A Strategic Analysis of Mixed Channel Structure: Retail Store Ownership

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ABSTRACT

In order to meet the needs of different customer segments, manufacturers use multiple distribution channels. This paper will examine two of the most common types of multi-channel structures. Under Structure 1, a supply chain includes a manufacturer, its online store and its own retail store, like GAP’s business model. A profit maximization model is used to obtain optimal strategies in terms of optimal retail price and level of value-added services provided by manufacturer-owned retailer. Under Structure 2, a supply chain includes a manufacturer, its online store and an independent retail store, like Dell’s business model. Stackelberg game is applied to obtain the optimal retail price, wholesale price, and level of value-added services provided by an independent retailer. Furthermore, comparisons between these two business structures are discussed and managerial guidelines are proposed. Finally, numerical examples are provided and real business examples are discussed to illustrate and justify the theoretical results.

Keywords: Channel Integration, Equal-Pricing, Multi-Channel, Online Sale, Retail Store Ownership

1. INTRODUCTION

Emerging technologies are rapidly changing the structure of distribution channels. Companies need to define the best market structure to serve the customers. In order to meet different customer segments’ needs, more and more manufacturers use a multi-channel distribution structure which includes a manufacturer direct online channel, a manufacturer-owned retail store, and/or an independent retail store.
From late 2007, Dell began selling its products in retail stores and continued to expand the number of stores carrying its products (Calnan, 2009). Fried (2008) reported that Tony Weiss, vice president for Dell’s Global Consumer business, said: “Moving into retail is a prime example of Dell listening to its customers.” in a statement. Industry analysts also believed that online sales haven’t been affected by the move into stores (Calnan, 2009).

The retail stores can help manufacturers to build brand awareness, gather market information, and provide product consulting and return, and other services. So manufacturers tend to pursue a multi-channel strategy, including online channels and retail stores. Dell, Apple, Gap and others all took similar decisions.

This channel conflict is the biggest deterrent for the manufacturer to go ahead with the mixed channel business model. Frazier (1999) states that mixed channel would increase revenue, but also would lead to channel conflicts. There are a number of ways to alleviate the channel conflict. Manufacturers allow retailers to provide some value-adding activities on the base products to different channels (Mukhopadhyay, Zhu, & Yue, 2008). Cattani, Gilland, Heese, & Swaminathan (2006) studied a case where the manufacturer commits to matching the traditional channel retail price in the direct channel in order to mitigate channel conflict. This equal-pricing policy is a common guideline for a multi-channel structure. The same products should be charged at the same price regardless of channels. For example, www.apple.com, Apple retail store and Best Buy have the exact same price for same Apple product.

We will use the equal-pricing policy to study two of the most popular multi-channel structures. Under Structure 1, the supply chain includes a manufacturer, its online store and its own retail store. For example, GAP clothing manufacturer sells its products through www.gap.com and Gap retail store. However, a manufacturer incurs a high fixed cost to establish its own retail store. So Structure 2 is preferred by some manufacturers, selling products from an independent retail store. Under Structure 2, the supply chain includes a manufacturer, its online store and an independent retail store. For example, Dell sells its products through www.dell.com and Best Buy retail store. In this research, we will find the optimum decision variables for each structure and compare these two business structures.

2. LITERATURE SURVEY

There are several research studies related to strategic multi-channel structure. Balasubramanian (1998) models the competition in the multiple-channel environment from a strategic viewpoint and also study the role of information in multiple-channel markets. Chiang, Chhajed, & Hess (2003) state that the direct marketing could be used for strategic channel control purposes. They find that the manufacturer is more profitable even if no sales occur in the direct channel. Yao & Liu (2003) study diffusion of customers between two channels and find that, under certain conditions, both channels would enjoy stable demand. Tsay & Agrawal (2004) provide an extensive review of quantitative approaches to model the multi-channel structures, with particular emphasis on the implications of the Internet for distribution strategy.

One of the concerns of multi-channel distributions is the channel conflict. One way of eliminating the possibility of this channel conflict includes offering differential products at different channels. Fay (1999) purposes a manufacturer sells a basic version of the product, and let the retailer add further value to the product before selling to the final customer. Cohen, Agrawal, Agrawal & Raman (1995) study an intermediary who perform specific value-adding functions, and get compensated for this service by the manufacturer or distributors by a side payment. Mukhopadhyay et al. (2008) let a retailer add value to the product so as to differentiate its offering to the customers. They propose a contract for manufacturer between the two channels, a manufacturer online channel and a retail store. Viswanathan (2000) studies the multi-channel issue from the product diff-
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