

8.5: Channel Dynamics

Learning Objectives

1. Explain what channel power is and the types of firms that wield it.
2. Describe the types of conflicts that can occur in marketing channels.
3. Describe the ways in which channel members achieve cooperation with one another.

Channel Power

Strong channel partners often wield what's called channel power and are referred to as channel leaders, or *channel captains*. In the past, big manufacturers like Procter & Gamble and Dell were often channel captains. But that is changing. More often today, big retailers like Walmart and Target are commanding more channel power. They have millions of customers and are bombarded with products wholesalers and manufacturers want them to sell. As a result, these retailers increasingly are able to call the shots. In other words, they get what they want.

Category killers are in a similar position. Consumers like you are gaining marketing channel power, too. Regardless of what one manufacturer produces or what a local retailer has available, you can use the Internet to find whatever product you want at the best price available and have it delivered when, where, and how you want.

Channel Conflict

A dispute among channel members is called a channel conflict. Channel conflicts are common. Part of the reason for this is that each channel member has its own goals, which are unlike those of any other channel member. The relationship among them is not unlike the relationship between you and your boss (assuming you have a job). Both of you want to serve your organization's customers well. However, your goals are different. Your boss might want you to work on the weekend, but you might not want to because you need to study for a Monday test.

All channel members want to have low inventory levels but immediate access to more products. Who should bear the cost of holding the inventory? What if consumers don't purchase the products? Can they be returned to other channel members, or is the organization in possession of the products responsible for disposing of them? Channel members try to spell out details such as these in their contracts.

No matter how "airtight" their contracts are, there will still be points of contention among channel members. Channel members are constantly asking their partners, "What have you done (or not done) for me lately?" Wholesalers and retailers frequently lament that the manufacturers they work with aren't doing more to promote their products—for example, distributing coupons for them, running TV ads, and so forth—so they will move off store shelves more quickly. Meanwhile, manufacturers want to know why wholesalers aren't selling their products faster and why retailers are placing them at the bottom of shelves where they are hard to see. Apple opened its own retail stores around the country, in part because it didn't like how its products were being displayed and sold in other companies' stores.

Channel conflicts can also occur when manufacturers sell their products online. When they do, wholesalers and retailers often feel like they are competing for the same customers when they shouldn't have to. Likewise, manufacturers often feel slighted when retailers dedicate more shelf space to their own store brands. Store brands are products retailers produce themselves or pay manufacturers to produce for them. Dr. Thunder is Walmart's store-brand equivalent of Dr. Pepper, for example. Because a retailer doesn't have to promote its store brands to get them on its own shelves like a "regular" manufacturer would, store brands are often priced more cheaply. And some retailers sell their store brands to other retailers, creating competition for manufacturers.

Vertical versus Horizontal Conflict

The conflicts we've described so far are examples of vertical conflict. A vertical conflict is conflict that occurs between two different types of members in a channel—say, a manufacturer, an agent, a wholesaler, or a retailer. By contrast, a horizontal conflict is conflict that occurs between organizations of the same type—say, two manufacturers that each want a powerful wholesaler to carry only its products.

Horizontal conflict can be healthy because it's competition driven. But it can create problems, too. In 2005, Walmart experienced a horizontal conflict among its landline telephone suppliers. The suppliers were in the middle of a price war and cutting the prices to

all the retail stores they sold to. Walmart wasn't selling any additional phones due to the price cuts. It was just selling them for less and making less of a profit on them (Hitt, et. al., 2009).

Channel leaders like Walmart usually have a great deal of say when it comes to how channel conflicts are handled, which is to say that they usually get what they want. But even the most powerful channel leaders strive for cooperation. A manufacturer with channel power still needs good retailers to sell its products; a retailer with channel power still needs good suppliers from which to buy products. One member of a channel can't squeeze all the profits out of the other channel members and still hope to function well. Moreover, because each of the channel partners is responsible for promoting a product through its channel, to some extent they are all in the same boat. Each one of them has a vested interest in promoting the product, and the success or failure of any one of them can affect that of the others.

Flash back to Walmart and how it managed to solve the conflict among its telephone suppliers: Because the different brands of landline telephones were so similar, Walmart decided it could consolidate and use fewer suppliers. It then divided its phone products into market segments—inexpensive phones with basic functions, midpriced phones with more features, and high-priced phones with many features. The suppliers chosen were asked to provide products for one of the three segments. This gave Walmart's customers the variety they sought. And because the suppliers selected were able to sell more phones and compete for different types of customers, they stopped undercutting each other's prices (Hitt, et. al., 2009).

One type of horizontal conflict that is much more difficult to manage is dumping, or the practice of selling a large quantity of goods at a price too low to be economically justifiable in another country. Typically, dumping can be made possible by government subsidies that allow the company to compete on the basis of price against other international competitors who have to operate without government support, but dumping can also occur due to other factors. One goal of dumping is to drive competitors out of a market, then raise the price. Chinese garlic producers were accused of this practice in the early 2000s, and when garlic prices soared due to problems in China, other countries' producers were unable to ramp back up to cover the demand. U.S. catfish farmers have recently accused China of the same strategy in that market. While there are global economic agreements that prohibit dumping and specify penalties when it occurs, the process can take so long to right the situation that producers have already left the business.

Achieving Channel Cooperation Ethically

What if you're not Walmart or a channel member with a great deal of power? How do you build relationships with channel partners and get them to cooperate with you? One way is by emphasizing the benefits of working with your firm. For example, if you are a seller whose product and brand name are in demand, you want to point out how being one of its "authorized sellers" can boost a retailer's store traffic and revenues.

Oftentimes companies produce informational materials and case studies showing their partners how they can help boost their sales volumes and profits. Channel partners also want to feel assured that the products coming through the pipeline are genuine and not knockoffs and that there will be a steady supply of them. Your goal is to show your channel partners that you understand issues such as these and help them generate business.

Sometimes the shoe is on the other foot—retailers have to convince the makers of products to do business with them instead of the other way around. Beauty.com, an online retailer, is an example. Selling perfumes and cosmetics online can be difficult because people want to be able to smell and feel the products like they can at a department store. But Beauty.com has been able to convince the makers of more than two hundred upscale cosmetic brands that selling their products on its Web site is a great deal and can increase their revenues. To reassure sellers that shoppers can get personalized service, Beauty.com offers the site's visitors free samples of products and the ability to chat live online with skin and hair care consultants (Evans, 2007).



Figure 8.17

Boar's Head creates in-store displays like the banner shown here to help its channel partners sell its products.

Wikimedia Commons – [Boars Head distplay](#) – CC BY-SA 3.0.

Producing marketing and promotional materials their channel partners can use for sales purposes can also facilitate cooperation among companies. In-store displays, brochures, banners, photos for Web sites, and advertisements the partners can customize with their own logos and company information are examples. Look at the banner in Figure 8.17. Although it looks like it was made by the grocery store displaying it, it wasn't. It was produced by Boar's Head, a meat supplier, for the grocer and others like it.

Educating your channel members' sales representatives is an extremely important part of facilitating cooperation, especially when you're launching a new product. The reps need to be provided with training and marketing materials in advance of the launch so their activities are coordinated with yours. Microsoft is a company that does a good job of training its partners. Before launching operating systems such as Windows XP and Vista, Microsoft provides thousands of its partners with sales and technical training¹.

In addition, companies run sales contests to encourage their channel partners' sales forces to sell what they have to offer. Offering your channel partners certain monetary incentives, such as discounts for selling your product, can help, too.

What shouldn't you do when it comes to your channel partners? Take them for granted, says John Addison, the author of the book *Revenue Rocket: New Strategies for Selling with Partners*. Addison suggests creating a dialogue with them via one-on-one discussions and surveys and developing "partner advisory councils" to better understand their needs.

You also don't want to "stuff the channel," says Addison. Stuffing the channel occurs when, in order to meet its sales numbers, a company offers its channel partners deep discounts and unlimited returns to buy a lot of a product. The problem is that such a strategy can lead to a buildup of inventory that gets steeply discounted and dumped on the market and sometimes on gray markets. This can affect people's perceptions of the product and its brand name. And what happens to any unsold inventory? It gets returned back up in the channel in the next accounting period, taking a toll on the "stuffers'" sales numbers.

Lastly, you don't want to risk breaking the law or engage in unfair business practices when dealing with your channel partners¹. We have already discussed confidentiality issues. Another issue channel partners sometimes encounter relates to resale price maintenance agreements. A resale price maintenance agreement is an agreement whereby a producer of a product restricts the price a retailer can charge for it.

The producers of upscale products often want retailers to sign resale price maintenance agreements because they don't want the retailers to deeply discount their products. Doing so would "cheapen" their brands, producers believe. Producers also contend that resale price maintenance agreements prevent price wars from breaking out among their retailers, which can lead to the deterioration of prices for all of a channel's members.

Both large companies and small retail outlets have found themselves in court as a result of price maintenance agreements. Although the U.S. Supreme Court hasn't ruled that all price maintenance agreements are illegal, some states have outlawed them on the grounds that they stifle competition. In some countries, such as the United Kingdom, they are banned altogether. The safest bet for a manufacturer is to provide a "suggested retail price" to its channel partners.

Channel Integration: Vertical and Horizontal Marketing Systems

Another way to foster cooperation in a channel is to establish a vertical marketing system. In a vertical marketing system, channel members formally agree to closely cooperate with one another. (You have probably heard the saying, "If you can't beat 'em, join 'em.") A vertical marketing system can also be created by one channel member taking over the functions of another member; this is a form of disintermediation known as vertical integration.

Procter & Gamble (P&G) has traditionally been a manufacturer of household products, not a retailer of them. But the company's long-term strategy is to compete in every personal-care channel, including salons, where the men's business is underdeveloped. In 2009, P&G purchased The Art of Shaving, a seller of pricey men's shaving products located in upscale shopping malls. P&G also runs retail boutiques around the globe that sell its prestigious SK-II skin-care line (Neff, 2009).

Vertical integration can be forward, or downstream, as in the case of P&G just described. Backward integration occurs when a company moves upstream in the supply chain—that is, toward the beginning. An example occurred when Walmart bought McLane, a grocery warehousing and distribution company. As much as physical facilities, Walmart also wanted McLane's operating knowledge in order to improve its own logistics.

Franchises are another type of vertical marketing system. They are used not only to lessen channel conflicts but also to penetrate markets. Recall that a franchise gives a person or group the right to market a company's goods or services within a certain territory or location (Daszkowski, 2009). McDonald's sells meat, bread, ice cream, and other products to its franchisees, along with the right to own and operate the stores. And each of the owners of the stores signs a contract with McDonald's agreeing to do business in a certain way.

By contrast, in a conventional marketing system the channel members have no affiliation with one another. All the members operate independently. If the sale or the purchase of a product seems like a good deal at the time, an organization pursues it. But there is no expectation among the channel members that they *have* to work with one another in the future.

A horizontal marketing system is one in which two companies at the same channel level—say, two manufacturers, two wholesalers, or two retailers—agree to cooperate with another to sell their products or to make the most of their marketing opportunities, and is sometimes called horizontal integration. The Internet phone service Skype and the mobile-phone maker Nokia created a horizontal marketing system by teaming up to put Skype's service on Nokia's phones. Skype hopes it will reach a new market (mobile phone users) this way. And Nokia hopes to sell its phones to people who like to use Skype on their personal computers (PCs)².

Similarly, Via Technologies, a computer-chip maker that competes with Intel, has teamed up with a number of Chinese companies with no PC-manufacturing experience to produce \$200 netbooks. Via Technologies predicts that the new, cheaper netbooks the Chinese companies sell will quickly capture 20 percent of the market (Hill, 2009). Of course, the more of them that are sold, the more computer chips Via Technologies sells.

Key Takeaway

Channel partners that wield channel power are referred to as channel leaders. A dispute among channel members is called a channel conflict. A vertical conflict is one that occurs between two different types of members in a channel. By contrast, a horizontal conflict is one that occurs between organizations of the same type. Channel leaders are often in the best position to resolve channel conflicts. Vertical and horizontal marketing systems can help foster channel cooperation, as can creating marketing programs to help a channel's members all generate greater revenues and profits.

Review Questions

1. What gives some organizations more channel power than others?
2. Why do channel conflicts occur?
3. Which organization(s) has the most power to resolve channel conflicts?
4. How can setting up vertical and horizontal marketing systems prevent channel conflicts?

¹“Ten Mistakes to Avoid with Channel Partners,” *irieAuctions.com*, www.irieauctions.com/Alternate_Distribution_Channel.htm (accessed December 12, 2009).

²“Skype Expands Mobile Push,” *Financial Times*, March 31, 2009, 20.

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