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Do channel members value the multiple-cooperation strategy?

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ABSTRACT

When the manufacturer distributes his products through online and traditional channels, what type of innovative marketing strategy can be utilized to solve the channel conflict and improve the performances of all channel members? Our research addresses this important question by initiating a triple cooperative strategy for channel members to employ in a manufacturer – retailer dual-channel supply chain. Our results show that when the product is less compatible with online channel than with traditional channel, channel members can utilize a triple cooperative strategy to improve channel coordination and their individual performances effectively and efficiently. First, the manufacturer can utilize supportive retail sales effort as a valuable coordination mechanism to improve the performances of all channel members in the dual-channel distribution. Second, a channel coordinative price strategy can be utilized to further improve the performance of whole channel. Finally, a profit sharing mechanism is needed to create a Pareto result for both the manufacturer and the retailer. Furthermore, we extend our model to study the value of triple cooperative strategy in a manufacturer – two competitive retailers supply chain and derive the optimum marketing strategy.

1. Introduction

In the business market, many manufacturers such as Lenovo, HP, Clarks, Compaq, Panasonic, Mattel, P&G, and H2O, in a variety of industries, pioneered this dual channel strategy (Tsay and Agarwal, 2004; Seifert et al., 2006; Chen et al., 2008; Amrouche and Yan, 2012). Companies found that a dual channel strategy benefited them by increasing their profits (Yao and Liu, 2003, 2005; Cai, 2010). But, subsequently the manufacturers realized that these benefits came with a disadvantage. When the manufacturer opens an online channel to sell the products to consumers directly, the online channel takes away some consumers from the retailer. When the product is highly compatible with online sales, more consumers would switch to the manufacturer's online channel to buy, which makes the online channel become a serious competitive threat to the retailer. This is especially true when the retailer has less bargaining power or market share in the market, the retailer is less likely to receive a lower wholesale price from the manufacturer since the manufacturer always has the power and profit maximizing incentive (Jeuland and Shugan, 1983). As a result, the retailer may have to cut the retail price to counter the threat of the manufacturer's online channel and take a reduced profit (Chiang et al., 2003). Therefore, the retailer now sees the manufacturer as a direct competitor and as a result, and her reaction ranges from decreased support for the product to outright refusal to stock the product. This competitive threat between the retailer and manufacturer is one potential source of channel conflict.

To mitigate the channel conflict (i.e., channel conflict is a situation in which channel partners have to compete against one another, and channel conflict can cost a firm and its partners money as partners try to undercut one another (Rosenbloom, 1973)) and increase channel efficiency (i.e., the degree to which the total investment in the various inputs necessary to effect a given channel decision can be optimized in terms of outputs (Rosenbloom, 1973)), manufacturers have to take the lead in making strategic decisions and manage the dual-channel retailing in a way that allows them to keep the trust of their distributors (traditional retailers). Thus manufacturers are reacting in different ways to mitigate the channel conflict. Some Home Depot's suppliers (e.g., Stanley Works) have rejected their online plan after receiving the warning letter from Home Depot (Brooker, 1999). This is a channel coordination example that highlights other important issues (Jeuland and Shugan, 1988) that occur in the literature on supply chain coordination. Home Depot is an example of a dominant retailer (Raju and Zhang, 2005) and this example above captures negotiation and bargaining power (Dukes et al., 2006) within the channel and the negotiation through the warning letter and resulting negotiations could result in possible spiffs and channel coordination (Caldieraro and Coughlan, 2007).

Keenan (1999) has given examples where the manufacturers

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took steps to explain to the retailers that online channel is targeted to a different market segment. Chiang et al. (2003) utilize an analytical model to illustrate that online channel is not always detrimental to the retailer. Yue and Liu (2006), Cai (2010), and Yan (2011) also proposed some other coordinative mechanisms (e.g., information sharing, revenue sharing, brand differentiation) to alleviate the channel conflict.

In this paper, we propose an innovative strategy to solve the channel conflict and improve the channel performance effectively and efficiently, and this innovative strategy is not currently addressed in the dual-channel retailing literature. We show, through our modeling and subsequent results, channel members can utilize a triple cooperative strategy (i.e., supportive retail sales effort plus channel coordinative price plus profit sharing) to improve channel coordination and their individual profits. When a manufacturer employs dual-channel distribution to sell his products, it needs to resort to valuable coordinative mechanisms to solve the channel conflict. Thus a Pareto result can be created for the manufacturer and his retailer. The coordinative mechanisms among channel members have been recognized as strategic tools in improving channel performance.

When a triple cooperative strategy is implemented, the manufacturer can, therefore, convince the retailer that the channel competition is not an issue and she can benefit from the dual-channel distribution as well. Specifically, we initiate a triple cooperative strategy and study how this valuable strategy can be utilized to solve the channel conflict and improve channel performance in the dual-channel competition. First, the manufacturer can employ supportive retail sales effort as a valuable coordination mechanism to improve the performances of both the manufacturer and the retailer when an online channel is opened. Supportive retail sales effort, in our paper, can be defined as a discretionary payment from manufacturer to retailer for demand stimulating sales effort (e.g., presale advice, product introduction, product trying, product demonstration in store, technical and shopping assistance, product information in web, etc.). In the business market, the manufacturer often offers a discretionary payment to a retailer to improve her sales effort in order to enhance channel coordination (Weistein et al., 1990; Kim and Staelin, 1999). Second, a channel coordinative price strategy can be utilized to further improve the performance of whole channel. However, not all channel members can benefit from the channel coordinative price strategy. Hence, a profit sharing mechanism can help create a win–win result for both the manufacturer and the retailer. As a result, all of channel members can benefit from such a triple cooperative strategy.

The remainder of our paper is organized as follows. Section 2 contains a summary of the pertinent literature. Sections 3 and 4 analyze the different scenarios and show key findings. Numerical examples are provided in Section 5, and conclusions and managerial implications are presented in Section 6. All proofs are given in the Appendices.

2. Literature review

The importance of the pricing mechanism is extremely important as it must motivate retailers as well as insure the manufacturers improve their profit outcomes, which should insure competitors' profits are reduced (Raju and Zhang, 2005). Although there are cases such as Ingene and Parry (1995) that find that channel coordination is not always in the manufacturer's best interest when independent retailers compete between themselves for customers. There are other studies that highlight positive outcomes for channel coordination. Jeuland and Shugan (1983) showed that under channel coordination that quantity discounts can be used when price and non-price decision variables are involved. Iyer (1998) examined how manufacturers should coordinate channel distribution when there are two retailers competing on both price and non- price attributes. Iyer (1998) found that it will take more than a menu of two-part tariffs are sufficient to coordinate such a channel. In the presence of a dominant retailer (Raju and Zhang, 2005), optimal channel coordination can be achieved through either quantity discounts or a menu of two-part tariffs. A study by Ingene and Parry's (1995) and extended by Tsay and Agarwal (2001) showed that channel coordination occurs in the retail competition using price and service effort dimensions.

The studies above capture channel coordination and pricing mechanism. However, it is recognized that the power dynamics also impact channel coordination. It has been recognized that dominance or power of channel members has been increased by the retailers such as chain supermarkets, mass merchandisers, wholesale clubs, and category killers dominate the industry because of a large market share as addressed by Raju and Zhang (2005), but also (1) offer significant opportunity to consumers and to coordinate with manufacturers, (2) they represent the largest distribution for large manufacturers (Useem, 2004), and (3) these retailers are often the price leaders (Stone, 1995; Wierenga and Soethoudt, 2010). A powerful firm with numerous online outlets performs financially better than less powerful firms with numerous online channels (Geyskens et al., 2002). Levary and Mathieu (2000) showed that dual channel distribution with optimal channel coordination between powerful firms is likely the most promising strategy for the future. Using a consumer model to regulate the firm's optimal prices charged when they compete in a traditional versus an online channel and firm power is less of a consideration (Cattani et al., 2006). Dukes et al. (2006) have found that power dominance and negotiation are not a zero-sum game, as most channel members view it. They pointed out that the impact of superior volumes and the efficiency of directing all resources may essentially much stronger profits to specific channel members.

In this paper, however, we place an emphasis on the point that adding online distribution channel creates a channel conflict and then coordination mechanisms are needed. Adding online distribution channel to existing retail system and then forming a dual-channel distribution system have been studied by many scholars. For example, King et al. (2004) used an analytical model to show that the dual-channel distribution (consisting of an online channel and a traditional channel) has the most promise for the future. Yao and Liu (2003, 2005) found that consumer diffusion and pricing strategy have significant effects on firm performance in the dual-channel distribution. Yan and Ghose (2010) revealed that forecast accuracy significantly impacts the performances of both traditional and online retailers. Hua et al. (2003) found that delivery lead time significantly impacts the pricing strategy and corresponding profits of both the manufacturer and the retailer in a manufacturer and retailer dual-channel supply chain.

When the manufacturer utilizes dual channels to distribute his products, channel competition and conflict is a serious issue and cannot be avoid. Hence, coordinative mechanism(s) becomes an imperative tool to be utilized to coordinate the dual-channel distribution and solve the issue of channel conflict. Various coordinative mechanisms in prior research are employed to alleviate the channel conflict. Tsay and Agarwal (2004) showed that the sales efforts of both online and traditional channels can be used to coordinate the dual-channel distribution and improve the channel member performance when the manufacturer opens an online channel to sell products directly to consumers. Yue and Liu (2006) demonstrated that information sharing can be utilized to coordinate the dual-channel distribution. Cai (2010) showed that the revenue-sharing can be utilized to coordinate the dual-channel