Avoiding Channel Conflict

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Facing a roomful of her 12 largest distributors at a meeting last march, Suzanne Feldkamp confidently revealed her company's latest e-commerce plan. Miller Electric, a manufacturer of welding equipment, wanted to shift from indirect to direct selling, handling sales leads generated from its Web site itself while making its distributors responsible for delivering the goods. The reaction was remarkably swift-and overwhelmingly negative.

"It didn't go over well at all," laments Feldkamp, electronic communications manager at Miller Electric, based in Appleton, Wis. By owning the sales transaction, distributors argued, Miller Electric would be able to set prices and eventually cut the channel out completely. Not wanting to offend its distribution channel, Miller Electric conceded defeat and quickly drafted a new plan.

As Feldkamp found out that day, managing channel partners-distributors, resellers, retailers, and dealers-is a tricky business. Channel relationships are complex and vary greatly from industry to industry, says Bob Parker, an analyst at AMR Research. When well-known manufacturers, big distributors, and even giant retailers are all trying to agree on a single e-commerce strategy, "you have to wonder who's managing whom," Parker says. All the parties have their own sphere of influence they're used to controlling.

It's no wonder companies are being careful when navigating the new channel rules in e-commerce. Inevitably, whenever technology introduces new rules of doing business, somebody is bound to be unhappy. In this case, talk centers on who gets the leads off a manufacturer's Web site. With manufacturers tying their Web sites to their channel partners', governance issues ignite spirited debates.

For manufacturers, it's tempting to handle juicy sales leads popping up on their Web site. Not only are margins better when selling direct but B2B customers that actively seek brands online are also primed to hit the buy button-companies don't surf the Internet for fun. But manufacturers know they need their distributors and resellers to provide a local face on a global presence. The argument is no longer about disintermediation-the channel must be integrated into a manufacturer's e-business strategy.

"Not long ago, some technology suppliers questioned the viability of middlemen," says Karen Smith, senior analyst at market research firm Aberdeen Group. "However, there are many channels that continue to enhance and bring value to the sales and distribution chain in the Internet age-ones in which new technologies are enabling the clicks-and-mortar model."

In most cases, channel partners "ultimately own the end customer relationship," says Robert Mirani, director of CRM strategies at market research firm Yankee Group. "Companies are finding that profits from direct sales do not offset losses from alienated channel partners." The question is how to make it a win-win situation.

The Internet Temptation

Quelling channel partner concerns is a major managerial hurdle for nearly every manufacturer with an e-commerce strategy. Negotiations among manufacturers, distributors, and retailers are tough, because frequently no one is really sure who's sitting in the power seat in a channel relationship. The influence a manufacturer has over its channel depends on how prominent a role its products play in the channel's business. In the high-tech sector, which has a long history of moving products through channel partners, it's the name-brand manufacturers that carry considerable clout (more on that later).

Manufacturers of niche products don't fare as well. For instance, its ultimate customers don't really care that Miller Electric is part of $10.5 billion Illinois Tool Works, so it has its work cut out for it in competing with Lincoln Electric, a $788 million manufacturer of similar equipment (when ITW bought Miller in 1993, the latter was a $250 million company). Manufacturers in Miller's circumstances looking at e-commerce solutions cannot assume that the channel will do business the way they want it to, warns Scott Sims, channel and customer solutions manager at Arthur Andersen's business consulting practice.

You can't blame them for being tempted, though. Miller Electric's Web site receives 60,000 visitors every month, many of them looking for welding equipment. The site has emerged as an important generator of not only leads but also sales. Half of the leads the site generates result in sales. "This kind of closure rate is just astronomical," says Feldkamp.

It's no wonder Miller Electric executives considered handling these Internet leads themselves. Then again, Miller Electric has an army of 900 distributors that want the business, too. So who's in the driver's seat? Even though many manufacturers tout a lot of traffic and opportunity on their Web sites, distributors often hold the keys to business. That is, they've nurtured personal relationships with customers.

Following the brouhaha at its aforementioned meeting, Miller Electric has embarked on a pilot project with four of its top distributors-and already it's encountering rough waters. Using tools from e-commerce software and services vendor InfoNow (whose competitors include Click Commerce and Comergent), each distributor has built a customized e-storefront that's integrated with Miller Electric's Web site. Ultimately, Miller Electric came to a compromise in which sales leads generated by Miller Electric's Web site are given to distributors. Once customers designate items they want to buy on Miller Electric's site, they must choose from a list of nearby distributors. The customers and their shopping lists are then whisked off to the selected distributor's electronic storefront, where they receive pricing and availability and complete the order.

Once the customer is in the selected distributor's e-storefront, Miller Electric is out of the picture. In other words, the distributor has total control over its e-storefront and may offer special prices and warranties on Miller Electric products, complementary products such as protective gear, and even competing products.

But by having customers fill shopping carts before transferring to a distributor's e-storefront, Miller Electric deters most people from buying rival products. "It's a bit of insurance that we're not simply sending a distributor a lead, only to have that lead buy another brand," says Feldkamp.

But the process isn't foolproof. The way customers get to the storefront has at least one distributor upset; Miller Electric's process for listing distributors is simple-maybe too simple. When a customer inputs a zip code, the three closest distributors pop up. Moreover, only the distributor's name, address, and contact information are provided. "To be flat-out honest, we still have some points of contention about how Miller Electric is handling this," says Doug O'Dell, director of e-commerce at Linweld, a distributor of industrial and medical gases and welding supplies that sells in the single-digit millions worth of Miller Electric products a year.

Such a simple process doesn't give Linweld the opportunity to show off its strengths, especially during the most critical phase of a sale, when a customer is choosing between distributors. Even in the Yellow Pages, Linweld can separate itself from the crowd. With Miller Electric's e-commerce strategy, "there's no differentiation right now," says O'Dell, "and we're struggling with it."

Linweld offers more than 30,000 products from 200 vendors and has invested heavily in training centers and repair services for customers. O'Dell believes that its million-dollar relationship with Miller Electric should entitle Linweld to have its name in bold type "or be put at the top of the distributor list," argues O'Dell. "We have some mom-and-pop distributors in our area that enjoy the same advantages that we do, and we just don't think that's right." Feldkamp counters that Miller Electric does give prominence to distributors that provide services. How? Customers are asked: Do you want a distributor that offers both products and services? If the answer is yes, then distributors such as Linweld get preference. For sure, such compromise measures often don't go far enough.

In Miller Electric's case, Linweld is in a powerful position because of the amount of Miller Electric products it moves. In addition to an e-storefront, Linweld also runs an extranet for key customers. Eventually, Linweld must decide whether to merge the two. "This e-storefront from Miller Electric is a test for us," explains O'Dell. "If twelve or more months pass and we're not seeing the right results, then we'll probably dissolve the e-storefront." (O'Dell wouldn't elaborate on what those results would be.)

Customer First, Channel Second

Leveraging the Internet, though, does not mean that a manufacturer must bow down to its channel partners. Channel strategies must be designed to meet the needs of end users, agrees Arthur Andersen's Sims. End users expect to be able to obtain product information, support, and services and buy products "when and how they want to," he says, "and they will choose the channel and manufacturer that most efficiently provide this."

Companies such as Hewlett-Packard wield powerful name brands that resonate with consumers and businesses alike. Moreover, Hewlett-Packard's PC market share has been under siege by rival Dell Computer-the original inspiration for thoughts of disintermediation-thus forcing Hewlett-Packard to make changes in the way it handles its online business. At the Hewlett-Packard Web site, for instance, anyone can buy products such as PCs and printers. "We leave it up to the customer to decide how it wants to do business with us," says Dave Chmelka, marketing program manager at Hewlett-Packard and himself a former reseller.

Although 90 percent of Hewlett-Packard's sales currently flow through the channel, more customers want to buy products directly, figuring they can get a better price by cutting out the reseller. In a recent survey, Hewlett-Packard found that roughly 35 percent of respondents in small-to-medium businesses wanted to buy straight from the company.

But this doesn't mean that Hewlett-Packard can forsake its army of resellers, which numbers more than 40,000 in North America alone. "The biggest concern among resellers is that we'll undercut them on price, but we wouldn't do that," Chmelka says. Although Hewlett-Packard realizes that it needs to offer its products directly, it's also helping channel partners become e-commerce-enabled.

Hewlett-Packard is using InfoNow to build electronic storefronts for its small to midsize resellers, in the hope that they'll become part of its e-commerce community. Potential customers on Hewlett-Packard's Web site are asked the following question: Do you want to buy through Hewlett-Packard or a reseller?

Because customers are often businesses and thus would like to compare pricing among various manufacturers or are in need of consulting and integration services, many choose to buy through a reseller. If they want to buy directly from Hewlett-Packard, there isn't much resellers can do, given HP's sheer size and reputation.

Customers opting to see a directory receive a list of nearby resellers. At the top of the list are resellers that have certified expertise in the products being solicited. After the referral, Hewlett-Packard's involvement ceases. But if a business wants a reseller to contact it, the request is considered a "lead" that has a high likelihood of success.

The process for determining which reseller gets the lead is somewhat complex. Roughly 8,000 resellers in North America qualify for Hewlett-Packard's Web-based Leads Program. To qualify, resellers must be certified in installing and servicing Hewlett-Packard products and demonstrate their ability to sell them. Resellers with extremely high sell-through rates or that sell almost exclusively Hewlett-Packard products are awarded special status. "Often, we try to pass leads to the resellers who are doing the best, based on these guidelines," says Chmelka.

After a lead is awarded, the reseller is required to report the results-even if the purchaser ended up buying a competing product. Resellers that don't report back to Hewlett-Packard risk receiving "strikes" and eventually getting dropped from the program. The requirement for follow-up is Hewlett-Packard's compensation for its investment in building the e-commerce site and doling out leads.

The process is complicated enough that it requires some governance. Twenty resellers sit on a board that governs Hewlett-Packard's channel projects. They meet every 6 to 12 months, looking for ways to improve the Leads Program. It's a way for Hewlett-Packard to keep its channel partners in the loop. For
instance, they asked for a better way to filter leads-many resellers didn't want to handle what they considered small sales. Consequently, Hewlett-Packard built this parameter into its selection engine.

Still, resellers argue that they aren't being treated fairly. Chmelka says he's constantly peppered with questions: How come this reseller is listed higher than me? Why is my competitor next door getting more leads? "I get an average of twenty e-mails a day from resellers with these types of concerns," Chmelka says, "but we have logic surrounding our lead-assignment process-it's not a subjective thing at all-so I just refer complaining resellers to these rules."

Can't We All Just Get Along?

Some companies, such as disk drive manufacturer Seagate, have it much easier. Seagate doesn't sell its wares to thousands of resellers directly but rather to only a few OEMs (such as Sun Microsystems and Compaq) and five master distributors (including Ingram Micro and Tech Data), which then sell to resellers. The number of channel partners Seagate deals with directly is "very manageable," says Craig Harmer, manager of e-business strategies at Scotts Valley, Calif.-based Seagate.

It really doesn't matter how Seagate delegates leads off its Web site, because its resellers are already familiar with the master distributors. These distributors have already established relationships with resellers for credit checks and discount pricing. Even so, Seagate offers a few tips about managing channel partners.

For starters, to get partners involved in e-commerce, manufacturers should look for something that represents a common problem to both parties and set up e-commerce as the answer to the problem. In other words, the problem, not the manufacturer, becomes the enemy. For instance, Seagate has a generic, two-year-old Web site that points resellers to distributors.

Often a reseller wants to buy in bulk and thus must negotiate with the distributor about special pricing and availability options. The whole approval process takes 48 hours or more to complete.

But if the distributor needs to make sure Seagate can deliver additional product-that is, more than what appears to be available-before committing to the reseller's order, it may take weeks-a lifetime for some technology products. Since time is of the essence, distributors call Seagate account managers as frequently as five times a day to track products. "Frankly, we're losing some orders because of our inability to react quickly," Harmer says.

Last year, Seagate assembled an e-commerce team to overhaul its Web site. In fact, distributors were clamoring for the changes, says Harmer. The renovation will center on integrating the Web site with all five distributors' ERP systems and Seagate's own ERP system. Using software from Comergent, Seagate will gain a better view of distributors' inventory and distributors will gain access to Seagate's product tracking system.

The Web site will include a central pricing system, which distributors can customize. The goal: Resellers will be able to go to Seagate's site, choose a distributor, place a large order, and then get a commitment that the product is available. Harmer admits that many of these features haven't been implemented yet. And concerns among competitors-about such factors as the security of sensitive purchasing information-are already cropping up. But for the most part, distributors have been accommodating.

Throw 'em a Bone

The Web doesn't have to be a bone of contention between manufacturers and their distribution channel. With some imagination-and a little luck-it can actually turn out to be a starting point for improved sales and relationships. Case in point: Home appliance manufacturer Maytag launched a Web site in 1995 featuring its famous lonely repairman. Two years later, Maytag introduced its Neptune washer-at the unbelievable price of $1,000. Retailers balked, believing they wouldn't be able to move such an expensive product. Maytag was in a quandary.

The company's response was to feature its Neptune washer on its Web site, emphasizing its strengths as an energy saver and an environmentally conscious product. It struck a chord with consumers, who sent Maytag $50 to reserve the product until it could be shipped to a nearby retailer. Without lifting a finger, and especially without having to carry risky inventory, big retailers such as Lowe's and Sears were getting presales from Maytag's Web site. This gave other retailers the confidence to carry the Neptune washer.

"We had such demand for the Neptune on our site that we took it to resellers, and they followed up on the presale lead," explains Ken Boyle, vice president and general manager of e-commerce at Maytag, based in Newton, Iowa. "Today, we get half a million visitors to our site. Any leads we get from it, we send to our retailer partners."

Boyle credits Neptune as the catalyst that helps Maytag manage channel partners in e-commerce today. Retailers received benefits without even asking, while witnessing the power of the Internet. Now Maytag is using products from software vendor Comergent to hook its Web site to retailers' Web sites, for seamless transference of leads. Like Miller Electric, Maytag will distribute these leads to the retailers that are closest to the consumer.

But no matter what lengths a manufacturer goes to to ease channel partner fears during an e-commerce transition, it's never easy. Seagate, Hewlett-Packard, and Miller Electric have all experienced at least some degree of channel conflict, even though they held various positions in the power structure. And manufacturers must be prepared for the fact that there will always be conflict, says consultant Sims, "and maybe even casualties."
Finding a happy medium, if one even exists, is a constant struggle, says Miller Electric's Feldkamp. "It's been a challenge for us," she admits. "You just have to keep the dialogue