



JOURNAL OF THE INSTITUTE FOR OPERATIONS RESEARCH AND THE MANAGEMENT SCIENCES

MARKETING SCIENCE

Volume:

Number:

Year:

Title:

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Marketing Science Homepage

<http://bear.cba.ufl.edu/centers/MKS>

Mail versus Mall: A Strategic Analysis of Competition between Direct Marketers and Conventional Retailers

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Abstract

Consumers now purchase several offerings from direct sellers, including catalog and Internet marketers. These direct channels exist in parallel with the conventional retail stores. The availability of multiple channels has significant implications for the performance of consumer markets. The literature in marketing and economics has, however, been dominated by a focus on the conventional retail sector. This paper is an effort toward modeling competition in the multiple-channel environment from a strategic viewpoint.

At the outset, a parsimonious model that accommodates the following consumer and market characteristics is introduced. First, the relative attractiveness of retail shopping varies across consumers. Second, the fit with the direct channel varies across product categories. Third, the strength of existing retail presence in local markets moderates competition. Fourth, in contrast with the fixed location of the retail store that anchors its localized market power, the location of the direct marketer is irrelevant to the competitive outcome.

The model is first applied in a setting where consumers have complete knowledge of product availability and prices in all channels. In the resulting equilibrium, the direct marketer acts as a competitive wedge between retail stores. The direct presence is so strong that each retailer competes against the remotely located direct marketer, rather than against neighboring retailers. This outcome has implications for the marketing mix of retailers, which has traditionally been tuned to attract consumers choosing between retail stores. In the context of market entry, conditions under which a direct channel can access a local market in retail entry equilibrium are derived. Our analysis suggests that the traditional focus on retail entry equilibria may not yield informative or relevant findings when direct channels are a strong presence.

Next, the role of information in multiple-channel markets is modeled. This issue is particularly relevant in the context of direct marketing where the seller can typically control the level of information in the marketplace, sometimes on a customer-by-customer basis (e.g., by deciding on the mailing list for a catalog campaign). When a certain fraction of consumers does not receive information from the direct marketer, the retailers compete with each other for that fraction of the market. The retailer's marketing mix has to be tuned,

in this case, to jointly address direct and neighboring retail competition.

The level of information disseminated by the direct marketer is shown to have strategic implications, and the use of market coverage as a lever to control competition is described. Even with zero information costs, providing information to all consumers may not be optimal under some circumstances. In particular, when the product is not well adapted to the direct channel, the level of market information about the direct option should ideally be lowered. The only way to compete with retailers on a larger scale with a poorly adapted product is by lowering direct prices, which lowers profits. Lowering market information levels and allowing retailers to compete more with each other facilitates a higher equilibrium retail price. In turn, this allows a higher direct price to be charged and improves overall direct profit. On the other hand, when the product is well adapted, increasing direct market presence and engaging in greater competition with the retail sector yields higher returns.

The finding that high market coverage may depress profits raises some issues for further exploration. First, implementing the optimal coverage is straightforward when the seller controls the information mechanism, as in the case of catalog marketing. The Internet, in contrast, is an efficient mechanism to transmit information, but does not provide the sellers with such control over the level of market information. A key reason is that the initiative to gather information on the Internet lies largely with consumers. The design and implementation of mechanisms to control aggregate information levels in electronic markets can, therefore, be an important theme for research and managerial interest. Second, direct marketers have traditionally relied on the statistical analysis of customer records to decide on contact policies. The analysis in this paper reveals that these policies can have significant strategic implications as well. Research that integrates the statistical and strategic aspects could make a valuable contribution.

The paper concludes with a discussion of issues for future research in multiple-channel markets, including avenues to model competition in settings with multiple direct marketers.

(Channels of Distribution; Catalog Marketing; Direct Marketing; Electronic Marketing; Internet Marketing; Competitive Strategy; Game Theory)