Coping with Manufacturers’ Dilemma in the E-Commerce Era: A Relational Model and a Strategic Framework

Xiaolin Li, Towson University, USA

ABSTRACT

From a channel conflict perspective, this paper proposes a Relational Model identifying key determinants of manufacturers’ intentions to establish an online direct sales channel (ODSC). The paper also develops a Strategic Framework as a guideline for manufacturers to formulate their Internet channel strategies. Unlike most other studies on channel conflicts that focus on channel management after the manufacturer has already established its ODSC, this study provides a comprehensive strategic analysis of channel conflicts based on a pre-ODSC context, which prevents unnecessary losses from channel conflicts before they occur.

Keywords: Channel Alignment, Channel Conflicts, Channel Customer Management, Channel Integration, Online Direct Sales Channel, Technology Adoption

INTRODUCTION

In recent year, most manufacturers have adopted the Internet for business purposes, but such adoption is still limited primarily to the gathering of business information, advertising (Fisher, Craig, & Bentley, 2007) and product search (Kula & Tatoglu, 2003). Few of them have taken advantage of the Internet’s disimmediation function promised for manufacturers.

What is preventing many manufacturers from selling directly online and pursuing the evidently promising online business opportunities? The explanation may be found in a dilemma that many of those manufacturers share: to build an online direct sales channel (ODSC) or to rely on traditional resellers (a general term in this paper referring to wholesalers, distributors, and retailers) to distribute products. Choice of either side of the dilemma seems risky for the manufacturers. If they do not sell their products directly over the Internet, people will go to those who do, and if they do sell their products directly on the Internet, then their distributors may drop them and carry products from manufacturers who do not compete with them (Wilson, 1998).

On one side of the dilemma, manufacturers may benefit from multi-channel distribution strategies in many ways (Webb, 2002): First, multi-channel distribution strategies enable manufacturers to more effectively customize products to meet various customer needs and...
shopping preferences and thus reach more market segments. Second, a single channel is usually optimal for specific goods but only a multi-channel strategy can maximize the effectiveness of distribution of a manufacturer’s whole production line. Third, manufacturers with excess capacity can take advantage of additional distribution outlets to sell their excess goods. The Internet has made multi-channel strategies even more desirable because of its potential to reduce costs, extend market reach, and customize products and services to meet customers’ needs.

On the other side of the dilemma, the introduction of a new technology into the distribution channel potentially increases the likelihood of channel conflict (Rosenberg, 1974). The emergence of the Internet and its increasing popularity as a sales channel has made channel conflicts one of the most serious challenges that manufacturers face. When a manufacturer builds its own online direct-sales channel (ODSC) to sell products directly to end customers, it immediately turns itself into its resellers’ competitor. The resellers may perceive the ODSC as a potential competitive threat to their profitability and may choose to retaliate by refusing to distribute or by reducing its distribution efforts for the manufacturer’s products.

While Internet and e-commerce technologies have accelerated the use of multichannel model among manufacturers (Mukhopadhyay, Yao, & Yue, 2008), recent research has suggested that the existence of the online direct sales channel along with the traditional sales channel frequently causes channel conflicts (Eyuboglu & Kahadayi, 2005; Mukhopadhyay, Yao, & Yue, 2008; Rosenbloom, 2007; Yan & Pei, 2009; Zhou, Zhuang, & Yip, 2007). Although many manufacturers have adopted the relationship marketing philosophy in recent years in hope of creating long-term relationships between its traditional channel and the online direct sales channel (Zhou, Zhuang, & Yip, 2007), there is still a possibility of channel conflicts because the manufacturer and its traditional reseller instinctively seek for their own interests (Gudonavičienė, Alijošienė, & Aukščionis, 2008). As Rosenbloom (2007) suggests, while integrating online direct sales channels with conventional sales channels to create a “seamless” experience for customer is ideal in theory, it is difficult in practice.

Many of the key issues related to channel conflicts remain crucial today (Alberto, 2005; Zhou, Zhuang, & Yip, 2007). Appropriately resolving these issues will have substantial impacts on manufacturers’ distribution performance, relationships with business partners, and the satisfaction of consumers’ needs (Gudonavičienė, Alijošienė, & Aukščionis, 2008).

Being aware of the importance of these issues, many researchers have conducted research on channel conflicts. However, most of the extant research focus on channel management after the manufacturer has already established its ODSC. Very little has been studied on the factors that affect manufacturers’ strategies prior to their establishment of an ODSC. Unfortunately, after a channel conflict occurs, damages to the manufacturer are already done and may never be repaired. Emotions may run high for a long period of time between the manufacturer and the reseller. A long-standing strategic relationship with a distribution partner, which often constitutes an important part of the manufacturer’s competitive advantage, may already be damaged beyond repair or destroyed entirely. The findings from such studies, therefore, may be of limited usefulness.

To avoid unnecessary loss of business opportunities from an ODSC or unanticipated channel conflicts, manufacturers need to identify possible reactions of current resellers, analyze the potential sources of such reactions, recognize the possible nature of the conflict process, and then formulate a strategy based upon values gained and risks faced prior to establishing an ODSC. Building upon behavioral theories including the Theory of Reasoned Actions (TRA), Expected Utility Theory (EUT), and Prospect Theory (PT), this paper proposes a Relational Model, which maps the relationships between manufacturers’ intentions to establish ODSC and critical factors underlying
such intentions. Based on the Relational Model, the paper also develops a Strategic Framework, which can serve as a guideline for manufacturers to formulate their Internet channel strategies. The Objectives of the study include:

- To establish a Relational Model mapping the relationships between key determinants of manufacturers’ intentions and their distribution strategy prior to their initiation of an ODSC.
- To establish a Strategic Framework based upon the Relational Model. The Strategic Model serves as a guideline for manufacturers to formulate their channel strategies.
- To formulate a series of propositions that may be useful for future research.
- To present the academic and managerial implications of the study.

The rest of the paper is structured as following: Next section provides a literature review of channel conflicts and distribution strategies. Emphasis will be placed on literature about channel conflicts with the involvement of the ODSC. Then I develop the Relational Framework, which models a synergic TRA-EUT-PT view of determinants of manufacturers’ intention to establish an ODSC. After that I present the Strategic Framework. The final section concludes the paper with implications of the study and direction for future research.

LITERATURE REVIEW

A distribution channel may be defined as producers and various middlemen joined to perform activities necessary to move goods from points of production to points of consumption (Rosenberg, 1974). It is one of the most critical factors for a manufacturer’s success. Possessing strong distribution channels increases barriers for entrants and thus may constitute a significant competitive advantage. The channel conflict refers to the situation in which one channel member of a distribution network perceives another channel member’s behavior as a barrier to achieving its business goals. This is perhaps one of the most serious concerns for manufacturers as they add e-commerce.

The channel conflict received enormous attention during the 1970s and 1980s (Frazier, 1999). In the 1990s, the channel conflict received relatively less attention because of the emphasis of the relationship-marketing paradigm, which is a strategy emphasizing the importance of relationship building between different members of the channel. Recently, however, with the emergence and growth of e-commerce, coupled with the trend toward multi-channel distribution, the channel conflict has regained attention and become a hot topic again (Eyuboglu & Kahadayi, 2005; Falk et al., 2007; Rosenbloom, 2007; Mukhopadhyay, Yao, & Yue, 2008; Yan & Pei, 2009; Zhou, Zhuang, & Yip, 2007).

Generally speaking, the channel conflict literature has focused primarily on three areas: (1) the effect, positive or negative, of channel conflicts on involved firms, (2) factors that contribute to channel conflicts, and (3) strategies to manage channel conflicts. The first area pertains to the positive (functional) or negative (dysfunctional) effects of channel conflicts. Many researchers (e.g., Stern, 1996) see channel conflicts as dysfunctional because it is opponent-centered and may cause reduction of channel efficiency, increase of channel cost, and emotional disruption of alliance between firms. However, others argue that channel conflicts also have positive or functional effects. For instance, channel conflicts can potentially propel changes and it can be used to evaluate management performance (Anderson & Narus, 1990; Rosenberg, 1974). Overall, previous studies view channel conflicts as damaging or even devastating to the firms involved.

Another frequently examined area of channel conflicts is the factors contributing to channel conflicts. Webb (2002) summarizes three primary factors that contribute to channel conflicts: goal incompatibility, domain dissensus, and differing perceptions of reality.
Others identified more specific factors including online pricing, lack of trust (Steinfield et al., 2002), and channel power (Lee et al., 2003). While virtually every study has identified some unique factors contributing to channel conflicts, very few of them have integrated the factors into a conceptual model, which can be used as a guideline for manufacturers to manage channel conflicts.

In addition, other studies focus on manufacturers’ strategies to ease or manage channel conflicts. Lee et al. (2003) prescribed market differentiation, product differentiation, intermediary support, conflict avoidance, channel absorption, information sharing, and profit sharing as possible strategies for coping with channel conflicts. Bucklin et al. (1997) cited Charles Schwab’s establishment of an online channel to satisfy latent consumer demand for the “do-it-yourself” customer segment, and Kendall-Jackson’s selling of brands of wine online different from those carried by its retail channels, as examples of differentiation strategy. Steinfield et al. (2002) presented click-and-mortar or synergy as an effective strategy to manage channel conflicts. Most of these strategies are based upon a post-ODSC context, where the manufacturers already built their ODSCs, often without strategic analysis prior to initiating such ODSCs. While those strategies may be of help to the manufacturers in controlling damages from channel conflicts, they are of little usefulness in preventing or avoiding unnecessary and unanticipated channel conflicts.

Unlike the case with most previous studies, the models proposed in this paper are based upon a pre-ODSC context, where the manufacturers already built their ODSCs, often without strategic analysis prior to initiating such ODSCs. While those strategies may be of help to the manufacturers in controlling damages from channel conflicts, they are of little usefulness in preventing or avoiding unnecessary and unanticipated channel conflicts.

THEORETICAL DEVELOPMENT AND THE RELATIONAL MODEL

The Relational Model proposed in this paper draw support from various behavioral theories, particularly the Theory of Reasoned Actions (TRA), Expected Utility Theory (EUT), and the Prospect Theory (PT). Although these theories emphasize different aspects of organizational behaviors, they have several features in common: (1) they are all theories of decision-making under risky alternatives; (2) they all assume that decision makers (individuals and organizations) are self-interested; and finally (3) they all assume that decision makers are rational, that is, they plan for their actions through reasoning processes to maximize utilities and minimize risks. As noted earlier, whether to establish an ODSC is a manufacturer’s dilemma of risky alternatives; moreover, it is reasonable to assume manufacturers are self-interested and rational. Hence, these theories are all appropriate to the ODSC issue.

Theory of Reasoned Actions

The Theory of Reasoned Action (TRA) and its later derivative, Theory of Planned Behavior (TPB), are concerned with the determinants of people’s (or organization’s) intentions to perform particular behaviors. Such determinants include motivational factors, which indicate how much effort the decision maker would like to make to perform the behavior, and non-motivational factors, such as the availability of opportunities and resources to perform the behavior.

Ajzen was among the earliest researchers to study TRA and TPB (Ajzen, 1991). He proposed three independent antecedents of intentions to perform a given behavior: (1) attitude toward the behavior, which refers to the decision maker’s favorable or unfavorable evaluation or appraisal of a given behavior; (2) subject norms, which refers to the perceived social pressure to perform or not to perform the behavior; and (3) perceived behavior con-
control, which refers to the level of efforts (time, money, efforts, etc.) available to perform the behavior. The more favorable the attitude and the subject’s norms toward the behavior and the stronger the perceived behavioral control, the stronger would be the decision maker’s intention to perform the behavior in question.

Based on such theory, the antecedents of a manufacturer’s intention to establish an ODSC can be grouped in three factors (Figure 1): (1) the manufacturer’s attitude toward ODSC on its potential to bring gains or losses; (2) social influences or pressures from other social parties such as the manufacturer’s suppliers, clients and competitors; and (3) the availability of opportunities or resources to establish an ODSC, including the manufacturer’s current IT infrastructure, IT smarts, and budgetary support for an ODSC. The more favorable an attitude it has toward ODSC, the more pressure the company faces from other parties, and the more resources it has available, the more likely the manufacturer will intend to establish an ODSC.

3.2 Expected Utility Theory

Expected Utility theory (EUT) can be traced back to the eighteenth century when Gabriel Cramer and Danniel Bernoulli worked separately to explain the Petersburg Paradox (Schoemaker, 1982). The EUT theory has been widely used for modeling decision-making under risk (Tamura, 2005; Schoemaker, 1982) and has played a central role in theories of measurable utility (Schoemaker, 1982). It has been frequently used prescriptively in management science (particularly decision analysis) and predictively in finance and economics (Schoemaker, 1982).

The core of the EUT concerns choices among risky alternatives. According to the

Figure 1. Determinants of a manufacturer’s intention to establish ODSC: The TRA View
EUT, if \( x_i \) denotes the outcome vector and \( p_i \) denotes the probability associated with the outcome, then people will try to maximize:
\[
\sum_{i=1}^{n} F(p_i)U(x_i)
\]

Essentially, the EUT predicts or prescribes that people would combine outcomes and probabilities multiplicatively to make choices among risky alternatives. According to this theory, a manufacturer’s intention to establish an ODSC is determined by its perceived utility gains from online sales or from maintaining conventional resellers and its perceived utility losses from missed online sale opportunities or from retaliation of resellers (Figure 2). The synthesis of the two factors, taking probabilities into account, determines the manufacturer’s intention to establish an ODSC.

**Prospect Theory**

Prospect Theory (PT) was originally developed by Kahneman and Tversky (1979) and validated by many later studies (e.g., Chou, Chou, & Ko, 2009). The theory was developed as an extension to the EUT to solve some paradoxes unexplained by the EUT. PT has been found to be able to resolve some well-known issues associated with EUT, such as inconsistency of risky utility (Abdellaouia, Barrios, & Wakker, 2007) and descriptive deficiencies (Abellan-Perpiñan, Bleichrodt, & Pinto-Prades, 2009).

As in EUT, people make choices among risky alternatives based on gains and losses in PT. However, as opposed to EUT, in Kahneman and Tversky’s Prospect Theory gains and losses are relative to a reference point (usually the status quo or one’s current assets) rather than the final assets. In other words, value is treated as a function of two factors: (1) the asset position that serves as a reference point and (2) the magnitude of change (positive or negative) from the reference point (Kahneman & Tversky, 1979).

PT also replaces probabilities in EUT with a new variable named decision weights. Although Kahneman and Tversky (1979) argue that decision weights are different from probabilities, they are essentially similar, both referring to the decision maker’s subjective probabilities inferred from preferences. The PT view of determinants of a manufacturer’s intention to establish an ODSC (Figure 3) is similar to the EUT view with slight differences in names of

---

**Figure 2. Determinants of a Manufacturer’s Intention to Establish ODSC: The EUT View**

![Diagram showing the EUT view of determining a manufacturer's intention to establish an ODSC.](image-url)
terms. But with regard to the weighting function required to model precautionary decisions in prospect theory, risks tend to be exaggerated through the overweighting of small, medium-sized, and moderately large probabilities (Kusev et al., 2009).

Although each of the three theories, TRA, EUT, and PT, has its own merits and limitations, they have something in common; that is, perceived benefits (utilities, values or gains) and perceived risks (losses) are consistently emphasized across all three theories. Future empirical studies should be cautious while selecting the theory to address particular issues related to decisions under risky alternatives.

Based on the above discussion, we propose,

Proposition 1: The manufacturer’s intention to establish an ODSC will be positively related to the foreseen benefits from an ODSC.

Proposition 2: The manufacturer’s intention to establish an ODSC will be negatively related to the perceived risks from intermediary retaliation.

In addition to perceived benefits and risks, the availability of resources (Cragg & King, 1993; Lee, 2004) and social pressures such as the pressures from clients, suppliers, and competitors (Nielsen, Høst, & Mols, 2005) also contribute to the manufacturer’s intention to initiate an ODSC. Therefore, we also propose:

Proposition 3: The manufacturer’s intention to establish an ODSC will be positively related to the availability of resources and social pressures.

Figure 3. Determinants of a Manufacturer’s Intention to Establish ODSC: The PT View
related to the availability of resources required.

Proposition 4: The manufacturer’s intention to establish an ODSC will be positively related to its perceived level of social influences.

As analyzed through the TRA, EUT, and PT views of the manufacturer’s intention to establish an ODSC, the primary factors affecting a manufacturer’s perceived benefits and risks of an ODSC, social influences, and availability of resources to establish an ODSC. Further investigation into the determinants of these factors is useful in formulating a model that includes indirect factors useful for strategic channel analysis.

Among those factors, the availability of resources such as financial abilities and personnel competences essentially determines the manufacturer’s ability to build an ODSC. Thus it directly affects the manufacturer’s intention to build an ODSC. Social influences refer to the pressures a manufacturer faces from various parties to establish an ODSC. For instance, it may face pressure from a major competitor to sell directly online, or it may be compelled by some key clients to establish an ODSC for easy transactions. Sometimes, the manufacturer may intend to establish an ODSC simply because other manufacturers in the industry have done so. Social influences and the availability of resources directly affect the manufacturer’s intention to initiate an ODSC; that is why they are included in the Relational Model. However, because the determinants of those two factors have little relevance to channel conflicts, analysis of such determinants is beyond the scope of this study.

Determinants of Perceived Risks

In extant research, perceived risks have frequently been found to be a critical antecedent of the behavioral intention to adopt an e-business technology. For example, Jih, Wong, and Chang (2005) found that perceived risks impacts the adoption of Internet banking services. However, little research attention has been focused on the determinants of perceived risks. The following section examines the factors that are likely to influence a manufacturer’s perception of risks from a channel management perspective.

Threat to the Reseller’s Profitability

As noted earlier, the manufacturer’s major risk in the establishment of an ODSC is from possible retaliation of the reseller. The reseller will retaliate only if it views the manufacturer’s move toward an ODSC as a serious threat to its profitability. The manufacturer should look for mechanisms to initiate a potentially profitable online direct sales channel without jeopardizing its current reselling channels. For this reason, it should analyze the relative importance of and its contribution to each existing reseller’s revenues and profits. Through this analysis, the manufacturer would be better able to assess the likely reaction of its resellers and to develop appropriate channel strategies accordingly (Nair & Pleasance, 2005). Based on this discussion we propose:

Proposition 5: The level of risk of an ODSC estimated by the manufacturer will be positively related to the perceived threat that the ODSC will pose to the reseller’s profitability.

The perceived threat of the manufacturer’s ODSC initiative to the reseller’s profitability depends on two important variables: (1) the similarity of marketing mix between the planned ODSC and the reseller’s sale channel and (2) the possibility of synergy between the ODSC and the reseller’s sale channel. The marketing mix variables that strongly affect perceived threat to the reseller’s profitability mainly include product (products sold on the ODSC), place (geographic location, or more generally, market segment served by the ODSC), and price (the pricing of products on the ODSC).

When the manufacturer’s ODSC serves a different market segment or when it sells...
different products or sells similar products to different market segments, it will have limited impact on the reseller’s profitability. Being aware of the sensitivity of products and market segment served, some manufacturers have tried to differentiate their ODSC from their resellers’ sales channels in those aspects. For instance, through its ODSC Kendall-Jackson offers brands of wines that are rarely carried by its retail channels, which sell more popular brands such as Vintner’s Reserve and Grand Reserve (Bucklin et al., 1997).

Price erosion on the Internet is among the biggest concerns of the reseller. Research has found that ODSC pricing is the single most critical issue over which most Internet channel conflict is generated (Webb, 2002). A general rule is that while ODSC is expected to distribute different products to different market segments from the reseller’s sales channel, it is also always expected to price its products higher than the reseller’s channel. Based on the analysis above, we propose:

Proposition 5a (1): The perceived level of threat of the ODSC to the reseller’s profitability will be positively related to the predicted similarity of products sold on the ODSC and on the reseller’s sales channel.

Proposition 5a (2): The perceived level of threat of the ODSC to the reseller’s profitability will be positively related to the predicted similarity of market segments served by the ODSC and by the reseller’s sales channel.

Proposition 5a (3): The perceived level of threat of an ODSC to the reseller’s profitability will be negatively related to the perceived level of the manufacturer’s pricing of products on the ODSC as compared to on the reseller’s sales channel.

One additional variable affecting the perceived threat to the reseller’s profitability is the likelihood of synergy. The manufacturer and the reseller may pursue channel integration to improve profitability through synergy effects that may not be available to those that treat their channels independently (Anderson et al., 1997; Steinfield et al., 2002). For instance, they can divide channel roles so that different channel members focus on different functions in the value delivery channel (Bucklin et al., 1997). The benefits from synergies include lower costs, differentiation through value-added services, improved trust, geographic and market extension (Steinfeld et al., 2001). The manufacturer’s ODSC may also have spillover effects, generating increased purchases in the reseller’s physical channel (Ward, 2001). The potential increase of overall profitability through increased quality of service and sales because of synergy effects may reduce or even eliminate the threat to the reseller’s profitability. Thus, we propose,

Proposition 5b: The perceived level of threat of a manufacturer’s ODSC to its reseller’s profitability will be negatively related to the level of potential for synergy between the ODSC and the reseller’s sale channel.

The Manufacturer’s Reliability on the Reseller

The manufacturer’s reliance on the reseller is reflected in three aspects: (1) the percentage of volume of products distributed through the reseller, (2) the availability of alternative distribution channels; (3) the costs (time, financial and human resources) required to replace the original reseller with a new distribution channel (Lee et al., 2003).

Overall, traditional manufacturers usually rely heavily on the physical (as opposed to the Internet) distribution network to sell their products. Such a distribution network is also one of their most important competitive advantages. Giving up such a distribution channel constitutes a high risk of loss for them. However, a startup manufacturer who currently uses the physical distribution network but does not gain a strong competitive edge from such use may see it worthwhile seizing opportunities on the online sales channel. Since such companies
have little to lose when the reseller retaliates, retaliation from the reseller may be of little use, therefore, such retaliation will be perceived as less likely to occur.

Proposition 6: The manufacturer’s perceived likelihood of reseller retaliation will be positively related to its perceived level of reliance on the reseller.

Relative Market Power of the Reseller

Channel power, which is a channel member’s ability to control the decision variables of the marketing strategies of other channel members, is the most frequently cited cause of channel conflicts (Lee et al., 2003). As noted above, firms are rational and self-interested. When a reseller has superior channel power over the manufacturer it will be more likely to retaliate against a manufacturer’s establishment of an ODSC in order to prevent others from following suit. As Rosenberg (1974) points out, compared with the manufacturer, the larger and the more powerful the reseller, the more likely a complaint can be magnified into a major conflict issue that affects the manufacturer’s distribution system.

On the other hand, if the reseller has less market power than the manufacturer, it may be more tolerant of the manufacturer’s ODSC initiative. For example, Kodak is a well-established manufacturer and it has superior channel power over its resellers. The consumer buys a Kodak camera from a physical store usually because of the brand of the product, not because of the name of the reseller. Essentially, Kodak rather than the reseller owns the customers. Therefore, retaliation from a reseller will pose very limited risk to Kodak. The ineffectiveness of such retaliation discourages the reseller from actually carrying out any retaliation. Therefore, we propose,

Proposition 7: The manufacturer’s perceived likelihood of reseller retaliation will be positively related to the relative channel power of the reseller.

Determinants of Perceived Benefits

Feasibility of Products to Sell on ODSC and Estimated Volumes

Although virtually every product can be sold online, not all products are equal on the Internet. The characteristics of the online sales channel (e.g., easy for information search and comparison but lack physical interactions) determine that some products with specific attributes are more suitable to be sold on the ODSC than others. The following list a few product classifications that may be linked to how effective a product can be sold on an ODSC.

- **Search Goods vs. Experience Goods**: Search goods are those marked by attributes that can be obtained prior to purchase while experience goods are those marked with attributes that cannot be known until the purchase and use of the product (Nelson, 1970). Experience goods, such as wine or automobiles, which need to be experienced (tasted or test-driven) to know whether they are good, may not be very suited to be sold on the ODSC unless a “virtual experience” can be created (Klein, 1998).

- **Durable vs. Nondurable Goods**: Whether a product is durable may also impact its online potential (Norton & Norton, 1988; Rhee, Riggins, & Kim, 2009). Nondurable goods such as grocery products that are purchased routinely tend to be more suited for a physical store while nondurable goods such as stereo systems that last for a long time and usually cost much may have a promising online market.

- **Digitized Goods vs. Nondigitized Goods**: the online channel is very convenient for transporting (downloading) digital products such as software, music, and video. These have become the most popular products online. According to the December 2002 monthly Online Retail Index (NRF/
Forester, 2002), music, software, and videos are among the top online items while non-digitized products are relatively less popular online.

Other attributes of products that are likely to be linked to their online success (failure) include information intensity (Palmer & Griffith, 1998), the frequency and magnitude of purchase (Rhee, Riggins, & Kim, 2009), and asset specificity and complexity of the product descriptions (Malone, Yates, & Benjamin, 1987). The manufacturer must analyze the major attributes of its products and determine whether its products are promising to sell online, which in turn, should be taken into account when forecasting its sales volume on the ODSC and the potential values of initiating an ODSC. Based on the discussion above, we propose,

Proposition 8: The foreseen benefits of a manufacturer’s initiative in ODSC will be positively related to the perceived level of feasibility of its products to sell online.

Proposition 9: The foreseen benefits of a manufacturer’s initiative in ODSC will be positively related to its predicted sales volume through an ODSC.

**The Reseller’s Effectiveness in Selling Products Online**

One factor that determines the manufacturer’s perceived value of an ODSC is whether its conventional resellers have effectively established a web presence for its products. If the answer is yes and the reseller is already working effectively in digging gold out of the web and/or through the physical distribution channel for the manufacturer, then the manufacturer will have no reason for selling products directly online itself. The perceived value of establishing an ODSC will also be relatively low. However, if the reseller is not effective in selling the manufacturer’s products, then the manufacturer will be motivated to establish its own ODSC (Modahl, 2000). A manufacturer will take such action particularly when it is not satisfied with the reseller’s efforts to sell its products but does not have sufficient negotiating power to force the reseller to build better web presence for its products.

When the reseller is not working as effectively as the manufacturer expect and the manufacturer does have a strong negotiating power, then the manufacturer may be motivated to adopt an online direct sale channel as an effective tool to motivate the retailer to improve its retail services (Yan & Pei, 2009). Based on the above analysis, we propose:

Proposition: 10: The manufacturer’s foreseen benefits of building its own ODSC will be negatively related to the reseller’s ability to sell the manufacturer’s products online.

**The Relational Model**

Synthesizing all the analyses above, I develop an integrative Relational Model that maps the relationships between the manufacturer’s intention to establish an ODSC and key determinants underlying such intention (Figure 4).

The framework can serve as guideline for addressing some of the key issues related to channel conflicts (Bucklin, 1997): 1) are the online channel and traditional offline channel serving the same market (same products same consumers)? 2) Is the deteriorating profitability of one gripeing player (reseller, for instance) the result of another channel’s encroachment? 3) Will the decline of one channel (either online channel or offline channel) necessarily harm the manufacturer’s profits?

**THE STRATEGIC FRAMEWORK**

From the Relational Model above, we have developed a Strategic Framework (Figure 5), based on which the manufacturer can make strategic decisions on whether and under what conditions it should initiate or avoid an ODSC, taking into account the potential values of an ODSC and the losses from possible retaliation of traditional intermediaries.
Channel conflict management is crucial for the channel performance and relationship between a manufacturer and its resellers (Gudonavičienė, Alijošienė, & Aukščionis, 2008). Facing channel conflicts and the possibility of retaliation from the reseller, the manufacturer essentially has three options: (1) ignore a possible retaliation and initiate a full scale ODSC, (2) stay away from ODSC in order to save its relationship with the reseller, and (3) establish an ODSC but compromise with the reseller in the scale of the ODSC, segments and products served on the ODSC, or through mutually beneficial programs. Making the appropriate choice may define the success or failure of the manufacturer.

A channel conflict resolution involves three major steps: 1) identifying the potential or existing conflicts (in this paper we focus on potential conflicts), 2) evaluating the possible impact of the conflict, and 3) identifying and implementing a proper channel conflict solution strategy (Gudonavičienė, Alijošienė, & Aukščionis, 2008).

What strategy to use depends on the estimated values that the manufacturer is expected to gain from the initiation of an ODSC and the perceived risks that it will have to face from channel conflicts. Based on such values and risks, we developed four scenarios: Low value low risk, low value high risk, high value low risk,
and high value high risk. Different strategies should be employed under different scenarios.

- **Low Value High Risk Scenario:** Referring to Figure 5, if the estimated value from an ODSC is low but risks resulting from the channel conflicts are high, it won’t be worth initiating the ODSC. It simply does not make business sense to take a high risk of losing a reseller that the manufacturer strategically relies on to pursue another sales channel that is not expected to offer the manufacturer substantial values.

- **Low Value Low Risk Scenario:** When the estimated values from a new ODSC are limited and the risks from channel conflicts are low, then the manufacturer should take caution if it chooses to initiate an ODSC. In this case, it is not worth the firm’s all-out effort for an ODSC even though the current risk from channel conflicts is low, because such risk may increase when channel power structure changes in the future.

- **High Value Low Risk Scenario:** If the estimated risk from a channel conflicts is low but estimated values from an online direct sales channel is high, then the manufacturer should establish a full-scale ODSC and at the same time try to maintain its relationship with the traditional resellers.

- **Critical Scenario:** when estimated values from the ODSC and risks from channel conflicts are both high, the manufacturer should make efforts to initiate an ODSC and capture the opportunities on the online channel. But at the same time the manufacturer must take measures to maintain a normal relationship with the traditional reseller. The task can be daunting since the likelihood of reseller retaliation is high. Some of the strategies include channel integration and channel offer differentiation (Bauer, Falk, & Hammerschmidt, 2006; Falk et al., 2007; Neslin, 2006). Essentially, the manufacturer can assure the reseller that it will sell different products or sell the same products to different customer segments, those not currently served by the reseller. To ease possible tension, the manufacturer may also seek to create the illusion of differentiation among the customers by using different names and numbers for the same items and introducing minor product modifications (Bucklin et al., 1997). In addition, the manufacturer can establish mutual-promotion or revenue-sharing programs with the reseller. For example, the manufacturer may list its reseller’s physical locations on its web site or it can allow a customer to order from the manufacturer’s web site and pick up the products from the reseller’s physical store. These tactics are likely to help shift the reseller’s attention away from the potential threat that the manufacturer’s ODSC pose to its profitability and focus on how to build channel synergy and benefit from the manufacturer’s new channel.
**DISCUSSION**

**Implications for Research**

This paper proposes a Relational Model of a manufacturer’s intention to establish an ODSC. The manufacturer’s perceived benefits from the ODSC and perceived risks resulting from channel conflicts, social influences, and availability of resources are the major factors contributing to its intention to build an ODSC. The perceived benefits of an ODSC, in turn, are determined by the potential of the manufacturer’s products to sell online, the predicted size of online markets, and the intermediary’s effectiveness in selling the manufacturer’s products. The perceived risk of reseller retaliation is determined by the level of threat to the reseller’s profitability, the manufacturer’s reliance on the reseller, and the reseller’s channel power relative to the manufacturer’s. Based on the Relational Model, this paper also develops a Strategic Framework, which manufacturers can use as a guideline to formulate Internet channel strategies as to when and at what level they should initiate an ODSC.

Both the relational model and the strategic framework proposed in this study contribute to the theoretical foundation for future research on Internet channel conflicts, particularly in the context of manufacturers.

**Implications for Business Practice**

The study also contributes substantially to business practice. The online direct sales channel has provided manufacturers with a relatively inexpensive way to reach its customers directly. However, prior to initiating a dual-channel model, manufacturers are faced with the task of integrating its online channel with its existing conventional channels (Rosenbloom, 2007). Otherwise, potential damages from Internet channel conflicts may offset any benefits the manufacturer gain from an ODSC and further, jeopardize its relationships with traditional resellers. The first contribution of this study to business practice is that the Relational Model presented in this paper offers a guideline on what variables and aspects manufacturers should consider prior to initiating an online direct sale channel so as to realize the benefits from the ODSC, and at the same time, minimize the negative impacts of channel conflicts.

Second, the relational framework also has significant practical implications for channel customer management. For instance, when determining whether it should initiate an online direct sales channel, the manufacturer may need to refer to the Relational Framework proposed in this study and estimate potential values of the online direct sales channel by forecasting the market size on the new channel. The manufacturer should determine whether the online direct sales channel will reach sizable new customers, or the customers are expected to come primarily from the firm’s prior traditional channels (Rosenbloom, 2007). Also, the manufacturer should assess the possibility that a failure in integrating multiple-channels may result in customer dissatisfaction and loss of customers to competitors.

Third, manufacturers can also use the Strategic Framework proposed in this paper as a guideline to formulate their Internet channel strategies on whether and at what level to launch an ODSC. Essentially, the channel strategy that the manufacturer should employ depends on the intensity of conflicts, which could vary considerably from case to case. When the conflict is expected to be intense, the implementation of a channel alignment program should be planned to resolve the conflicts (Zikmund and Catalanello, 1976). The emphases of such alignment program should be on channel integration, channel offer differentiation (Bauer, Falk, & Hammerschmidt, 2006; Falk et al., 2007; Neslin, 2006), and the reinforcement of channel trust, which is crucial for the channel harmony (Balasubramanian, Konana, & Menon, 2003). For instance, the manufacturer can build a plan to maintain trust of its reseller by making a cooperative gesture and pursuing a network organization structure for repeated, enduring exchange relations with the reseller (Goethals & Vandenbulcke, 2005). It may also consider improving its E-business...
infrastructure to enhance its relationship coordination with its reseller (Osmonbekov, Bello, & Gilliland, 2009). In addition, the manufacturer may consider employing behavior-based coordination strategy and problem-solving approach to resolve conflicts, enhance collaborative communication and cooperation, and strengthen trust (Sahadev, 2005).

However, when channel coordination is too costly or the costs cannot justify the benefits of managing both online and the traditional offline channels, then a channel alignment program may not work and channel integration thus won’t be a feasible strategy (Falk et al., 2007). In that case, manufacturers may have to choose to use a “status quo preserving strategy” and give up the ODSC initiative and focus totally on the traditional offline sales channel (Falk et al., 2007). Or they have to employ a “status quo substitution strategy” and switch completely from the traditional offline channel to a new online direct sales channel (Deleersnyder et al., 2002; Pauwels & Neslin, 2006). “Status quo substitution strategy” is an offensive marketing strategy. The manufacturer must use it with caution. As Neslin et al. (2006) suggest the “status quo substitution strategy” may complicate channel customer management; that is, customers may feel frustrated when being forced to switch to the online direct sales channel and thus may switch to a different vendor or brand. If that constitutes a serious concern, “status quo preservation strategy” may be a preferred strategy.

Finally, if a manufacturer has multiple existing resellers prior to initiating an ODSC, it may use the Relational Model proposed in this paper to assess the estimated values of the ODSC and risks linked to the potential channel conflicts, and then use the strategic framework to evaluate and prioritize different resellers.

Future Research

The study has raised some opportunities for future research. First, the relational model focuses only on the theoretical modeling of the effect of a series of crucial factors on the manufacturer’s channel decisions. Future research is needed to empirically test parts of the entire model. Second, the Relational Model is formulated strictly from the perspective of a manufacturer. Future studies can also be conducted to explore the ODSC issue from different perspectives, for instance, from the perspective of a reseller (wholesaler, distributor, or retailer). For example, researchers can investigate a reseller’s reactions to a manufacturer’s decision to establish an ODSC and the factors underlying such reactions. Just as this study contributes to the literature by providing a guideline to manufacturers in their formulation of Internet channel strategies, other studies will be useful in providing models guiding resellers in their formulation of Internet channel strategies.

REFERENCES


Copyright © 2010, IGI Global. Copying or distributing in print or electronic forms without written permission of IGI Global is prohibited.


NRF/Forrester Research. (2002). *December 2002 NRF/Forrester Online Retail Index*.


Xiaolin Li is an assistant professor of e-Business and Technology Management at Towson University. He received his Ph.D. in Management Systems from Kent State University. Dr. Li’s current research interests are the adoption, continuation, and valuation of technological innovations, and global strategies. His research has been published or accepted for publication in Journal of the Association for Information Systems, International Journal of Operational Research, Journal of Information Systems Education, International Journal of Learning and Intellectual Capital, Journal of Current Research in Global Business, and Journal of Global Commerce Research. His research has also won the “Distinguished Research Paper Award” from the Decision Science Institute 40th Annual Conference (2009) and “Honorable Mention Best Student Paper Award” from Midwest DSI Annual Conference (2006)