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Do channel members value supportive retail services? Why?☆

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ABSTRACT

When a manufacturer opens an online channel to compete with its retailer, how can the channel conflict be resolved and the relationship between channel members be improved? Our research proposes supportive retail services as an effective incentive to coordinate the dual-channel distribution and govern the relationship between channel members. We use a profit-maximization model to show that supportive retail services can be utilized to alleviate dual-channel competition and achieve a Pareto result for all channel members. As product compatibility with the web changes, the manufacturer's financial support for retail services also changes. When the product is more compatible with the web, the manufacturer would like to offer more financial support as an effective incentive to the retailer to improve its retail services. However, the value of supportive retail services always increases for the manufacturer but first increases and then decreases for the retailer as product compatibility with the web increases.

1. Introduction

In the business market, many manufacturers in a variety of industries, such as Hewlett & Packard, Lenovo, Dell Computer, Compaq, Sony, Panasonic, Mattel, Pioneer Electronics, Cisco System, P&G, and Estee Lauder, have begun to use online channel to sell their products directly to consumers. This action on the part of manufacturers gives rise to channel conflict. Channel conflict is a situation in which different channels (e.g., online and traditional channels) have to compete against each other (Amrouche & Yan, 2012; Chiang, Chhajed, & Hess, 2003). Particularly when the product has a high compatibility with the web (i.e., the extent synergy between the characteristics of a product and the Internet), the channel conflict between online and traditional channels becomes much more serious (Yan & Bhatnagar, 2008).

A question therefore arises as to when a manufacturer should open an online channel, given that this channel could be potentially in conflict with its traditional retailer. A related question is that once the manufacturer opts to open an online channel, how to ensure its success and reduce the negative effect of channel conflict. Our results show that in order to use dual channels (i.e., online and traditional channels) to distribute a product, the manufacturer can utilize supportive retail services (i.e., the manufacturer offers money support to the retailer to improve its retail services) as effective incentive to achieve a Pareto result (i.e., win–win situation) for all channel members. Retail services can be defined as demand-enhancing services provided by the retailer, such as store customer support, presale advice, product samples, product demonstration in store, technical and shopping assistance, etc. In the business market, Procter & Gamble (P&G) often offers money support as incentive to its retailer, Walmart, for retail services improvement (Raju & Zhang, 2005).

It is well known that retail services play a strategically important role in stimulating consumer purchases. Efficient retail services create a favorable attitude towards a particular retailer and thus stimulate consumers to purchase from this retailer. This paper mainly considers supportive retail services as an effective incentive to coordinate dual channels when the manufacturer opens an online channel to compete with its retailer. Retail services, which are typically unavailable through the online channel, can help a retailer improve its market demand and performance effectively (Fay, 1999; Yao & Liu, 2005).

In our research, we specifically look at what might happen when a manufacturer simultaneously opens an online channel and invests in supportive retail services. The result of such an action is not obvious and needs rigorous analysis. The retailer could view the manufacturer's online channel as a threat and fear that its profit would be hurt. In the meantime, the retailer may benefit from the improved retailer services. Introducing an online channel and offering financial support to improve retail services and thereby improve the whole market demand could possibly yield higher returns for both the manufacturer and the retailer. Given that the manufacturer offers financial support to the retailer from its own pocket, it may be tempting to reason that the manufacturer gives some profit concession to its retailer while opening an online channel. Our model, however, indicates that this reasoning may not

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always hold. We investigate these and other situations in our research. Based on our results, we propose the optimal marketing strategies for the manufacturer and the retailer to employ.

The remainder of our paper is organized as follows. Section 2 provides a summary of the relevant literature. Section 3 presents our modeling framework. Section 4 presents our detailed model analysis. Numerical examples are presented in Section 5. Conclusions are presented in Section 6, and managerial implications and limitations are summarized in Section 7. All relevant proofs are given in the Appendix for clarity of exposition.

2. Literature review

Online versus traditional retail competition has been intensely studied in recent decades. For example, Chiang et al. (2003) study dual-channel competition without consideration of retail services and show that a wholesale price discount can be utilized to achieve dual-channel coordination. Our research not only addresses dual-channel competition but also investigates the strategic value of retail services in the dual-channel coordination. Cai (2010) utilizes a game-theoretic model to show that a revenue-sharing contract could be beneficial for both the supplier and the retailer when the supplier opens an online channel. However, Cai (2010) neither considers the importance of product compatibility with the web nor addresses the value of supportive retail services in the dual-channel competition, as we do. Yan and Ghose (2010) examine the effect of forecast accuracy on online retailer performance versus traditional retailer performance and reveal that forecast accuracy has a different impact on the online and traditional retailers. Yan and Pei (2011) assess the value of information in a dual-channel manufacturer–retailer supply chain and illustrate that information collaboration and profit sharing can effectively improve each channel member's profit. However, both Yan and Ghose (2010) and Yan and Pei (2011) focus solely on pricing factor and do not address how to use supportive retail services as an effective incentive to coordinate dual-channel distributions. Our research not only considers price factor but also addresses the strategic value of supportive retail services in dual-channel coordination.

Some papers do consider the importance of using incentives to govern the relationships between different parties. For example, Bergen, Dutta, and Walker (1992) use agency theory to show that all marketing activities can be explained through agency relationships involving within-firm (e.g., with employees) and inter-firm contracts (e.g., channel members). Heide (1994) reveals that inter-organizational governance is an important phenomenon, including the initiation, ongoing relationship management, and termination between partners. However, both Bergen et al. (1992) and Heide (1994) do not address the issue of channel competition between online and traditional channels or how to use incentives to coordinate competitive channels, as we do. Claro, Hagelaar, and Omta (2003) show that firms in a bilateral relationship are strategic partners whose purpose is to provide long-term benefits for all members. Gilliland, Bello, and Gundlach (2010) reveal that the relative dependence of firms (i.e., the comparative level of each firm's dependence on the other (Palmatier, Dant, & Grewal, 2007)) plays an important role in influencing the effectiveness of unilateral and bilateral control processes. However, both Claro et al. (2003) and Gilliland et al. (2010) do not address the value of specific incentives (e.g., supportive retail services) to firms, consider the importance of product compatibility to the web, or investigate the effect of product compatibility with the web on the value of supportive retail services in online vs. traditional channel competition. Our paper addresses their limitations by focusing on online vs. traditional channel competition, proposing supportive retail services as an effective incentive to coordinate channel distribution, and considering the importance for the online channel of product compatibility with the web and its vital influence on the value of supportive retail services in dual-channel coordination.

Most studies about retail services and channels focus solely on competitive services. For example, Iyer (1998) shows that differentiated prices and services can help coordinate the whole supply chain, and Tsay and Agarwal (2000) reveal that the whole supply chain also can be coordinated through the retailer's purchase quantity and service level. Neither Iyer (1998) nor Tsay and Agarwal (2000), however, consider product compatibility with the web and the value of supportive retail services in dual-channel coordination, as we do. Yan and Pei (2009) conduct a theoretical study to show that a retailer's competitive services in a strategic alliance market structure can help channel members improve their performances. However, Yan and Pei (2009) do not consider the importance of supportive retail services involved in a manufacturer's usage of an online channel and also do not address the strategic effect of product compatibility with the web on the value of supportive retail services in dual-channel competition, as we do.

In this research, we study the strategic role supportive retail services play in a dual-channel environment when considering product compatibility with the web. We develop valuable business models to derive important marketing strategies for business managers. To our knowledge, our research is the first one to propose that supportive retail services be utilized as an effective incentive to alleviate online vs. traditional channel competition and to help channel members achieve a Pareto result. Furthermore, our research is also the first in the extant literature to study how product compatibility with the web impacts the value of supportive retail services for channel members in an environment of dual-channel competition. Specifically, when a manufacturer opens an online channel to compete with its retailer and offers financial support to the retailer as incentive to improve retail services, several questions arise. The questions addressed in our research can be summarized as follows.

1. How does product compatibility with the web impact the manufacturer's financial support of retail services?
2. Is financial support to help a retailer improve its retail services beneficial to both the manufacturer and the retailer?
3. When product compatibility with the web is considered, how does the value of supportive retail services change for the manufacturer and the retailer, respectively?

Then based on our results, we derive optimum market strategies for both the manufacturer and the retailer to employ. Business managers can utilize our insights to make wise investments in retail services to improve channel efficiency and channel member performance.

3. Model framework

3.1. Dual-channel model with supportive retail services

In this section, we consider a single-product manufacturer–retailer supply chain where a monopolist manufacturer distributes its product through a single retailer under an exclusive territory arrangement. In addition to a traditional retailer where the manufacturer sells the product to a retailer at a wholesale price w, the manufacturer also selects an online price p_1 and sells the identical product through an online channel to consumers. At the same time, the retailer competes against the online channel by updating a retail pricep_2. Consumers could purchase products either from the retailer or directly from the online channel.

The parameter θ represents product compatibility with the web. There is a substantial body of literature (e.g., Balasubramanian, 1998; Chiang et al., 2003) which indicates that when the same product is purchased through an online channel, the consumer's consumption value (i.e., amount willing to pay) for the product will be less than the consumer's consumption value for the identical product purchased through a traditional channel. Kacen, Hess, and Chiang (2002) provide further evidence that product compatibility with the web, based on