MANAGING PRODUCT LINE MISMATCH WITH DISTRIBUTORS

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Most distributors of industrial and building products apply a single selling strategy to all of their products, despite the significant differences that may exist among them. At one extreme are commodity-oriented distributors who compete on the basis of price, and at the other extreme are distributors of specialty products who compete on the basis of service, quality, and inventory availability. Distributors usually structure their sales incentive plans, advertising and promotion efforts, delivery programs, and other customer service functions so as to support the type of products that dominate their mix.

For a variety of reasons, manufacturers must often work with distributors whose approach to the market is quite different from their own. In such cases, manufacturers should make a conscious effort to manage the conflicts that arise from the mismatch between their products' selling requirements and the dominant selling strategy of the distributor. Conflicts over pricing, inventory breadth and depth, and specification sales efforts are among the most common difficulties. Unless these conflicts are managed carefully by the manufacturer, they are likely to produce a state of constant tension with the distributor. This article provides

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guidelines for diagnosing product line mismatch and offers practical ideas for avoiding or minimizing conflict.

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Manufacturing firms that use independent distributors face many problems in aligning their marketing strategies with the strategies of their distributors. Obviously, manufacturers would prefer to deal only through distributors that fully understand and enthusiastically support the manufacturer's marketing strategy. Most manufacturers do not enjoy this ideal situation, however, and are therefore confronted with the problem of managing an imperfect match of strategies.

How Mismatches Arise

Many distributor networks develop in a fairly haphazard way, through a combination of opportunism, implementation of strategies long since abandoned, reaction to competitive situations, and other factors unrelated to the manufacturer's current strategic direction. Marketing managers are therefore often confronted with situations not of their own making which, nevertheless, must be managed. Two of the most common sources of imperfect matches in marketing approach are acquisitions and weak market position.

Acquisitions

Many companies inherit distribution systems from firms they acquire, and they are faced with integrating a distributor network that may not be strategically aligned with the goals of the acquiring firm. There are many reasons why a firm would acquire a company whose distributor network is not perfectly compatible with its own strategy:

- The need for manufacturing capacity
- The desire to gain market share in nondistributor markets (i.e., OEM segments)
- The need to forestall a competitor from acquiring the target firm and thereby gaining a significant advantage
- The belief that major parts of the acquired distribution system can, over time, be brought into strategic alignment with the acquiring firm

Indeed, to the extent that firms identify potential acquisitions by looking for complementary rather than overlapping distribution networks, it is almost inevitable that this mismatch will occur to some degree.

Weak Market Position

The market leaders in each industry are the manufacturers most likely to attract solid distributors whose existing strategy is consistent with the manufacturer's own. Therefore, smaller competitors in the industry must often build relationships and grow through distributors whose strategic goals may not coincide with their own. The marketing problems of such companies are very different from the problems faced by a market leader, which can pick and choose its distributors on the basis of strategic compatibility.

Product Line Mismatch

While there are many ways in which a manufacturer's distribution system may be misaligned with its strategy, this article focuses on a common, but poorly misunderstood, reason for underperformance by distributors: a mismatch between the distributor's product mix and the selling requirements of the manufacturer's product line. This mismatch can cause severe conflicts even when both distributor and manufacturer are reputable, financially stable, and highly professional companies, and even in the absence of the more obvious sources of conflict, such as disputes over credit terms, the handling of direct accounts, and policies regarding returned goods and freight allowances. Effective management of product line mismatch conflicts requires an understanding of the factors determining a distributor's approach to its market.

Factors Affecting Distributors' Selling Strategy

Just as manufacturers differ from one another in the breadth of their product lines and the emphasis they place on different product and company attributes (e.g., price, quality, service, product differentiation), distributors also differ from one another in size, in the types of customers they service, and in the mix of product lines they carry. These differences have important implications for marketing managers.

Size

A distributor's size can have a significant impact on the types of manufacturer support programs it is likely to use and, therefore, on the effectiveness of marketing dollars invested in these programs by the manufacturer. Large distributors make heavy use of training programs, sales leads, and incentive programs, while smaller distributors are more interested in concessions on minimum order quantities, credit, and expedited shipments.[2] Size also affects the selling and administrative resources a distributor has available to apply to a given product line and, therefore, the distributor's flexibility to adapt to products with different selling requirements.

Customer Base

A distributor's customer base also has a major impact on its ability to represent a given product line. When the distributor's existing customer base overlaps the user base of the manufacturer's product, the distributor can gain sales without calling on an entirely new group of customers.[1]

Product Mix

Along with size and customer base, the distributor's product mix has a major impact on its selling strategy and on its effectiveness in representing a manufacturer's product line. Some distributors' product mix is dominated by undifferentiated, commodity-like products, while others carry more specialized and differentiated product lines. While most distributors have both types of product lines in their mix, their overall approach to the market is usually dominated by one or the other.

To facilitate comparison, Table 1 contrasts the inventory policy, customer base, and selling strategy of a typical commodity-oriented distributor with those of a specialty distributor.

Most Distributors Use a Single Selling Strategy

As Table 1 indicates, the differences between commodity and specialty distributors are significant. Taken together, these differences often represent fundamentally different approaches to the market. Few distributors have the resources or the marketing sophistication to adapt their selling strategies to conform to the requirements of each product line they carry, and in many instances such adaptation would be wholly impracticable. Intentionally or unintentionally, most distributors apply a common selling strategy to all of the products they carry.

Specialty distributors tend to concentrate their selling efforts on small and medium-sized purchasers within a fairly compact geographic area. They rely on frequent deliveries to maintain customer loyalty, and they recover their high cost of servicing these accounts through high selling prices. The focus on small and medium-sized accounts is not necessarily voluntary: for many specialty product lines, the number of high-volume users is very small and these large customers are often handled directly by the manufacturer.

Commodity-oriented distributors, on the other hand, target a broader geographic area, "high-spotting" volume accounts and bypassing the smaller customers, who are expensive to service. These smaller users often fill their requirements essentially at the retail level or at a semi-retail level such as through "stocking dealers." These are often big customers of the larger distributor who carry a small inventory above their internal requirements and charge a premium to nearby small or occasional users. Commodity-oriented distributors typically rely on price as a principal selling tool, compensating for lower gross margins partly by controlling selling costs and partly by achieving higher inventory turnover than their more specialized counterparts.

Product Line Mismatch Causes Conflict

When a product's attributes conflict with the distributor's selling strategy and market orientation, conflict arises. Figure 1 illustrates the problem in a general way.

As Figure 1 indicates, the area of compatibility is broadest when both manufacturer and distributor are in the middle range of the spectrum between commodity and specialty orientation. This is so because a manufacturer whose product line is specialized, but also has some attributes of a commodity (perhaps a certain segment of the line is much more price-sensitive than another, for example) is likely to understand the dynamics of commodity selling and the pressures that affect a distributor of commodity products. Similarly, a distributor whose product line contains some successful specialty products is likely to understand the pricing and product line management imperatives of a producer of specialty products.

On the other hand, a distributor whose orientation is completely dominated by commodity products is likely to have little tolerance for the requirements of a specialty product and will probably view the manufacturer as slow-moving, obsessed with seemingly insignificant changes in the product line, and inexplicably devoted to "unnecessary overhead" such as advertising, specification sales efforts, and fancy product literature. A manufacturer of commodity products attempting to distribute through a specialty-oriented distributor will

Table 1
Attributes of Commodity vs. Specialty Distributors

	Commodity Distributor	Specialty Distributor
Inventory		
Breadth of Inventory	Few SKUs	Many SKUs
Inventory Policy	Narrow and deep	Broad and shallow
Inventory Turns	High	Low
Policy on Off-Grade Goods	Sell at discount	Return to manufacturer
Customer Base		
Number of Customers	Low to medium	Medium to high
Order Frequency per Customer	Medium to high	Low to medium
Line Items per order	Low	Medium to high
Average Order Size	Medium to high	Low to medium
Order-Processing Cost	Low	High
Selling Strategy		
Basis of Commission Plan	Sales volume	Gross margin
Basic Sales Approach	Price	Availability, variety, service, value
Use of Rebate Programs	High	Low
Use of Merchandising Aids	Low	High
Perceived Need for Technical from Manufacturer	Low	High

have similar feelings: the distributor is a "margin hog," never uses the rebate matrix, is not aggressive in pursuing sales, and spends too much time on small accounts which will never produce significant sales volume.

The problems that can arise from these issues are as serious as the more widely understood disputes over credit, freight, and so forth. To illustrate how serious the problems can become, we will consider the case of Ajax Distributors and Bravo Manufacturing Corporation.

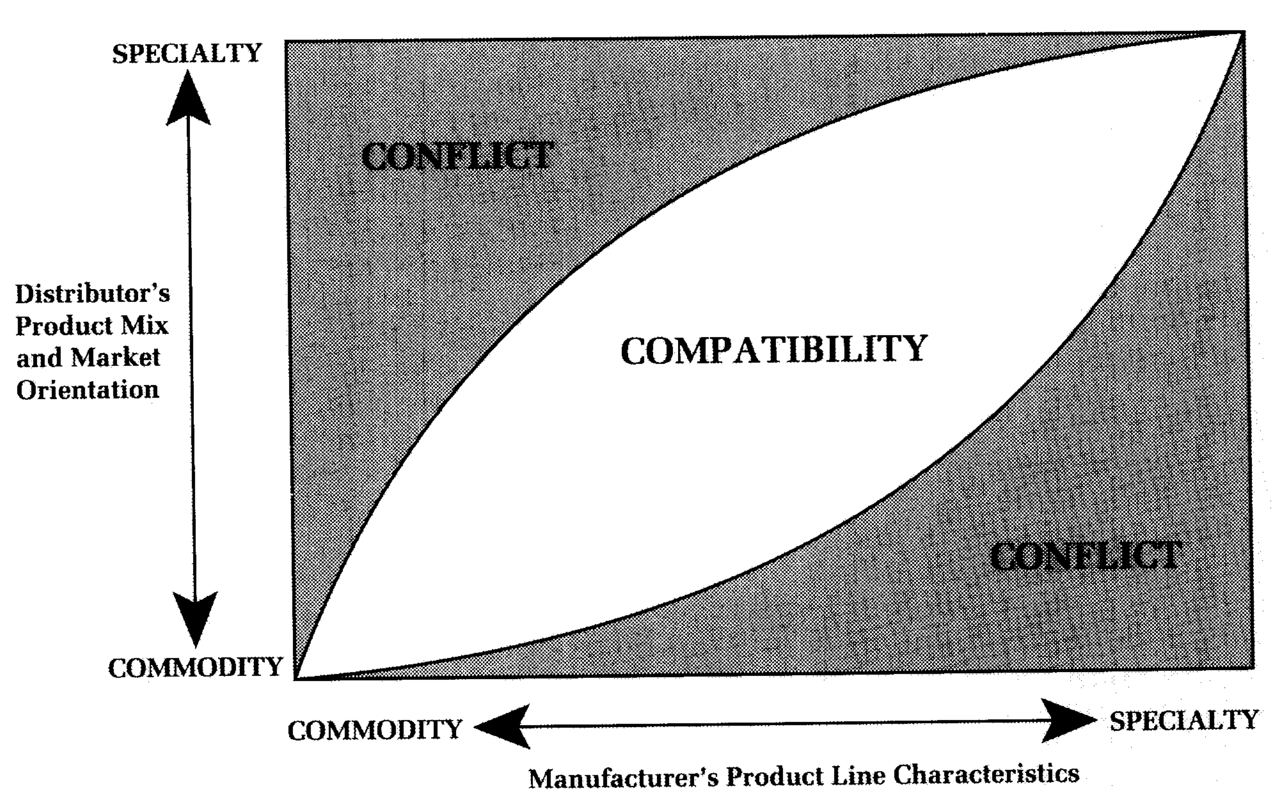
Ajax Distributors and Bravo Manufacturing Corporation

Courtship and Honeymoon

Ajax Distributors, a well-established and financially sound distributor of building products, has historically focused on high-volume, fairly undifferentiated products. Ajax's salespeople are paid commissions based on sales volume, and its inventory consists of a small number of items in large quantities. Inventory turnover is critical because gross margins are thin. Ajax's suppliers have tight credit policies, typically net ten days, and little patience with overdue accounts. Ajax has historically had an excellent payment record.

Bravo Manufacturing Corporation's product line is broad and highly differentiated, While it is not the market share leader in its industry, its product is well regarded and the company is known for its responsiveness to customer requirements. Bravo has a sales force devoted to servicing distributors, and a smaller, separate sales force dedicated to gaining specifications for Bravo's products. Specifiers are

Figure 1
Conflict and Compatibility Between Manufacturers and Distributors



concentrated in certain large markets, and specifications frequently result in sales in markets far distant from the specifier. A design firm in Chicago, for example, might specify Bravo products for projects in Oklahoma City and Phoenix.

Ajax welcomes the Bravo product line because of its high gross margins, averaging 35 percent in comparison to 21 percent for Ajax's existing lines, and because of the extensive advertising and promotional support Bravo provides. For its part, Bravo is pleased by Ajax's reputation, market coverage, and sound financial condition.

Some conflicts may be so severe that termination of the relationship is the best solution.

Although Ajax is initially shocked by Bravo's proposed stocking order (150 products in three grades and five sizes each, or 2,250 stock-keeping units), these concerns are assuaged by Bravo's agreement to provide generous payment terms on the opening order, to share the cost of the storage racks required to store the product, and to offer Ajax a one-time inventory swap of unsold material after six months.

So far, so good. The initial order is shipped, Bravo's regional sales manager holds a two-day training seminar to acquaint Ajax's fifteen salespeople with the product line, and a one-week sales blitz coincides with the introduction of the product.

Pricing and Inventory Disputes

An Ajax salesperson identifies a high-volume purchaser of Bravo-type products currently buying direct from a competing manufacturer at a price 30 percent below Ajax's quoted price. The salesperson insists that Ajax could get the business if it could meet the price. The requirement is for two items in one size and one grade, with a regular order pattern and few, if any customer, returns. Ajax approaches Bravo's sales manager looking for a price reduction on these two items and is turned down. Bravo has considered quoting this account on a direct basis in the past, but believes that the pricing is too low and that the account doesn't value Bravo's reputation for quality.

Ajax is getting concerned about inventory turns. Of the 2,250 SKUs (Stock Keeping Units) it agreed to stock, 1,100 have no sales at all after two months. Ajax wants to accelerate the inventory swap-out agreement and exchange everything that hasn't moved for an equivalent quantity in the SKUs that have generated sales. Bravo refuses, saying that slow inventory turnover on some items is compensated for by the higher gross margins, and adding that availability of slow-moving items is a key to retaining customers. Ajax disagrees and decides to run a price promotion to move the unsold items. Despite a 20 percent price reduction, the results are negligible. However, several of Ajax's large customers ask why they can't get the twenty percent reduction on the Bravo items they do buy. Ajax refuses to make this reduction but does agree to a 10 percent reduction on Bravo products to two large customers in return for their commitment to buy a higher percentage of their commodity products from Ajax.

The Specification that Went Sour

Bravo introduces ten new items into the product line, supported by nationwide advertising in the trade journals and a strong specification sales effort. Because the items are untested, Ajax refuses to put them in stock, despite Bravo's arguments. Six weeks later Ajax receives a very large order for one of the new items. This order has resulted from a specification gained by a Bravo salesperson in a major design center. While the order is large, a small amount of material will allow the customer to get the job started, as long as delivery of the remainder is prompt. Since Ajax has no material in stock, it agrees to pay the cost of air-freighting a small amount of material from Bravo's factory inventory. Bravo, in turn, agrees to expedite the production of the remaining requirement.

During this short delay, however, the customer has checked with another distributor carrying a competing line; doing this is permissible because the specification is an "or equal" rather than "exclusive." The customer doesn't want to switch the specification, because doing so would entail getting permission from *its* customer; however, the customer is impressed by the competing distributor's lower quote and points this out to Ajax. Already on the defensive because it initially had no material in stock, Ajax agrees to meet the lower price on the whole order and asks Bravo to provide a rebate which will preserve Ajax's margin.

Many distributor networks develop in a fairly haphazard way.

Bravo refuses to do this, citing the need to recover advertising and specification sales costs and pointing out that the problem would never have arisen if Ajax had stocked the new items in the first place. Irritated, Ajax responds that it is already stuck with 1,100 "dog" SKUs which were put in stock on Bravo's recommendation. In the end, Ajax fills the specification order at a very low gross margin and begins to wonder about the value of Bravo's extensive and costly specification effort. Ajax also wonders whether an across-the-board price reduction equivalent to the cost of the specification sales program might not be a more straightforward and effective way of increasing sales.

Divorce Proceedings

After six months, the relationship between Ajax and Bravo has deteriorated very badly. Ajax reviews the performance of the product-line against the projections made six months ago and concludes that it was sold a bill of goods. Nevertheless, Ajax feels that the Bravo line can still be a good one if it is managed properly. Accordingly, in taking advantage of the six-month inventory swap-out agreement, Ajax proposes to return to Bravo all inventory SKUs except the top thirty sellers and to receive in exchange an equivalent dollar value of inventory in these thirty items. Ajax's plan is to focus its sales efforts and inventory holdings on the items that are moving and to refer requests for the lower-volume SKUs to the manufacturer or to competitive distributors. Ajax further proposes that Bravo discontinue its local advertising efforts and its specification sales support and pass this cost reduction through to Ajax in the form of an across-the-board price reduction.

Bravo's managers are appalled by this proposal. Without a broad and representative inventory there will be no opportunity to develop specification sales or small accounts, and the line will be reduced to competing on price for large orders. Bravo is ill-positioned to do this, since it is not the low-cost producer. Similarly, eliminating advertising and reducing prices ignores Bravo's greatest strengths: the diversity and adaptability of its line, and its reputation for quality and service. In Bravo's view, the Ajax proposal would force it to abandon its strengths and deliberately cheapen its product.

At a "summit meeting" between the owner of Ajax and Bravo's Vice-President of Sales, the two companies try to thrash out all the issues and come to an agreement about how to proceed. Ajax is by now convinced that it doesn't need 2,250 SKUs; it might accept one hundred rather than thirty, but it refuses to carry items that turn over so much more slowly than the rest of its products. Ajax is convinced that the Bravo line is overpriced, but as a compromise it is willing to accept a price reduction which applies only to the ten highest-volume items. Ajax understands that Bravo's product line is more specialized than its other lines, but its customers are saying that Bravo's price is too high. Ajax adds that it has received overtures from a foreign supplier of Bravo-type products, whose line is much narrower than Bravo's and who will ship only in container-load quantities, but whose pricing is much lower.

Bravo's Vice-President of Sales is in a difficult situation. By all of the usual measures, Ajax is the best distributor Bravo has signed up all year: financially strong, lots of salespeople, good reputation. Yet agreeing to the proposals made by Ajax's owner will make it impossible to market the Bravo product line the way it should be marketed.

Diagnosing a Mismatch

What went wrong? In the six months of their relationship, Bravo never shipped an order late and never balked at replacing defective material. Ajax paid its bills on time, overcame its reservations about the initial stocking order, and developed sales opportunities which it felt were reasonable and should have been pursued. The two companies never disagreed over credit, freight allowance policy, or returned goods policy. Yet their attempt to work together failed, and the failure probably damaged both companies' reputation in the marketplace. A more detailed comparison of Ajax's existing product lines and the Bravo product line before the relationship was initiated would have revealed significant differences in selling requirements and customer preferences. In theory, if these differences were severe enough, both companies should have backed away from the proposed partnership.

Yet in the real world it is seldom possible to take such a purist stance. For a company like Bravo—which is not the market share leader nor the low-cost producer, but rather a quality and service-oriented company with a medium market share—Ajax could very well have been the best opportunity to penetrate the local market. And for a distributor like Ajax, with a solid reputation in commodity products but little experience in specialty goods, the Bravo line offered significant profit opportunities.

Warning signs of conflict emerged fairly early in the relationship. Because neither party consciously attempted to manage the conflict, it led to a difficult and expensive separation. Table 2 lists some typical warning signs of product line mismatch.

Managerial Implications and Recommendations

Few manufacturers can afford to discontinue their relationships with reputable, financially sound distributors simply because of disagreements over priorities and selling approaches. After all, marketing managers are expected to overcome the problems arising from these disagreements, not simply to point them out.

Table 2
Signs of a Mismatch

Commodity Distributor Selling a Specialty Products	Specialty Distributor Selling Commodity Products
1. Wants big price breaks on high-volume items.	1. Wants more sales support from the manufacturer.
2. Thinks the product line is too broad.	2. Thinks the product line needs more variety and distinctiveness.
3. Won't stock low-volume items.	3. Always running out of high-volume items.
4. Focuses sales efforts on large customers; doesn't follow up on smaller opportunities.	4. Tries to convince customer that the product is different from competing products and deserves a price premium.
5. Salespeople think product is too time-intensive to sell.	5. Salespeople think they have nothing to sell with.

The following recommendations may assist manufacturers in improving their management of imperfect distributor match without sacrificing their strategic marketing thrust.

Evaluate Distributors for Product Line Compatibility

Whether reviewing existing distributor performance or planning for the recruitment of new distributors, managers should clearly understand the influence of a distributor's existing product mix on its selling strategy. Some conflicts may be so severe that termination of the relationship is the best solution. If the relationship is determined to be worth preserving, however, managers should consciously identify compromises which can be made to minimize conflict without abandoning their basic marketing strategy.

Be Flexible on Inventory

Don't be dogmatic about initial stocking orders. If the distributor is highly sensitive to inventory turns (as was Ajax) consider a phase-in of inventory. For example, the initial stocking inventory might have been 1,000 SKUs instead of 2,200, with Bravo agreeing to expedite shipments of the nonstocked items from factory inventory for a period of six months. This arrangement would have given Ajax time to see for itself the "lumpy" demand for low-volume SKUs which is caused by specifications, and the importance of avoiding competitive encroachments on specifications by having a "tripwire" inventory large enough to get the customer's job started.

When Ajax proposed to reduce its inventory to thirty or one hundred SKUs from 2,200, it was applying the selling strategy of its other product lines to the Bravo line. Yet it might never have reached this drastic conclusion if its initial experience with inventory turns had been closer to what it was used to.

Spread out Sales Blitzes and Training

A series of one-day mini-blitzes instead of one huge opening blitz would have lessened the disruption to the Ajax sales force. Similarly, the training provided by Bravo to the Ajax salespeople might have been split into two shorter sessions: one prior to the product introduction to provide a basis of product knowledge, and another three months later to address questions that have arisen during the salespeople's initial experience with the product. All salespeople resist activities that reduce their customer contact time, and spreading out the activities reduces the resistance.

Use Pricing Flexibility to Make a Point

On the specification that went sour, Bravo could have partially rebated Ajax and followed up with a meeting to explain the dynamics of specifications and the margin opportunity that exists if inventory is in place. Commodity distributors have pricing strategies that are notoriously difficult to change. The recent case of Quaker State Motor Oil, which attempted to shift its pricing strategy without first enlisting the agreement and support of its distributors and thereby lost significant volume, illustrates the dangers of ignoring distributors' ingrained pricing attitudes.[3]

Encourage and Support an In-house Product Specialist

Ajax needs a product specialist focusing on the Bravo line. Bravo should consider co-paying for this position and assigning a technical support person or a specification representative to work directly and regularly with the product specialist. The product specialist could perform two critical functions: become the in-house Ajax expert on the Bravo product, and actively pursue the development of small accounts which are not initially attractive to other salespeople. A commission plan based on total Ajax sales of Bravo products would be a desirable refinement of this measure.

Propose a Margin-Based Commission Plan

Because the Bravo product line is more selling-intensive and relationship-intensive than most of Ajax's products, Ajax's salespeople have little financial incentive to take time away from products they were familiar with to concentrate on the Bravo line. A commission plan based on gross margin rather than sales volume would have provided immediate reinforcement of the value of the Bravo line. Distributors often resist such proposals because of the perceived complexity of adding a second commission plan, and in many cases because distributors' sales reporting systems are not sophisticated enough to distinguish gross margin by product line. A manufacturer can minimize this resistance by offering the distributor a specific proposal rather than making the general recommendation, and by offering its salesperson's assistance in showing the distributor's personnel how to collect the necessary information and calculate the commissions.

Conclusion

Most manufacturers do not have the luxury of a distributor network that sells their products exclusively, nor can most distributors survive by selling a single product line. Both parties are therefore confronted with conflicts arising from mismatch between the distributor's sales orientation and the characteristics of the manufacturer's product. These conflicts can best be managed if they are recognized for what they are and dealt with directly.

End Notes

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