crisis Change Model).¹⁰ This study led to the following changes in distribution at General Electric (adoption and change phase): (1) the extension of factory direct service; (2) an increase in the number of factory branches; and (3) an increase in the number of field warehouses. The decision to increase the number of field warehouses demonstrates that General Electric was somewhat aware of a separation in the normative and extant channels.

By 1963, General Electric, as well as other manufacturers, was experimenting with a different physical distribution channel in an effort to alleviate the burden of carrying a higher level of inventories from the dealer. Instead of shipping the product to the dealer for delivery to the consumer, the manufacturer or distributor inventoried the merchandise for the dealer and made deliveries from his inventory to the dealer's customer. This relieved the poorly financed dealer of the expensive inventory function allowing him to postpone

¹⁰ Ibid., p. 70.

purchase of the product and shift another function to the manufacturer. Several years prior to this, in an effort to decrease the dealers' inventory carrying costs and ordering costs, manufacturers were also shipping mixed carloads direct to the dealer from the manufacturer's mixing warehouse, thus, bypassing at least in the physical distribution sense the distributor level. This allowed dealers to postpone purchase and reduce inventory requirements because the order cycle time had been reduced. In both cases, the dealer's dependence on the manufacturer was increased. This, in turn, increased the manufacturer's control of the channel. In general, these innovations in distribution were copied by other producers; however, differences do exist as manufacturers have attempted to differentiate their products on this basis.

The General Electric strategy can be summarized as having two major objectives. They are: (1) the reduction of costs and increased profits and (2) increased control of the distribution channel. Throughout this period, General Electric attempted to reduce the costs of distribution first through the construction of Appliance Park and then later through the reorganization of the distribution system. In reducing costs, the ultimate effect would be to increase profits. At the same time, General Electric's management also wanted to increase its control over the channel of distribution. During this period, the factory branch system which General Electric had used to some extent throughout its history was coupled with field warehouses which could provide quicker direct shipment of appliances to dealers. These changes it was hoped would reduce the fluctuations

in demand and thus both increase General Electric's control over distribution and reduce cost. Later, General Electric was further able to extend its control of the channel by providing factory direct service. Thus, due to General Electric's large economic resources, the company was able to extend its control over the distribution system and reduce the system's cost. These two objectives along with strong product development, advertising, and a strong dealer network have made General Electric a successful appliance manufacturer.

AVCO. The importance of distributors to single line manufacturers was discussed earlier. This importance is dramatized by the problems that faced AVCO in the early 1950s. Mindful of the trend toward full line manufacturing and its increased profit potential, AVCO executives were determined to offer to their independent distributors a complete line of both Bendix and Crosley appliances. It was perceived that the expansion of the product line would increase the protection to each of the companies core markets (Crosley in refrigerators and Bendix in washers). In the early 1950s, AVCO decided to first introduce a Bendix line of appliances and then later a Crosley line of appliances to the independent distributors. Because of this, many independent distributors were forced to choose between the Bendix and Crosley appliances and the one they were currently carrying. As a result of this conflict situation, many of these distributors discontinued the Bendix or Crosley line; and AVCO was forced to find other, usually second-rate, distributors.

In addition, because the two lines were exactly the same, except for nameplates, dealers were able to play the Bendix distributor against the Crosley distributor forcing each to reduce prices. These problems in the distribution system induced management to consolidate the two lines under one management. In 1953, the combined line, including Crosley television sets, was offered to distributors on an all-or-nothing basis. Again, distributors were faced with a conflict situation and had to make a decision as to which lines they should carry. Once again as distributors dropped the combined line, AVCO was forced to find other normally second-rate distributors. By 1956, after taking a 16.5 million dollar loss, AVCO discontinued the production of Crosley products and sold its inventory of Bendix washers to Philco for six million dollars. In a period of less than six years, AVCO, one of the largest appliance manufacturers, had gone out of the business.¹¹ AVCO's strategy of introducing two separate appliance lines through independent distributors had failed. AVCO's demise was due in large part to the industry imposed policy which restricts the distributor from carrying competing products. AVCO had little control over the channel and the independent distributor was able to deny its access to the market. The Whirlpool Corporation was one of the major beneficiaries of AVCO's demise.

Whirlpool. In the early 1950s, Whirlpool's distributor strategy and distributor network underwent several major changes. In the

¹¹Spencer Klaw, "Why AVCO Quit Appliances," Fortune, February 1957, pp. 138-140.

scramble over full lines, over 1,000 distributorships changed product lines between 1953 and 1955.¹² During this period, Whirlpool added new distributors but also lost many they had used for years, and the prospects of losing any more of its 70 independent distributors were not good. However, in spite of everything, Whirlpool had a strong distributor network prior to the 1955 RCA agreement.

The 1955 agreement between RCA and Whirlpool would have a lasting impact on the Whirlpool Corporation. The agreement immediately made Whirlpool a full-line manufacturer and this increased the protection for Whirlpool's core market (washers) which had been threatened by recent mergers. One of the provisions of the agreement was that Whirlpool would move as soon as possible to combine the two distribution systems. This provision led to a change in Whirlpool's strategy as it formulated a distribution system composed of old Whirlpool and RCA distributors as well as five factory branches. The cancellation of distributors along with the opening of its first factory branch caused conflict with a number of independent distributors. Many felt that they might also be replaced by factory branches; however, this was not to be the case.

In 1953, Whirlpool instituted its Distributor Advisory Council (DAC) which is still functioning. The purpose of the group is to improve relations between Whirlpool and its independent distributors. The group today consists of 14 representatives of distributors and

¹² "Whirlpool Corporation," Forbes, 1 February 1963, p. 19.

company branches who meet a minimum of once every year to: (1) consider the effect major company decisions will have on distributor margins, pricing, profits, and product lines; (2) serve as a sounding board and sales format for Whirlpool ideas. Since its inception, the DAC has been very successful in providing feedback from the field and smoothing the way for changes which have an effect on distributors. In addition, the DAC is credited with helping to keep manufacturer-distributor conflict to a minimum. Whirlpool uses the group to increase its influence and power over its independent distributors. This, in turn, increases Whirlpool's control over its channel of distribution and makes the distribution system more effective.

Whirlpool has attempted to increase the efficiency of its channels in other ways. In 1971, Whirlpool designed a computer simulation model entitled the Whirlpool Heuristic Analytical Model of Logistics (WHAMOL). The purpose of this model is to simulate Whirlpool's distribution system so that the least cost method of physical distribution can be selected--consistent with service and time constraints. The purpose of WHAMOL is to reduce both functional costs and total distribution costs in the channel as well as to help maintain a service level consistent with company standards. The higher service level helps to differentiate the company's product while increasing Whirlpool's power and control over its dealers.

Over the years, Whirlpool has elected, because of changing market conditions, to alter its distribution system. After the war, it selected dual distribution in order to defray research and

development costs. Again in the 1950s, Whirlpool developed a full line because its major competitors were developing full lines. In the mid-1950s the absence of good distributors who could deliver a reasonable share of the market led Whirlpool to establish factory branches. Whirlpool has worked to establish good relations with its independent distributors. This policy has led to increased coordination and control over the channel. With this control it has been possible to expand both sales and profits. Finally, the WHAMOL system has done much to aid in the planning of the distribution network and the reduction of distribution cost. This overall strategy has proven very successful as Whirlpool is the most profitable in the industry.

Kelvinator. By the middle fifties, Kelvinator's core market was once again threatened and management was concerned. Profits were declining enough to consider reverting back to independent distributors, and prospects did not look good for a recovery (shock phase of the Crisis Change Model). Although independent distributors were considered, management was of the opinion that this change would affect sales volume so adversely that more would be lost than gained (acknowledgment phase).

Finally in 1968, Kelvinator was acquired by White Consolidated Industries. White management immediately reversed Kelvinator's pattern of distribution by closing factory branches and going back to independent distributions (adoption and change phase). White chose not to maintain its investment in the factory branches and was unconcerned about the potential reduction in sales volume. White's management is

very cost conscious; consequently, its decision to revert back to independent distributors was based solely on which channel provided the lowest cost method of distribution.

Several factors entered into this decision including: (1) a change in the demand which reduced distributor margins; (2) increasing power of the dealer vis-à-vis the manufacturer; (3) independent distributors provided the lowest cost distribution; and (4) a new management team with a different philosophy had taken control. Under this new cost cutting policy, Kelvinator is content to take a smaller market share. This type of policy may achieve results in the short run, however, a long run strategy needs to be implemented so that Kelvinator does not cost cut itself out of this market.

Frigidaire. Frigidaire's distribution system remained relatively stable with factory branches in major metropolitan areas and some independents in rural areas. This situation existed from 1950 until the mid-1960s. However in 1965, the only apparent reason for the addition of these independents was general manager Terrell's feeling that they provide increased sales at a lower cost than factory branches.¹³ It would appear that the decision to add the independent distributors was made on the basis of one man's influential position and friendship with the distributors rather than careful analysis and planning. Thus in 1968, when Campbell,¹⁴ a long-time Frigidaire

¹³Richard L. Terrell became General Manager of Frigidaire in 1965.

¹⁴Harold W. Campbell became General Manager in 1968.

employee replaced Terrell as General Manager, Frigidaire shifted back to its policy of reducing independent distributors.

Another significant change in the distribution system occurred as a result of research originating in 1967. For years, Frigidaire had been an unprofitable division of General Motors (shock phase of Crisis Change Model). In spite of attempts to reduce losses through normal cost cutting techniques, the unprofitability continued (defensive retreat). Because of this unprofitability and shifting dealer requirements, an extensive distribution study was undertaken (acknowledgment phase). Its goal was to determine the changes in the market place and to outline Frigidaire's response to these changes. The study revealed a significant shift in the responsibility for inventory. Inventory and the costs associated with it were shifting away from the dealer and toward the manufacturer. The dealer was thus able to postpone purchase and reduce the costs associated with carrying inventory. The dealer was becoming more demanding in an attempt to meet changes in consumer demand.

The shifting responsibility for inventory led the Frigidaire management to restructure its warehousing system (adaptation and change phase of model). The net result of the project was that the number of warehouses were cut from 88 to 46, and the vast majority of Frigidaire's dealers were within 24 to 36 hours transit time from a warehouse. To further speed delivery, a rapid ordering system called FRONTIER was installed to handle orders on a real-time basis. The computerized system allows dealers to place orders and receive immediate confirmation

that the appliance is in stock and will be shipped.¹⁵ Thus, Frigidaire substituted the transportation function for the inventory function in the channel.

The major objective of the entire system was to maintain a high customer service level and reduce the inventory burden of the dealer. The regional distribution warehouse network was established to insure a customer service level of 48-hour delivery, and to provide this at the lowest cost possible. In addition, this program made the dealer more dependent on the manufacturer and provided the manufacturer with an increased level of control. Frigidaire was not concerned with minimizing the total cost of distribution but rather attempts to maintain a minimum service level and control the distribution channel. Frigidaire's strategy is different from the other successful producers in the industry in one major way. The other producers emphasize cost minimization while at Frigidaire this does not seem to be as big a consideration. General Motors seeks to control the distribution of appliances in the same way it controls the distribution of automobiles. Consequently, it distributes factory direct.

In addition to the customer service level, legal questions and problems are important considerations to Frigidaire management. Even though an alternative might be cheaper, it may not be selected because of the anti-trust implications.

¹⁵ For a brief description of how Frigidaire's FRONTIER System works see "A Logistics Approach Speeds the Flow," Appliance, January 1971, pp. 36-37.

Westinghouse. The Westinghouse Appliance Corporation has for many years been a company that distributes primarily through factory branches. This pattern has persisted throughout Westinghouse's history in the major appliance business and is basically an extension of its practices in other fields. In the early years of the company, other products were distributed through factory branches, and so it was natural for them to follow the same distribution pattern in major appliances.

In August 1974, the major appliance division of Westinghouse, under the increasing pressure of financial losses (shock phase), undertook a major reorganization of the appliance distribution system. This reorganization resulted from the realization that normal cost cutting procedures had failed (defensive retreat) and that the industry was changing while Westinghouse remained static. Specifically, management came to the conclusions (acknowledgment) that: (1) multiline manufacturers were becoming the dominant force in the industry; (2) the small dealer, except for secondary and rural markets, was being replaced by large dealers or consolidated into buying groups; (3) there was increasing pressure to find methods to reduce the cost of distribution; (4) there were increasing losses accruing to the appliance division; and (5) normal cost reduction programs were having no effect. Each of these factors created pressure on Westinghouse management to do something about its current distribution system.

In an effort to solve these problems, a group was formed to study the distribution system (acknowledgment) with the overall goal

of reducing marketing costs while maintaining the customer service level. The study resulted in a super-region concept being instituted at Westinghouse.

Adoption of the super-region concept resulted in a reduction in the cost of distribution primarily due to the reduction in overhead and administrative costs. The regions were reduced from 36 to 6 while distribution was spun off to independent distributors in rural areas because this was the least cost method of distribution. Distributors now cover approximately 40 percent of the geographical area but account for only 22 percent of sales. The warehousing to support the regional system consists of a regional depot system in which each region has a large mixing warehouse shipping direct to dealers. Service is factory direct to all locations or spun off to independent service centers in rural areas.

In attempting to determine whether or not to use a factory branch or an independent distributor, Westinghouse management utilizes several evaluative criteria. These criteria include: (1) cost of distribution; (2) the competitive nature of the market (highly competitive markets call for a factory branch); (3) geographic market coverage; (4) control of the independent distributor in the builder market; and (5) legal considerations.

The Westinghouse strategy includes the following: (1) the use of independent distributors to reduce cost; (2) provide a high level of customer service; and (3) maintain control over the channel. The success of this overall distribution strategy has been obscured

because for years the parent company has allocated large amounts of fixed overhead to the appliance division. (For example, millions of dollars of corporate overhead were allocated to the appliance division.)

This section of the chapter has provided a brief summary of the major developments which occurred during the growth of the appliance industry. Some of these developments involved: (1) introduction and changes in products; (2) the growth of the manufacturers; (3) the evolution of both distributors and dealers; and (4) the distribution strategies of the major producers. The next section provides the conclusions reached in this research.

Conclusions

The first research objective was to develop a chronology of the growth of the appliance industry and the development of prevailing channel structures. This objective was reported in Chapter IV and summarized earlier in this chapter. The second research objective was to isolate the manner in which vertical channel decisions relative to structure were made by executives holding representative roles within the major firms constituting the appliance industry. This objective was reported in Chapter V and summarized earlier in this chapter. The third research objective was to determine which behavioral and/or economic theories of channel formulation and change predicted or explained the structural development of the appliance industry. The theoretical framework developed in Chapter III will be used to organize the

conclusions of this study. Analysis of the research results lead to the following conclusions.

First Conclusion

That several macroeconomic theories including: Alderson's core-fringe concept; the institutional life cycle; dialectic processes; the normative channel; postponement speculation; and the theory of a differentiated oligopoly were consistent with behavior in the appliance channel and provided insight for practical decision making and theory development.

All of the theories classified as macroeconomic were useful in explaining and/or predicting behavior in the appliance channel.

Core-fringe concept. Alderson's core-fringe concept provided an explanation for several instances of channel behavior. These instances included: (1) manufacturers entry into the appliance market; (2) the dealers entry into the appliance market; (3) manufacturers providing consumer financing; (4) entry of public utilities into the appliance market; (5) department stores entry into the market; (6) the establishment of factory branches; (7) addition of appliances by distributors; (8) the proliferation of appliance lines after the war; (9) development of factory service; (10) the development of factory direct shipments; and (11) manufacturers providing floor planning. Each of these was viewed as a strategic thrust into the market to extend the enterprise's domain and protect the core market.

Institutional life cycle. The institutional life cycle provided an explanation and basis for predicting change in channel institutions. Manufacturers, distributors, and dealers have all gone through the innovation, accelerated development, maturity, and some are

in the decline stage of the institutional life cycle. In addition, it was pointed out that different dealers could be in different stages of the life cycle at the same time.

Dialectic process. The dialectic process of thesis-antithesis then synthesis helps to explain the emergence and characteristics of the appliance dealer. This dealer was first shown to be a synthesis of the public utility dealer and the department store. Then, utilizing the appliance dealer as the thesis and the discount house as the antithesis to form the specialty appliance dealer of today (synthesis). Thus, if the thesis and antithesis are known, it is possible to predict the eventual form the synthesis may take.

Normative channel. The theory of the normative channel was shown to be useful in explaining and predicting some instances of channel change. These include: (1) the overall trend toward concentration of the industry as barriers to entry were erected; (2) the early development of channel structure; (3) the development of middlemen to fill an institutional void; (4) the development of department stores; (5) the development of the discount house; (6) the shift of the service and inventory functions in the 1950s; (7) the elimination of some distributors in the mid-1930s; and (8) the shift in store location as consumers changed. As there are still benefits to be derived from economies of scale, institutions in the appliance channel are continuing to expand. This expansion will cause changes in the distribution channel as the extant channel moves closer to the normative channel. The astute observer identifying the future economic conditions could then predict in which areas change would occur.

Postponement speculation. The theory of postponement speculation provided a basis for predicting and explaining the location of inventory in the channel. As the cost to the dealer of carrying inventory for a wide product line increased, backward postponement occurred and delivery time from a speculative inventory was reduced. In addition to predicting this channel change, this concept would have also explained why it occurred. In addition, it would have predicted that a speculative inventory would have existed in the channel. The existence of this inventory in turn presents an opportunity for competent middlemen to demonstrate that they can perform this function at a lower cost. Finally, it was useful in explaining and predicting why manufacturers used forward postponement in the early years of the industry.

Oligopoly. The normative theory of oligopoly predicts and explains a wide range of activity in the channel. It provides an understanding of industry pricing policies, product differentiation, and promotional expenditures. In addition, the increasing concentration of the industry can be viewed as the normal tendency of an industry that erects several barriers to entry. When the macroeconomic aspects of oligopoly are coupled with its microeconomic aspects in the next section, it provides a powerful tool for explaining and predicting channel behavior.

Second Conclusion

That several microeconomic theories including: functional cost minimization; total cost minimization; and sales and/or profits were consistent with behavior in the appliance industry channels and thus provided insights for potential decision making and theory development.

Functional cost minimization. Behavior in the channel of distribution for appliances was consistent with predictions of functional cost minimization. Manufacturers spun off functions that could be performed cheaper by specialists. Incidents which demonstrate attempts to minimize functional costs include: (1) the use of independent local delivery; (2) the use of independent service companies; (3) the use of independent distributors in rural areas; (4) the use of independent distributors and dealers; and (5) the WHAMOL System at Whirlpool.

Total cost, sales, and profits. Cost, sales, and profits were a basis upon which manufacturers have made many decisions. These factors are interrelated with the normative theory of oligopoly. Together they explain the reasons underlying most of the channel decisions. Manufacturers continually referred to the cost of a particular decision or the revenue or profits a decision would yield. The major decisions at Kelvinator, Whirlpool, Gibson, White-Westinghouse, Frigidaire, and General Electric were all made after considering these factors. Kelvinator reorganized its distribution system after sustaining losses. Westinghouse reorganized its distribution system to reduce the total cost while maintaining the same level of customer service. Gibson utilizes independent distributors because they are the lowest cost

method of distribution. Whirlpool developed WHAMOL in an effort to reduce the cost of distribution while maintaining the same level of customer service. General Electric planned and constructed Appliance Park in an effort to reduce the total cost of distribution.

Third Conclusion

That the theory of countervailing power and the theories of control helped to explain behavior in the appliance industry and provided insights for decision making and theory development.

Power. Manufacturers and dealers in the appliance industry channel have continually attempted to increase their power. Manufacturers have increased their power vis-à-vis dealers by: (1) their size; (2) differentiating their product; (3) providing floor planning; (4) providing service; (5) providing management, sales, and service training for dealers; (6) adding new products and new lines; (7) by granting franchises; (8) providing sales displays; (9) by using factory branches; and (10) providing financing. Dealers have attempted to increase their power vis-à-vis manufacturers by: (1) increasing their size; (2) aggressively merchandising the product; (3) adopting multiple lines; (4) their proximity to the customer; and (5) by pooling orders. Throughout the history of the appliance industry, manufacturers or dealers attempted to countervail the power of one another. When department stores countervailed the power of manufacturers in the 1930s, manufacturers countered by instituting factory branches and heavy in-store promotions. When manufacturers increased their power after the war, this was countered by dealers adding multiple lines. This has existed throughout the history of the appliance industry.

Control. The theories of control proposed by Bucklin and El-Ansary and Robicheaux help explain behavior in the channel. The relationships between manufacturers and dealers and manufacturers and distributors are typified by attempts to control (or the power to change or modify) the behavior of other participants. Kelvinator, in 1938, reorganized its distribution to increase its control over distributors and dealers. The process of quota setting for distributors and dealers is a bargaining process which can be explained by the models of channel control. In addition, the purpose of the Whirlpool Distributor Advisory Council is to persuade the distributors to agree with the company's programs. Frigidaire, General Electric, and Westinghouse all made numerous attempts to increase their control over channel middlemen.

Fourth Conclusion

That the conflict change model helped to explain behavior in the appliance channel and provided insights for decision making and development of theory.

The conflict change model provided an explanation for a number of instances in the channel. These include: (1) the 1938 Kelvinator reorganization; (2) the 1945-1955 General Electric reorganization; (3) AVCO's withdrawal from the appliance market; (4) Frigidaire's introduction of dealers in the 1960s; (5) Kelvinator's reorganization in the mid-1950s; and (6) the 1974 reorganization of Westinghouse. In all of these cases, the enterprises adjusted to their environment in a process described by the Crisis Change Model. Thus, it may be possible to predict what phases an organization will go through when adapting to conflict situations.

Fifth Conclusion

That there was no significant behavior and/or economic theory that explained or predicted all interrelated occurrences in the appliance channel.

Each of the theories identified thus far explained and/or predicted some occurrences in the appliance channel. However, no single theory was able to explain all the occurrences in the channel. The economic theories such as: functional cost minimization; total cost minimization; sales and/or profits; and the theory of an oligopoly failed to take behavioral aspects into account, while the behavioral theories disregarded cost, sales, and profits. Finally, there are theories which are specific to given situations such as: institutional life cycle and dialectic processes. Each of these theories explained some segment of channel behavior. What is needed is an integrative or general theory of the channel. A theory that would tie the divergent aspects of the current theories together. This general theory would use existing theories as a base and integrate them into a cohesive whole.

Sixth Conclusion

That the industry policy limiting distributors to one brand of a product had an effect on the distribution structure of the industry and increased the level of industry concentration.

The research outlined several instances where this industry policy limited competition in the industry and increased the level of concentration. These include: (1) the largest manufacturers were first to use the best distributors in the 1920s; (2) with the expansion

of product lines in the 1950s many single line manufacturers were forced to expand their lines (if possible), be merged into a larger organization, or go out of business; (3) AVCO's demise in 1955 was the result of this policy; (4) any new manufacturers to the industry had to utilize second rate distributors or develop a completely new channel; and (5) currently, the industry is dominated by companies that have either been in the industry since the early years or merged with companies that have.

Recommendations for Future Research

Numerous theories of channel change have been advanced in the literature. These divergent conceptualizations indicate that the problem of predicting and explaining channel change has not been solved. The need for research in all areas of the channel is important if an understanding of channel decision making is to be forthcoming. This research focused solely on the distribution of major appliances and concentrated on the manufacturers' level within the channel.

The research identified several areas of theory that provide a basis for further research.

1. Tests of the institutional life cycle in different channels and with different institutions is needed. In addition, this research should define more closely the characteristics of the stages in the life cycle.
2. The dialectic process of change described the changes that the appliance dealer has undergone. Tests of this process

in other channels and at other levels in the channel are needed, and further research is warranted to more accurately predict where change will occur and why it occurs.

3. Functional spin-off explained some behavior in the channel. Additional research in other channels, at other levels within the channel, and between different channels is required to substantiate the findings in this research and define more closely when functional spin-off will occur.
4. The models of channel control offer promise in explaining channel relationships. Specific studies in other channels are needed to varify the assumptions of these models and to determine their predictive ability.
5. The theory of postponement speculation is useful in identifying whether or not inventory will exist in the channel. Research in several channels is needed to varify the cost relationships of this theory.
6. The theory of a normative channel has provided insights into channel development. Tests of this theory in other channels are important because the normative channel integrates the concepts of marketing functions and economic theory and may provide the basis for generating further hypotheses.
7. This research has identified an attempt by channel participants to increase their power in the channel. The amount and type of power a channel participant possesses can greatly affect the structure of the channel. Research measuring the effects of

the amount and type of power or channel formulation and change is needed.

8. The Crisis Change Model explained some behavior in the appliance channel. Research that applies the model to different types of decisions of varying degrees of importance is needed.
9. Additional research to determine the effect that change at the dealer level of the channel has on manufacturers' channel policies is necessary to understand the decision making process.

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