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Channel Conflict Management: How to Manage Through It and Win

IT MAY SEEM COUNTER INTUITIVE TO DISCUSS CHANNEL CONFLICT IN A SOFT ECONOMY. WHEN MOST OF OUR CLIENTS THINK ABOUT CONFLICT MANAGEMENT, THEY ASSUME THEY WILL NEED CONTROLS ON THE CHANNEL AND/OR A REDUCTION IN CHANNEL PARTNERS AS THE SOLUTION. AND WHO CAN AFFORD TO DO SO IN THE SOFT ECONOMY?

In reality, managing conflict is an imperative in a soft market. Channels are more sensitive to conflict because of the perceived impact on their bottom line. Therefore, they are quick to act to manage the conflict—which usually means less emphasis on the guilty brand. Few manufacturers can afford the loss in effective market coverage that this unilateral channel decision can result in. Thus, the need for the manufacturer to proactively address the issue.

Channel Conflict in Brief

Multichannel systems are a way of life for manufacturers today. Whether you are managing a mix of direct and indirect channels or a spectrum of high-support to low-support resellers, the reality is that channel conflict will be an ongoing issue in your marketplace. As the number of internet sites (potentially including your own) that offer your product for sale proliferates, this multi-channel structure becomes more complex and the channel conflict potential more pervasive.

A limited amount of channel conflict is healthy. It indicates that you have adequate market coverage. However, once the balance between coverage and conflict is lost, destructive channel conflict can quickly undermine your channel strategy, market position and product line profitability.

Conflict can show up in the market in a variety of ways. A point of confusion for many manufacturers is whether problems are truly symptoms of destructive channel conflict or other marketing or channel strategy issues. When faced with potential indicators of destructive conflict, you should audit your market position to identify the true cause and then quickly act to address it.

Channel conflict is managed by a combination of economics and controls. Economic solutions compensate channels fairly for functions performed and help direct channels away from actions that create destructive conflict. Controls put structure around a channel strategy to limit the potential for undue destructive conflict.

What is Channel Conflict?

Channel conflict can be defined as any scenario where two different channels compete for the same sale with the same brand. Conflict can take the form of a direct sales force competing with an independent distributor, two different types of competing distributors, two like distributors competing for the same sale, or all of the above.

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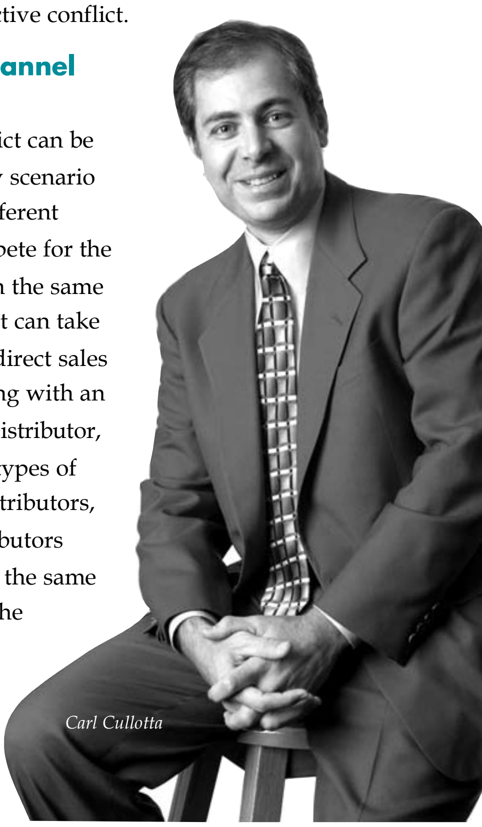

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ABOUT THIS ISSUE

In this issue of the Client **Communiqué**, we discuss the challenge of escalating channel conflict that often develops in difficult economics times. We outline different types of channel conflict, ways to recognize destructive conflict and proven methods to resolve conflict and preserve market share. We include several key questions to consider as a simple self audit of channel conflict in your market.

We also examine the need to restructure sales resources and still ensure the organization can execute effectively in the market. Finally, we offer a variety of revenue producing or cost cutting ideas that can be highly productive even when market constraints are high.

WHAT'S INSIDE

A few facts about achieving an appropriate balance between coverage and conflict:

- Lack of any channel conflict in a marketing strategy usually indicates gaps in market coverage
- Conflict cannot be eliminated. The goal of marketing management must be to optimize market coverage and manage a healthy level of channel conflict so that it does not become destructive
- Market share erosion and declining street prices are evidence that channel conflict is becoming destructive. Channels are responding to excessive competition by de-emphasizing the brand or by giving away too much in order to keep an account
- Every manufacturer will likely face destructive channel conflict at some point. As markets evolve and mature, many manufacturers will be required to add new, lower-cost channels in order to cover all major market segments. Often, destructive conflict arises because changes in the manufacturer's go to market strategy lags the market changes associated with market evolution.

Recognizing Destructive Channel Conflict

Channel "noise" regarding conflict always exists. (In fact, a lack of channel noise is often an early indicator of coverage gaps in the manufacturer's channel strategy.) However, it does not mean that your company is experiencing destructive channel conflict just because different internal factions or channel members are complaining about lack of manufacturer commitment or are uncomfortable with competition for some sales.

Increasing levels of noise or evidence of declining channel support for your product line would be indicators to pay attention to. It is a tough call, however, since destructive conflict tends to creep into a channel system over time.

External Indicators of Destructive Channel Conflict

Border Wars

These occur when multiple members of the channel network compete for the same sale in the same account. A limited number of border wars should be expected and are, in fact, one indication that you have good market coverage. A soft market creates the environment for increased border wars as channels get more aggressive to deliver revenue. Generally, channels will begin to react to channel conflict when incidence of border wars exceeds 10% to 20% of that channel's total business with a manufacturer's products.

Emotion

A necessary component of good channel management strategy is controlling the degree of emotion from the channel. However, as emotion builds, the channels will begin to react by reducing support of the product line or by switching out that line wherever possible. Emotion will often cause the channel to de-emphasize a brand even when it is not in the best interest of the channel. We have found that channels often have this discretion to control brand choice in as much as 40% of sales—they typically don't choose to exercise this discretion.

Customer Satisfaction

Conflict can erode customer satisfaction for two reasons:

- Customers will start to experience redundant buying costs when forced to deal with multiple channels offering essentially the same solutions in sales situations
- Competing channels focus on easy ways to win the sale in a conflict situation (such as dropping price) and begin to ignore less evident customer buying requirements

Channel Conflict Solutions

Channel conflict is an integral part of your channel strategy, so you must examine your market position and channel strategy before attempting to manage it. Taking a closer look at the problem often reveals that the perceived channel conflict issue masks a larger channel strategy issue. So prior to executing solutions to address channel conflict, the manufacturer is encouraged to examine all elements of its overall channel strategy, including pricing, end user segmentation, channel support programs, company policies, etc. Have you created a conflict situation through the design or implementation of these other components of channel strategy?

Destructive channel conflict is managed through economics and structural controls. Economics motivate the channels to avoid conflict. Structural controls lay the ground rules within which conflict is managed. With each tactic, communication before conflict arises is critical.

The right economic solution is dictated by the type of conflict being faced, the manufacturer's market and channel position, and the company's strategic goals. Economic approaches include;

- **DUAL COMPENSATION–** applied when conflict exists between direct and indirect channels. The goal is to move the indirect channel from a position of potential adversary for the direct sales force to one of "partner" for the direct sales force
- **ACTIVITY BASED COMPENSATION OR DISCOUNT–** used to manage cross-channel conflict or conflict between channels of differing cost structures and capabilities. Activity based discounts are applied by paying a channel a specific discount if it performs a measurable task or function. These discounts allow the "high-cost" channel to compete against "low-cost" channels for those customers who value the high support
- **SHARED COSTS–** the key difference between this concept and functional discounts is that functional discounts compensate the channel for incremental tasks via a discount on product sold, while shared costs pay directly for the task
- **COMPENSATION FOR MARKET SHARE–** usually applied to direct versus indirect conflict, the direct sales rep is compensated based on total market share in a territory. The goals of the sales rep are based on direct and indirect volume, thus motivating the direct rep to "partner" with indirect channels to maximize territory volume

Structural controls are only as effective as their enforcement. There is no value unless you are willing to clearly spell out the controls at the outset of the channel agreement and enforce the stated penalties to all channel members. The structural controls are typically applied to:

- **ACCOUNTS–** you specify "named" or "house" accounts where indirect channels can expect to compete with your direct channels. Named accounts are usually specified based on end-user sourcing capabilities, channel ability to meet end-user buying requirements, and volume and strategic value
- **PRODUCTS–** channels can qualify for franchising by product line/category across your company's offering. Product qualification is usually based on end-user product support needs, channel support capabilities, "fit" or positioning of the product category in the channel's overall business, and strategic considerations
- **GEOGRAPHY–** as a manufacturer, you can specify those geographies/account types in which you will provide sales support to the channel. These geographies are usually defined by granting the channel a primary area of responsibility

The successful marketer combines the elements of economic and control-related solutions that best address conflict challenges — framing them in an understanding of market position, channel position, and strategic goals.

Is Channel Conflict a Strategic Issue in Your Business Today?

Take a moment to consider the following questions:

1 Have you recently seen your market move through a "transition" point (e.g., from introduction to growth, from growth to maturity)?
2 Have you made any recent changes to your channel strategy (e.g., adding channel members, adding new types of channels)?
3 Have requests from the direct sales force or channels for special prices increased significantly?
4 Have gross margins eroded significantly in any customer or channel segments?
5 Have you seen a decrease in dollar revenue per direct sales rep and/or dollar revenue per channel location?
6 Have you experienced significant loss of market share or declines in customer satisfaction in any customer segments?
7 Have you experienced a decrease in your number of channels as a result of channels dropping your line?

If you answered yes to two or fewer questions, conflict is not a strategic issue for you today. If you answered yes to three or four questions, conflict could be impacting your business. Take this opportunity to "audit" your market position and enact strategies to manage destructive conflict. If you answered yes to five or more questions, conflict might be undermining your channel strategy and must be managed now.

If you would like to discuss any of these issues, then please contact Carl Cullotta at 312/558-4823 or *cpc@franklynn.com.*