Channel Conflict:

Historical Perceptions, Management Implications, and So Much More

Brent Driver & Zach Evans

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Channel conflict is not a new concept. It has been frustrating managers in the business world for many years. It has always accompanied the development of new marketing channels, such as the introduction of factory outlet and discount stores in the 1980s (Matta, Mehta 2001). Only recently, with the emergence of the Internet as a new and dynamic distribution channel, has this topic been more of a focal point in boardroom discussions. A recent survey of 50 manufacturers revealed that 66 percent believed that channel conflict was the biggest issue they faced in their online sales strategy (Hogan, Webb 2002). Channel conflicts in the e-commerce age are intensified by the unique channel characteristics of the Internet (Matta, Mehta 2001).

**Origins of Channel Conflict**

Channel conflict emerges as the market evolves and business strategies change. “The primary motivations for supplier firms establishing multi-channel arrangements are the desire to increase market share and to reduce costs. Firms are attempting to reconstruct the supply chain and make it more efficient, a process that will disrupt traditional channels, resulting in conflict both internally among the supplier’s channel managers and externally with distribution partners.” More often than not, objectives among channels cannot be achieved concurrently. If one channel is succeeding, it is likely at the expense of another (Hogan, Webb 2002). This is the norm in multi-channel business strategies. A diverse channel strategy is necessary, however, for survival in the marketplace. “Manufacturers have historically been tentative in their approaches to electronic commerce, primarily out of fear of direct competition with and potential damage to existing sales channels,” (Matta, Mehta 2001). The only thing that manufacturers fear more than alienating resellers is having no e-commerce plan at all.
As a result, businesses are forging ahead with e-commerce strategies regardless of the consequences (Bacheldor, Gilbert 2000). It is pretty easy to understand why. According to reports from e-commerce pioneers, using the Internet in a business-to-business application to provide information to customers and process orders can cut down errors and save time and money, as well as increase productivity among the sales staff (Kalin 1998). Many feel that it is ultimately the lure of greater profits that create the desire to sell direct to consumers. However, with that increased profit potential comes the increased risk of losing reseller relationships (Bartholomew 2000).

The expanding role of the Internet has created opportunities for easy and extensive access to customers. Additionally, the economics of materials delivery has been revolutionized by the logistical networks of third-party shippers such as FedEx and UPS (Agrawal, Tsay 2002). “The type and magnitude of channel conflict in the e-commerce marketplace depends on the nature of the industry and the individual company. Companies that don’t own or closely control their offline distribution channels risk damaging sometimes decades-old relationships and revenue streams. However, companies that control their own channels risk cannibalizing revenues with online stores,” (Matta, Mehta 2001).

In their 2002 study, Agrawal and Tsay have set forth the following motivations, which have led many manufacturing firms to start selling direct: (1) resellers do not usually carry the entire line of a manufacturer’s products, (2) direct control of pricing and distribution can lead to higher profit margins, (3) resellers can use their power to extract various concessions from the manufacturers, (4) manufacturers can provide a broader product selection in a better ambiance with higher service in direct outlets, (5) more
flexibility to experiment with product attributes, (6) closer contact with customers, and (7) protection from crises faced by resellers.

The desire for power may be the most direct cause of channel conflict. According to Coupey (2001), a hallmark of power is that it relies heavily on perception. In other words, any channel member may alter their behavior to the extent of the power that they perceive the other party to hold. Negotiations among manufacturers, distributors, and retailers are often about the power struggle. The influence that a manufacturer holds over its channel depends on how prominent its products are in the channel’s business (Kaneshige 2001). A well-known, large-scale manufacturer with a diversified channel strategy, such as Microsoft, may have more perceived power because they drive so much business. On other occasions, however, it may be the distributors who have more influence, which is often the case with manufacturers of niche products like tools and component parts. At the retail level, there are giants like Wal-Mart and The Home Depot, which often have the last word over many manufacturers. They believe that once their suppliers sell online, they become competitors (Bartholomew 2000). The Home Depot even sent a letter to more than 1000 of its suppliers in May 1999, which influenced suppliers such as Rubbermaid to stop selling online (Agrawal, Tsay 2002) (Bartholomew 2000). One can see how these negotiations might become somewhat complicated.

The Internet, however, has mostly given rise to more powerful consumers. These shoppers know what they want, when and where they want it, and they are more than willing to circumvent retailers to get it (Matta, Mehta 2001). The Internet has created a new set of expectations for the consumer that must now be met, regardless of what
channels are employed. A redefined customer experience, where the shops are never closed, prices are transparent, and personalization is emerging is fast becoming the standard. Companies with no physical storefronts and lower overhead are claiming market share from established businesses. The technology itself allows all business processes to function more quickly than ever before. There is also the growing potential for “mass customization” of merchandise. Existing channels may struggle to meet these new expectations or risk being replaced (Matta, Mehta 2001). While any channel member may own perceived power, manufacturers are usually the ones who are faced with the most decisions that can create, or curb, channel conflict.

**Identifying Channel Conflict**

One thing that managers must face is that conflict will always exist to some degree. To eliminate it totally would diminish business opportunities. In other words, in order for a company to grow their business, there must be some conflict. The key is recognizing when it becomes counterproductive. An obvious sign that your company has taken a misstep is when sales staff and business partners begin leaving. Another less identifiable sign is when the customer actually becomes aware of the conflict. “The bottom line for a company is how to manage the customer relationships with its production strategies,” (McDonald 1999). According to panelists at a 2002 vendor channel roundtable, just by defining the competitive playing field and some rules for channel participation, suppliers can minimize sales conflicts with their channel partners (Burke 2002).

Consider the Gibson Guitar Company. In 1997, they learned about channel conflict the hard way by offering their guitars for sale on their website at 10 percent
below list price. Dealers became irate, and the company ended the online sales effort after only a month. They listened hard to the complaints from their network of dealers and decided to compromise. Now, instead of selling guitars online, they only offer strings and other accessories. They have also added their parts catalog to the web site to sell items that were previously available only to dealers and repair shops, which is an excellent way to meet those customers’ needs. Walter Carter, the web site manager for Gibson, felt that their biggest mistake was failing to inform the dealers that they were planning to sell their guitars online (Kalin 1998).

**Hewlett-Packard Case Study**

There are ways to leverage the Internet to create a win-win scenario. Strategic decisions regarding distribution channels should be driven by the type of customer that a company intends to serve. A company can serve many types of customers, so long as it can afford to be in business with all the channels that will be required, while still maximizing their investment (McDonald 1999). Hewlett-Packard is the second largest manufacturer of personal computers in the U.S. (only Dell commands more market share at the moment). To compete more directly with Dell, HP was forced to make changes in the way it handles online business. Although 90 percent of Hewlett-Packard’s sales currently flow through the retail channel, more customers want to buy products directly. According to Dave Chmelka, marketing program manager at Hewlett-Packard, they believe in letting the customer decide how they want to do business with them. Therefore, anyone can go online and buy products such as PCs and printers.

That does not mean that HP is forsaking its army of resellers, which numbers more than 40,000 in North America alone. There is no undercutting when it comes to
price. In addition to selling directly online, HP is leading a process to build electronic storefronts for its small to midsize resellers. Their objective for this project is to generate leads for the resellers selling HP products. There are still those who argue the fairness of the process, but at least Hewlett-Packard is considering the entire scope of their business. To get partners involved in e-commerce, manufacturers should look for something that represents a common problem to both parties and set up e-commerce as the solution to the problem (Kaneshige 2001). As always, the bottom line is pure economics. While an inclusive e-commerce strategy may help to smooth out channel anxiety, such concessions to resellers and other intermediaries lower the potential profitability of the online business (Bacheldor, Gilbert 2000).

Levi Strauss & Co. Case Study

In the late 1990s, fashions were changing rapidly and executives at Levi Strauss & Co. were seeing a resurgence of interest in khakis (Zetlin 2000). As a result, in November 1998, the company launched web sites selling their Levi and Dockers brands online. The decision to sell online came after company executives learned that the number one request at dockers.com was for direct-to-consumer sales. Within a few months of the launch of the two web sites, the company “declared exclusive rights to sell Dockers and Levi online” (Hammond, Kohler 2000). This, of course, enraged large customers that were themselves sinking hundreds-of-thousands, if not millions, of dollars into e-commerce initiatives at this time.

By June of the next year, Levi ceased all online advertising efforts for its web sites. The company did not abandon its efforts completely—yet—it merely redirected its advertising dollars towards traditional media to drive traffic to the web sites. The
company claimed that the typical order of between $56 and $120 per customer was not high enough to justify the cost of the online advertising they were doing. After five more months of operating their e-commerce web sites, and only a year after initially launching the site, Levi announced that it would stop selling Dockers and Levis online. The reason Levi cited? The costs of running the sites were unaffordable given their ‘competing’ priorities (Hammond, Kohler 2000).

Observers of Levi’s actions believe that the motivation behind the change in the company’s attitude and position was due mainly to channel conflict (Hammond, Kohler 2000). Levi needed to balance their desire to build relationships directly with consumers (Zetlin 2000) with their need to extinguish the brush fires enveloping their relationships with traditional retailers. “Currently, Levi uses its site as a merchandising vehicle, with links to key retail partners’ sites, JCPenney.com and Macys.com, for consumers wishing to purchase online” (Hammond, Kohler 2000).

**Best Practices for Minimizing and Managing Channel Conflict**

Channel conflict is often thought of as dysfunctional and, therefore, unwanted. Conflict can, however, be healthy and desirable in certain situations. Conflict can serve to keep channel members from becoming too passive or lacking in creativity. This same conflict can also motivate members to adapt, grow, and seize new opportunities. From the manufacturer’s perspective, multi-channel distribution strategies can be beneficial in a number of ways. First, it does allow the manufacturer to gain much-needed insight into end-consumer’s needs and shopping patterns. Second, manufacturers with “broad product lines can benefit because it is unlikely that a single channel type will be optimal for all products.” Third, excess manufacturing capacity can be better utilized with
additional outlets when existing channels are over-supplied. Finally, manufacturers with a multi-channel distribution strategy can focus more on precisely targeting markets and improving their overall competitiveness (Webb 2002).

According to a 2000 study performed by Forrester Research, 75 percent of online consumers are likely to visit a manufacturer’s web site when researching a product to buy. Forty-two percent of those consumers visit the manufacturer’s web site after deciding what to buy, but not where to buy. Online consumers are empowered with information and are not hesitant to move on to a competitor’s product offering if they do not find the information and options they are looking for. Manufacturers and their channel partners must deepen their relationships and cooperation—when the manufacture chooses not to compete directly—to service and satisfy empowered consumers by sharing. These new types of relationships may take one of three forms (Matta, Mehta 2001):

<table>
<thead>
<tr>
<th>Relationship Form</th>
<th>Customers</th>
<th>Intangibles</th>
<th>Financial Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturer Support</td>
<td>• Retailer owns the customer relationship</td>
<td>• Manufacturer provides support and collateral</td>
<td>• Retailer keeps the margin and reduces costs with manufacturer merchandising and marketing help</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Retailer provides assortment and service; promotes the brand</td>
<td></td>
</tr>
<tr>
<td>Collaboration</td>
<td>• Manufacturer and retailer share aggregate customer data</td>
<td>• Manufacturer and retailer work together on merchandising and marketing plans</td>
<td>• Manufacturer and retailer share performance-based revenue</td>
</tr>
<tr>
<td>Seamlessness</td>
<td>• Manufacturer and retailer jointly manage and market to customers</td>
<td>• Manufacturer and retailer build one brand experience through new brand or partnership</td>
<td>• Manufacturer and retailer split revenues</td>
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It is not surprising that minimizing channel conflict is at the center of many companies' Internet strategies. Proper analysis and appropriate strategies can go far toward managing the degree that conflict channel members must overcome. But the question remains: how does a company decide when they should compete directly with their retailers online?

**Channel Decision Matrix**

Developed by Accenture Consulting, the Channel Conflict Strategy Matrix analyzes the “forces and opportunities for change” in a given industry and identifies “optimal change strategies” that a company may use to minimize channel conflict. When using the Matrix, it is important to understand that Market Power is defined as “a function of where power resides—with the supplier or with the channel” and that Channel Value is “a measure of how much worth the channel adds for the customer, beyond what the manufacturer provides”.

<table>
<thead>
<tr>
<th>Market Power</th>
<th>Channel Value Added</th>
<th>Forward Integrate</th>
<th>Cooperate</th>
<th>Compete</th>
<th>Lead</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supplier controls customers</td>
<td>Insignificant</td>
<td>• Identify new value proposition</td>
<td>• Look for win-win, grow the pie</td>
<td>• Create Internet-enabled direct link to customers</td>
<td>• Define appropriate approaches for the channel</td>
</tr>
<tr>
<td></td>
<td>Significant</td>
<td>• Act fast/independently</td>
<td>• Seek compromise</td>
<td>• Shift volume to new channel through promotions</td>
<td>• Make initial investment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Fill gaps in channel coverage</td>
<td></td>
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</table>
Once a company performs the exercise that determines Market Power and Channel Value for each channel, they can then use the Matrix as a “framework for strategic thinking”. This strategic look at each channel can (1) point out the safest and most effective combination of the Matrix and (2) show where to fight and where to mediate and/or avoid channel conflicts (Bendix, et. al. n.d.).

Competing directly with the channel is advisable when the Market Power resides with the suppliers and the channel adds little or no distinct value to the sales proposition. Through the use of technology, the airlines have been able to lower the cost of commissions to travel agents significantly by investing in electronic ticketing and Internet travel sites. Forward integrating with the channel is best when Market Power rests with the traditional distribution channel even though the channel adds little or no value to the transaction. Suppliers should consider “invading” the channel in order to increase its “capacity for value creation”. This can often be accomplished by creating an innovative offering that the regular channel cannot duplicate; without the ability to duplicate an offering, channel conflict may be forestalled for the foreseeable future. Suppliers must take the lead of their distribution channels when the value is high but Market Power is low. This situation is often caused by channel fragmentation and must be overcome by a strong leader so that the channel achieves its aims. When the traditional channel's Market Power and value to the channel are high, a situation exists that has the highest potential for hostility and conflict. Members of the channel often see themselves as equal to their suppliers and demand that those same suppliers take full advantage of every opportunity to cooperate with the channel to maximize the total value created. This may be done by creating a new customer segment that does not
conflict with the traditional channels or by limiting the number of products sold online (Bendix, et. al. n.d.).

Propositions for Minimizing Channel Conflict

Kevin Webb (2002), in his paper on Managing Channels of Distribution in the Age of Electronic Commerce, proposes several ways that manufacturers can minimize channel conflict. Once the decision has been made to sell direct to consumers online, lower levels of channel conflict will be experienced:

1. By not pricing products on their web site below the resale price of their partners.
2. By diverting fulfillment of orders places on their web site to their partners.
3. By promoting partners on their web site.
4. By encouraging partners to advertise on their web site.
5. By limiting the offering on their web site to a subset of their products.
6. By using a unique brand name for products offered on their web site.
7. The earlier the products offered on their web site are in the demand lifecycle.
8. The more effectively they communicate their overall distribution strategy.
9. The more effectively they coordinate their overall distribution strategy.
10. The more they make use of superordinate (over-reaching) goals.

These methods for minimizing channel conflict are, at best, idealistic and, at worst, impossible to implement given the pressure that companies are under to create e-business strategies that have a positive return on investment. The fact cannot be denied, however, that these propositions would have the desired effect of minimizing channel conflict between manufacturers and their partners. The shrewd manufacturer
will make use of the propositions that make the most sense for their given business situation.

**Conclusions**

“While retailers and manufacturers cautiously cross from channel conflict into the demilitarized zone of channel cooperation, consumers readily move between the different camps, sometimes even visiting manufacturers sites more than retailer sites.” These two camps must do the following if they hope to survive in today’s business environment: (1) satisfy mutual needs, (2) reduce redundancy, and (3) share costs. Why must manufactures and retailers come together and work with each other? “Coexisting with retailers online, manufacturers will sell less than their retail channel partners,” or about $50 billion in sales. However, manufacturers will “influence $235 billion in other sales” by affecting both on- and offline retail sales (Zrike, et. al. 2001).
Sources


