Managing Channel Conflict and Online Selling

By: John Henderson June 2019

Introduction

Manufacturers have always been concerned with channel conflict because of the damage it can cause to important channel relationships. We at Frank Lynn & Associates, Inc. (FL&A) refer to this as "destructive channel conflict." Destructive conflict occurs when the channel partner no longer supports your brand due to increased competition from a competing channel member. This is especially a concern when your products require presale support from the channel to get your products specified or if the products require education, technical support/engineering, demos, etc. Your channel partner incurs costs to perform these presale activities and needs to be reimbursed via the margin they earn on the sale of your products. A competing channel that has not incurred the presale costs, can offer a lower price to try to "steal" the business. If this happens often, the channel partner will shift their support to another product or another brand.

FL&A's *Nine Core Elements of a High Performing Channel Strategy* defines the critical characteristics of a successful channel strategy, and it is rooted in FL&A's 48 years of experience helping thousands of clients solve channel strategy issues across hundreds of business-to-business markets.

Traditional Conflict Management Approaches

Manufacturers use several traditional methods to attempt to manage channel conflict between competing "brick and mortar" resellers. Most of these traditional methods are designed to limit the number of authorized resellers competing for a sale. However, I should note that at FL&A we believe some channel conflict is a good thing. We have a saying – "If you don't have some channel conflict, you probably have a market coverage problem." But to get distributors and resellers to invest in supporting your brand, they need to believe that the amount of conflict is low enough such that the distributor can earn reasonable margins for the services they perform.

Traditional conflict management approaches can include the following:

- Restrict the resellers geography – reseller can only sell in the assigned territory
- Define a geographic focus – define "Areas of Primary Responsibility" (APRs). The reseller either must generate X% of sales in the APR or, the manufacturer will only support the reseller (with price and/or resources) in the assigned APR
- Allocated markets or customers – assign a market (e.g., residential vs. commercial) or a vertical (e.g., healthcare) or assign customer-types or specific customers (e.g., OEMs or Ford Motor). This type of allocation makes sense when you have channel partners that tend to specialize by type of market and/or customer type
- Limit product access – for example, limit access to technical products or specification products to select partners while making less differentiated products more broadly available
- Introduce a deal or "spec" registration program – this protects the reseller that performs the required presale activities by providing a special price to that reseller
- Introduce performance-based pricing – typically done via "tiered" partner programs that rewards better pricing to partners that do the most for you. This does not limit the number of competing partners, but it does limit the number that compete with the same price

Online Channel Conflict Management

When resellers transact online, manufacturers face a different challenge. The approaches used to manage online conflict depend upon whether you are managing online conflict created by authorized vs unauthorized resellers.

Online Conflict Caused by Authorized Resellers

It is much easier to address online conflict when caused by authorized resellers – even if the authorized reseller is a reseller that ONLY sells online. The reason for this is that the methods available to you allow you to "penalize" an authorized partner that does not follow your rules associated with online selling and online pricing.

The most common methods for managing online conflicts include a couple of the methods used to address traditional channel conflict. The last two methods previously mentioned can help manage online conflict:

- Deal or spec registration
- Functional or performance-based pricing

These two methods protect the resellers that have invested in supporting your brand and therefore provides better pricing to these resellers as opposed to a reseller that simply sells online. For example, online resellers typically do not have an outside sales force, a specifying resource and may not have a resource to address technical and/or customer service type questions. A functional/performance-based pricing program or spec program will provide better pricing to the reseller that has these resources. The differentiated pricing helps to manage conflict caused by low, online prices.

Other methods are used in conjunction with functional pricing programs to help manage online conflicts. The most restrictive approach is to prohibit online selling. Several manufacturers have determined this is the best approach, at least for a subset of their product line due to the amount of support the product requires.

The most common method used by manufacturers of B2B products is the introduction of a Minimum Advertised Price (MAP) policy or Internet MAP policy (IMAP). These policies are designed to penalize authorized resellers that advertise products online at prices below the established MAP price point. Penalties are typically written as a "three-strike" policy which can include loss of promotional funds, rebates, favorable discounts or eventually the loss of access to the product line for a period of time. MAP policies can be written so that the advertised price includes the "into the cart" price which can be very effective.

Some manufacturers take this a step further and introduce Minimum Resale Price (MRP) policies. These policies go beyond covering the advertised price and are used to define a minimum selling price. These policies are increasingly common with strong consumer brands (e.g., Apple, Bose) but are not as common with B2B manufacturers. The reason for this may be that ultimately, the penalty for violating an MRP policy is termination of the reseller.

The justification for installing a MAP or MRP policy is to allow your resellers to earn sufficient margins to cover their costs associated with performing valued services.

<u>Online Conflict Caused by Unauthorized Resellers</u>

Online sales by unauthorized resellers are typically the most difficult to manage. The reason – penalties created for authorized resellers do not work for unauthorized resellers. Because they do not buy from you directly, you cannot directly penalize them for not following your rules.

Because of this, the methods most commonly used to manage online conflict involve penalizing the authorized resellers that supply the unauthorized reseller. There are a variety of ways to do this:

1. Require the authorized distributor to notify its customers of the manufacturers online pricing policies
2. Penalize the authorized reseller for selling to other resellers that violate the policy
3. Create an "approved online reseller" program and only allow sales to approved online resellers
4. Create a "do not sell" list and penalize those that sell to those on this list
5. Prohibit sales to any reseller
6. Direct customers to purchase only from authorized resellers by
    - Promoting the benefits of authorized (training, product knowledge, post-sale support)
    - Promote the risks of unauthorized sources (non-genuine product, loss of warranty, etc.)
    - Provide rebates to customers that prove they have purchased from an authorized reseller

The challenge with all these approaches (with the exception of #6) is that the manufacturer must be able to determine which authorized distributor or reseller is supplying products to the unauthorized reseller. This can be difficult if there is no way of tracing the source of supply.

Managing online channel conflict is now a reality for most manufacturers. It is a challenge because traditional methods do not work (e.g., territory restrictions) or they only address part of the problem (e.g., differentiated pricing). The latter is only a partial solution because while prices may be differentiated, online resellers may be willing to still promote at low prices which can reduce the margins of traditional brick and mortar resellers.

A strategy to manage online channel conflict must become a critical component of your overall channel strategy. Online resellers, whether intended or unintended, are likely part of your channel so a plan to manage the conflict is imperative.

If you would like to discuss how FL&A can assist in effectively managing channel conflict or integrating an online strategy into your overall channel strategy, please contact Jim Fogarty @ jfogarty@franklynn.com.