The Impact of Manufacturer Distribution Decisions on Their Interaction with Retailers

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The Impact of Manufacturer Distribution Decisions on Their Interaction with Retailers

Session Chair: Kathleen Cleeren (KU Leuven)

Papers included in the session:

1. “Using Brand Exclusivity as a Channel Management Tool”, Fahmi Grey (UNC, Kenan-Flagler Business School) and Katrijn Gielens (UNC, Kenan-Flagler Business School).
2. “Private Label Supply by National Brand Manufacturers: Received Wisdom and Empirical Reality”, Yu Ma (McGill University), Mercedes Martos-Partal (University of Salamanca), Kusum L. Ailawadi (Tuck School, Dartmouth College), Óscar González-Benito (University of Salamanca).
3. “National Brands at Hard Discounters: How to Set the Marketing Mix”, Joep van der Plas (Tilburg University), Marnik Dekimpe (Tilburg University) and Inge Geyskens (Tilburg University).
4. “How Retailers Change Order Strategies When Suppliers Go Direct’, Femke Gryseels (KU Leuven), Els Breugelmans (KU Leuven), Kathleen Cleeren (KU Leuven), Michiel Van Crombrugge (Erasmus University Rotterdam).

The Impact of Manufacturer Distribution Decisions on Their Interaction with Retailers

The relationship between manufacturers and retailers is intriguing and has been subject to substantial structural changes. In the past, manufacturers clearly dominated the retailing landscape, which allowed them to enforce their prices and buying conditions on the typically small retailers. Throughout the decades, a shift in power has taken place due to the rise of store brands, availability of scanner data, scarcity in shelf space, pass-through of trade promotions, and the growing consolidation of retail chains. Because of these changes, the power balance in the retailing market has become more equal. While manufacturers can leverage their ownership of national brands that create store traffic, retailers ultimately decide which brands and products to carry in their assortment. While manufacturers and retailers are hence strongly depend on each other, their objectives often diverge. Hence, negotiations between retailers and manufacturers can become true power battles.

Decisions of both parties may shift this power balance. In this special session, we focus on different manufacturer distribution decisions that may change their relationship with the retailers. In the first two papers, we delve into the brand portfolio decisions at different retailers. In paper 1 ("Using Brand Exclusivity as a Channel Management Tool", by Fahmy Grey and Katrijn Gielens), the authors study the impact on manufacturer performance of limiting the distribution of brands to a selective set of retailers. In paper 2 ("Private Label Supply by National Brand Manufacturers: Received Wisdom and Empirical Reality" by Yu Ma, Mercedes Martos-Partal, Kusum L. Ailawadi and Óscar González-Benito), the authors investigate the decision to supply private labels to certain retailers, and asses its impact on manufacturer performance across many categories and retailers.

Manufacturers not only have the power to decide on the brand portfolio of their retailers, they can also decide on which particular distribution channels to use. Paper 3 ("National brands at hard discounters: How to set the marketing mix?" by Joep van der Plas, Marnik Dekimpe and Inge Geyskens) focuses on the decision to supply to hard discounters, and its impact on the conventional retailers. While the previous distribution decision entails circumventing particular retailers, the manufacturer may even make the more extreme decision to surpass all retailers by launching their own direct channel. In paper 4 ("How Retailers Change Order Strategies When the Supplier Goes Direct", by Femke Gryseels, Els Breugelmans, Kathleen Cleeren and Michiel Van Crombrugge), the authors investigate whether a direct channel addition changes the relationship with their retailers.

Paper 1: Using Brand Exclusivity as a Channel Management Tool

Fahmi Grey (presenting author) and Katrijn Gielens

Problem Statement

Traditionally, to manage relationships with their resellers, brand manufacturers excessively make use of trade allowances. Trade allowances allow brand manufacturers to influence downstream channel members such as wholesalers and retailers to promote and support the manufacturer's brand through actions such as price discounts, features, and displays (Gedenk, Neslin & Ailawadi 2010). On average, these trade allowances can amount to 40% of a brand's gross sales, which is the second highest line item on the ledger, after COGS (Deloitte 2020). Even more so, each year the volume of trade allowance seems to further escalate for a majority of brand manufacturers. Although retailers are happily accepting higher payments, for brand manufacturers, 67% of trade allowances generate a negative rate of return (Nielsen 2015). This is problematic as ultimately, the application of trade allowances is at the transgression of the retailer who can decide to either use them for actions favoring the brands or to drop trade allowances directly towards their bottom line (Cheveliar & Curhan 1976). As such, the brand manufacturer loses control over the execution of its intended marketing strategy. For brand manufacturers de-emphasizing the use of trade allowances is, however, not an easy feat as retailers see trade allowances as an important revenue stream. Throughout the years, the increased use of trade allowances has caused retailers to develop a dependency on these trade allowances that cannot be easily broken in an environment where manufacturers critically depend on retailers for consumer access.

In this study, we examine an alternative way of managing reseller relationships that can help reduce resellers' dependency on trade allowances. More specifically, we consider how the use of exclusive assortment contracts may align with retailers' goals while reducing their dependency on trade allowances. Exclusive contracts limit the distribution of a brand's products to a selective or even exclusive set of retailers. This type of retail differentiation can take different forms. The Honest Tea brand, for example, offers an exclusive flavor to Wholefoods, whereas Hanesbrands offered a branded line C9 of its Champion range to Target. For retailers these arrangements may offer several advantages, as they allow retailers to offer a selection that can better match their consumers' specific needs (Richards et al., 2017) and differentiate themselves from their competitors. At the same time, the exclusive lines allow retailers to benefit from the umbrella effect of the national brand's marketing campaigns while transferring marketing, production, and logistics costs to the manufacturer. For brand manufacturers, the main aim is to align retailers more with their strategic interests and reduce retailers' dependency on trade allowances.

So far, empirically few studies examined exclusive contracts due to the scarcity of data held tightly by both retailers and brand manufacturers. Using data in the Dutch CPG space, Gielens et al., (2014) were able to uncover the sales results for both retailers and manufacturers. Whereas net positive benefits for retailers offering an exclusive line were found, brand manufacturers offering exclusive lines realized lower sales levels when compared to an intensive distributions strategy. Whereas revenues indeed constitute an important part of the use of exclusive contracts, we further the discussion by focusing on how these arrangements change the required trade dollar mix, at all retail accounts and all channels. In addition, we also factor in the cost structure of exclusive contracts in order to calculate profitability. As such, we take the perspective of the brand manufacturer and provide a deep dive on how exclusive contracts may be used as an efficient and effective channel management tool that can influence the retailer's voracity for trade allowances while increasing each trade dollars effectiveness and brand manufacturer sales.

Research Objectives

Our research objectives are as follows

- How does assortment exclusivity of impact the *levels* of the other relationship management levers, such as
    - Trade allowances
    - Buy-in prices
    - Assortment requests

  at both the focal retailer and excluded retailers.

- Do exclusive contracts change the *effectiveness* of the other levers at the focal and competing retailers?
- Identify and measure the effectiveness of different types of trade promotions in conjunction with exclusive contracts.
- Measure and track the effectiveness of exclusive contracts on sales and profits across the contract period.

- Assess the overall profitability for the brand manufacturer when using exclusive contracts as a channel management tool.

Empirical study

Data

For his study, we work in close cooperation with a leading US brand manufacturer and obtained all sales, cost, assortment and trade allowance information for the six soft-goods categories in which the manufacturer operates. Specifically, we have access to all monthly shipment sales to resellers across a 10-year time horizon from 2010 to 2020. The manufacturer operates mainly through ten parent national brands, at 42 resellers, across seven channels of trade (i.e. B&M, Online). The brand manufacturer competes in mature categories that generate above average margin levels for traditional retailers, creating a heavy emphasis on proper category management for our resellers. Uniquely, we have insight in all outcome variables such as unit sales, revenue levels, profit levels, and margin implications based. At the most granular level, our financial information of wholesale price, trade allowances (various types), cost of goods sold, returns, and assortment can be observed at the brand, retailer, channel level. As such, we have full insight in all exclusive arrangements in all channels and at all retailers. The nature of exclusive contracts observed vary in nature and scope in type of introduction (i.e. sub-brand to product variant) and length of contract (i.e. one season to several years).

Modelling approach

Recognizing the panel nature of our data, we assess the unexplored causal link between both the introductions and exits of exclusive contracts on a brand manufacturer's trade allowances and sales. We use a DLM methodology to capture how exclusivity can create a varying effect on brand sales, individual retail account sales, trade allowance spending and its interaction with the marketing mix's parameter estimates (cf. Van Heerde et al., 2004). By utilizing the DLM methodology, we are able to track the effect over the life cycle of exclusive contracts, which then informs how brand manufacturers should optimize their marketing mix strategy. Such information enables brands to develop an strategy that reduces retailers' dependency on trade allowances and maximizes brand manufacturer sales, while maintaining a sustainable relationship with resellers.

Paper 2: Private Label Supply by National Brand Manufacturers: Received Wisdom and Empirical Reality.

Yu Ma, Mercedes Martos-Partal, Kusum L. Ailawadi (presenting author), Óscar González-Benito

Private labels form a very substantial portion of the packaged goods sales in many countries. Although national brand manufacturers love to hate private labels (hereafter PL), it is well known that at least some of them supply private label products to retailers in what is referred to as a dual-tracking strategy, but which ones do so, in which categories, and to which retailers is generally a well-kept secret. As a result, very little is known about the extent to which national brand (hereafter NB) manufacturers supply PL to different retailers, the factors that drive this decision, or its consequences.

Much has been written about whether NB manufacturers should supply PL in conceptual articles (e.g., Dunne and Narasimhan 1999; Hoch 1996; Quelch and Harding 1996) and in books that describe the PL supply landscape with in-depth case studies and other examples (e.g., Kumar and Steenkamp 2007; de Jong 2011; Steenkamp and Sloot 2019). There are also a number of theoretical models, set in different market assumptions, that tackle a NB manufacturer's decision to supply PL and a retailer's decision to source it from a NB manufacturer (e.g., Amaldoss and Shin 2015; Kumar, Radhakrishnan, and Rao 2010; Nasser, Turcic, and Narasimhan 2013; Soberman and Parker 2006). They capture the vertical interaction between the NB manufacturer and retailer and provide valuable normative insights, though, for tractability, they often do not allow for inter-manufacturer or inter-retailer competition.

Empirically, however, there is a real paucity of work on PL supply. A notable exception is the work by ter Braak, Deleersnyder, Dekimpe, and Geyskens (2013). In examining their key research question, which is whether supplying PL to a discount retailer generates goodwill for a NB manufacturer in the form of shelf space for its NB products, these authors also model the NB manufacturer's decision to supply PL. However, the analysis is based on one discount retailer in Spain and one in Germany, and it only covers the top five NB manufacturers in categories in which the discounter carries NBs.

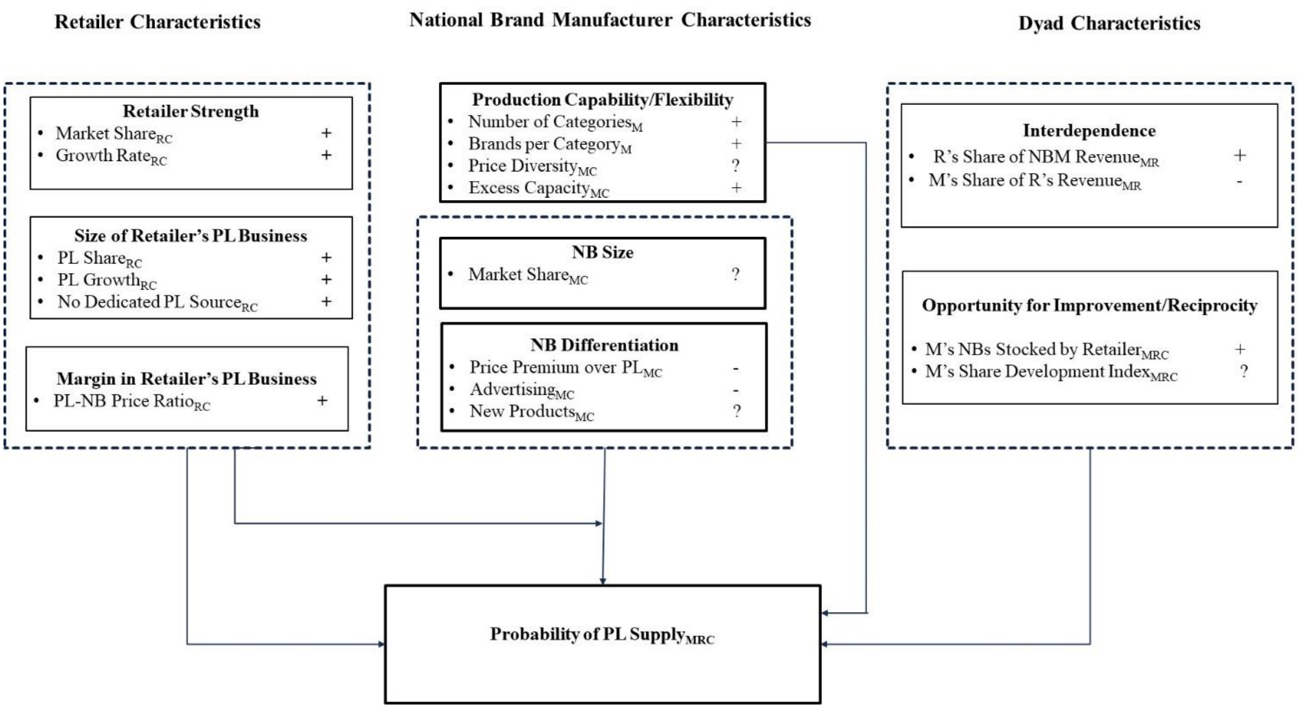
Our objective in this paper is to conduct an empirical analysis of the theory-based correlates of PL supply by NB manufacturers. Our data are from the Spanish grocery market. For six of the largest retail chains which together account for almost 70% of the market during the period of our analysis, we compile a unique dataset with cross-sectional information on the identities of PL suppliers in over 270 categories in one year and longitudinal scanner purchase data for all the NB manufacturers for the previous five years and the next two years. To our knowledge, this is the first broad empirical analysis of the PL supply decision by NBs – spanning all CPG categories, all NB manufacturers, and the major retailers in a country where PL has a significant presence.

First, we document the patterns of PL supply by dedicated PL suppliers versus NB manufacturers across categories and retailers, the extent to which dual-trackers supply PL in the same categories where they also have NBs or in other categories, and the extent to which they supply PL exclusively to one retailer or to multiple retailers in a given category. While descriptive, this is useful given the paucity of information on PL supply. It allows us to examine the extent to which patterns previously noted in surveys and anecdotal data generalize across all manufacturers and across retailers with different positioning in the market.

Second, we synthesize prior literature into a conceptual framework of retailer and manufacturer characteristics associated with the probability that a given manufacturer will supply PL to a given retailer in a category where the manufacturer sells NBs. Figure 1 presents this framework. We test the theory-based expectations from our framework using a pooled probit model of PL supply by NB manufacturer *m* to retailer *r* in category *c*.

Figure 1

Guiding Framework: Private Label Supply by National Brand Manufacturers



Third, we conduct a separate analysis of dual-trackers' decision regarding the categories in which to supply PL, including those in which they do not have NBs. This issue has not been addressed at all in prior theoretical work so our analysis is exploratory. We hope it can guide future theory development.

Fourth, we examine the extent to which NB manufacturers who supply PL to a given retailer in the year of our data perform better at those retailers in subsequent years compared to NB manufacturers that do not supply PL. We examine performance both in terms of depth of distribution and their share of retailer sales. This too is an exploratory analysis since we only have PL supply information for one year even though performance data are available for multiple years before and after that year.

Paper 3: National brands at hard discounters: How to set the marketing mix?

Joep van der Plas (presenting author), Marnik Dekimpe and Inge Geyskens

Hard discounters (HDs) are fundamentally disrupting the retailscape (Gielens and Gijsbrechts 2018). They are more price- and less service-focused than conventional retailers, and have a more limited assortment that is much more private-label (PL) oriented. In several European countries (e.g., Austria and Poland), HDs already obtain a market share above 30%. Their presence is even more overwhelming in their birthplace Germany, with a market share of 35% in 2018. In other countries, however, the HD format is still in its infancy. For example, HDs' market share in France, the second largest economy of Europe, was only 9.5% in 2018, while in the U.S. it was a mere 3.2% (Edge Retail Insight 2020). Nevertheless, business analysts expect that the format will become popular in these countries too (BCG 2017; Edge Retail Insight 2019).

Although their assortment is PL dominated, HDs allocate a limited amount of shelf space to national brands (NBs) to attract a segment of consumers that only purchases NBs in some categories (Ailawadi, Pauwels and Steenkamp 2008). For example, Aldi, the largest HD and sixth largest grocery retailer in the world, allocated on average 13.8% of its assortment to NBs in 2017, ranging from 3.9% in Belgium to 24.5% in Poland (Edge Retail Insight 2018).

By being included in the limited set of NBs that are sold at HDs, NBs can increase their reach and thereby grow their sales. At the same time, however, they may antagonize conventional retailers (Ailawadi and Farris 2017), who may drop their support for these NBs, which would decrease their sales. NBs that are sold through the HD channel therefore need to know how to set their marketing mix in this channel relative to the conventional retail channel in order to grow their total share in the market. Does a NB's total share in the market increase more when the price gap between the NB at HDs and the NB at conventional retailers is higher? Is it more or less effective to offer temporary price reductions at the HD channel? Is variety (more brand SKUs) at HDs important? And is it beneficial to distribute some SKUs exclusively through the HD channel?

We contribute to the literature in the following ways. Foremost, the limited academic research on HDs has predominantly focused on whether HDs should list NBs (Deleersnyder and Koll 2012; ter Braak et al. 2013), and if so, in which categories (Lourenço and Gijsbrechts 2013), without giving actionable insights on *how* this should best be done. A notable exception is Deleersnyder et al. (2007), who suggest that setting a larger price difference between the NB and PL at the HD and introducing more innovative NBs is always more beneficial (irrespective of the type of NB, category, or competitive retail structure). However, they do not examine promotion- and distribution-related factors, only consider the NBs' performance within the HD itself, while making abstraction of any contingency factors.

In contrast, we consider a much broader set of marketing-mix elements, explicitly account for the performance implications at other (conventional) retailers, and develop a rich contingency framework in which we consider various moderating factors for the effectiveness of these marketing-mix instruments. As to the latter, we consider questions such as: do leading NBs need to set their marketing mix in the HD channel differently than smaller brands? Is a NB's marketing-mix effectiveness in the HD channel contingent on the PL share in a category, and does this apply equally to each marketing-mix instrument? In addition, does the effectiveness depend on the share of the HD channel in a country and/or the level of retail concentration in that country?

Through AiMark, we obtained six years (2013-2018) of sales data from eight countries from GfK and Kantar. The dataset contains approximately 1000 NBs and 25 categories. In line with Datta, Ailawadi, and van Heerde (2017) and Nijs et al. (2001), we use a two-stage approach. In the first stage, we estimate a market-share attraction model for each category-country combination, where we express the NBs' marketing-mix support at the HD as a difference (e.g., the price gap) relative to the level at conventional retailers. To account for the fact that the listing of a NB at a HD is a strategic consideration, we specify a selection model that estimates the likelihood that a NB will sell through the HD channel (Heckman 1979). To address endogeneity in the NB's marketing mix instruments, we use Gaussian copulas (Datta, Ailawadi and van Heerde 2017).

In the second stage, we will regress the marketing mix elasticities that we obtained from the attraction model on NB, category, and country characteristics. We use weights equal to the inverse standard errors of the long-term elasticities of the marketing mix gap (Datta et al. 2020).

Paper 4: How Retailers Change Order Strategies When Suppliers Go Direct

Femke Gryseels (presenting author), Els Breugelmans, Kathleen Cleeren and Michiel Van Crombrugge

Suppliers increasingly decide to supplement their indirect distribution channels (such as independent multi-brand retailers) with a direct channel, that allows these suppliers to sell directly to the end-consumers (Gielens & Steenkamp, 2019; Vinhas & Heide, 2014). Retailers have often complained that suppliers are ‘viciously exploiting their retailers’ with such encroachment acts (Arya et al., 2007, p.651). As a direct channel addition introduces rivalry in the supplier-retailer relationship, it can make collaborations between the parties in the dyad tense and difficult (Arya et al., 2007; Brooker, 1999; Vinhas & Heide, 2014).

Although *game theoretical* research has studied how direct selling may affect some measures of B2B performance (Arya et al., 2007; Tsay & Agrawal, 2004; Xu et al., 2012; Kumar & Ruan, 2006), only a limited amount of research has *empirically* assessed the effects of direct channels on the incumbent retailer (Van Crombrugge et al., 2019a, 2019b; Vinhas & Heide, 2014). This prior empirical work, however, was mostly limited to a B2C point of view, with a focus on direct channel effects on sales made by consumers (Van Crombrugge et al., 2019a, 2019b), customer satisfaction (Vinhas & Heide, 2014), or on the retailer’s marketing mix of the focal brand towards consumers (Van Crombrugge et al., 2019b). We extend this research by taking a B2B point of view, and investigate if and how the order strategy is altered by which type of retailers.

In a first research question, we investigate the impact of the supplier’s direct channel introduction on four measures of B2B performance (order value, variety of products ordered, number of units ordered per product, and wholesale price per unit ordered). In a second research question, we examine whether retailers differ in changes they implement in the order strategy. More specifically, we investigate whether relationship characteristics (total interdependence, dependence asymmetry, relationship quality, order history) and/or retailer characteristics (specialization, size) play a moderating role.

We investigate a natural experiment of a large German toy supplier who formerly relied on indirect multi-brand retailers only but now supplements this with an online webshop. We use 1) archival data on B2B orders, before and after the direct channel addition and 2) survey data collected from retailers before the channel addition. Data was collected in two countries where the channel was added (the treatment group) and one country where it was not added during our observation period (the control group).

We compare the difference in performance for retailers in the treatment group to the difference in performance in the control group using an after-minus-before analysis with control-group. We find that the introduction of the direct channel causes a decrease in order value, because retailers order a smaller variety from the focal supplier while they do not change the number of units ordered per SKU nor was the average wholesale price per unit ordered re-negotiated. Hence, the retailer reacts by ordering a lower diversity of items and thus potentially allocating less shelf space to the supplier. Results on across-retailer differences indicate that retailer reactions are moderated by B2B relationship characteristics prior to the direct channel addition (interdependence, dependence asymmetry, relationship quality) and retailer characteristics (retailer size). B2B performance decreases less for sizeable retailers, highly interdependent retailers, and retailers with a higher relationship quality. In contrast, we find larger B2B performance decreases for partners with a high dependence asymmetry (i.e., situations where there is a power imbalance between the partners).

Our research will provide guidance to better anticipate on the possible impact of a direct channel introduction on B2B performance. Moreover, it will help identify those partners who will likely react more (less) strongly to the act, and identify which order measures are changed for which type of retailer. Using these insights, suppliers can proactively develop plans to mitigate the impact on each performance measure, and allocate resources to prevent the possible repercussions to those retailers who will likely react the strongest.

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