

Commentary

Managing Channel Profits

Abel P. Jeuland

Graduate School of Business, University of Chicago, Chicago, Illinois 60637, abel.jeuland@chicagogsb.edu

Steven M. Shugan

Warrington College of Business, University of Florida, Gainesville, Florida 32611, steven.shugan@cba.ufl.edu

Channel coordination and, more generally, coordination of activities between interdependent economic agents is even more important today than when the paper was published more than 20 years ago. One reason is the trend toward globalization and outsourcing caused, in part, by the development of increasingly complex products and services that integrate many different competencies. Coordination today involves all the aspects of the marketing mix: product design coordination, price and service coordination (the focus of “Managing Channel Profits”), coordination of availability in highly hybrid distribution systems to better reach an increasingly complex and fragmented market, and coordination of communication with the target market. “Managing Channel Profits” argues a tendency toward a lack of coordination without explicit institutional arrangements and coordination mechanisms such as quantity discounts and contracts to solve the problem. The price and service coordination ideas of “Managing Channel Profits” have been successfully applied for 25 years of developments in marketing of revenue- and cost-sharing arrangements between increasingly interdependent market participants.

Key words: coordination; cost sharing; revenue sharing; distribution channels; supply chain management; pricing; channel strategy

The Genesis of Managing Channel Profits

It is great to be bronze medalists in the Marketing Science Olympics of that important period when *Marketing Science* was a nascent journal! *Marketing Science* changed the course of our profession. By allowing pioneering quantitative research, it set the stage for a revolution that continues today. Research in marketing has reached new heights, and the best is yet to come. By publishing pioneering research, *Marketing Science* allows dissemination of innovative and often controversial research.

Among the visionary founders of *Marketing Science* are John Little and Frank Bass, who deserve acclamation for both founding the journal and for their enormous contribution to the *Marketing Science* literature. Another person deserving of praise is Subrata Sen, who published all of the articles in this issue. Subrata had a keen sense of what makes a paper important. He assigned Abel Jeuland as the area editor for Dick Thaler’s paper on “Mental Accounting.” *Marketing Science* greatly benefited from Subrata’s encouragement of submission of papers like Dick’s.

We (Abel and Steve) will be forever grateful to each other for being able to brainstorm in Chicago these

ideas about channels of distribution. In the 1980s, little research was being done by quantitative marketing researchers in marketing in the field of distribution. We are most happy to have contributed to the renewed interest in channels of distribution, a contribution that we should share with Rick Staelin and Tim McGuire (McGuire and Staelin 1983), and also Erin Anderson (1985), all of whom make the list of “classics.” In addition, we offer encouragement to those working in new areas, who suffer the poor attendance at the last sessions on new topics at the Marketing Science Conference.

The Critical Ideas

What stands out to us about “Managing Channel Profits” is how lucky we were to stumble onto an important idea that remains so true 20+ years later. The idea is now so obvious: It is that channel members are in a situation of mutual dependency and that these relationships should be managed well and nurtured; hence, the idea of channel cooperation and coordination. Multiple tools are available to channel members to share in the benefits but also the costs of doing business, business in which members mutually depend on one another. Pricing and promotion in

particular often lead to complex institutional arrangements involving profit sharing. Quantity discounts, return policies, slotting allowances, and cooperative advertising are all examples of this sharing. Many other marketing mix tools can also be better understood in light of “Managing Channel Profits.” It is most rewarding to observe that the profession has recognized the power of these ideas. The vote of our profession is an ultimate endorsement of the quality and impact of the research.

Marketing, not unlike other professions, needs important ideas. Economics provides a great example of the power of ideas. Gene Fama, at Chicago, had the great insight of efficient markets. In free securities markets, biases (optimism or pessimism) work themselves out. Markets constantly process new information, taking into account knowledge and risk preferences of buyers and sellers. This leads to the idea of owning index funds that passively own broadly diversified stocks. Of course, markets are not perfect. Yet, Gene Fama singlehandedly changed the way we look at and practice investing today. He has yet to receive the Nobel Prize, however!

One Regret

One possible regret concerns material in our original working paper that we deleted from the published version at the reviewer’s request. That material involved the importance of coordinating nonpricing variables. As we emphasized later (e.g., Jeuland and Shugan 1988b), it is important to study symmetric channels where every channel member provides added value and has his or her own unique decisions to make. We will not complain about the many cites that we received on price coordination, but we do stress that coordination is not an activity coordinated by a manufacturer. Every channel member is important.

Academic Literature

We are pleased that our research inspired, in any small way, the many subsequent research studies on channel coordination. Beyond our own research in this area (Jeuland and Shugan 1983, 1988a, b; Shugan 1985), it is only possible to mention a few related *Marketing Science* articles in recent years. Caldieraro and Coughlan (2007) considered spiffs and channel coordination. Arya and Mittendorf (2006) considered channel coordination in durable goods markets with dynamic concerns (e.g., consumers waiting to buy and incentives to flood the market). Li (2005) considered the role of cheap talk in channel coordination. Raju and Zhang (2005) considered channel coordination with a dominant retailer. Shaffer and Zettelmeyer (2004) considered channel coordination with different types of advertising. Kuksov and Pazgal (2007)

considered the role of slotting allowances in channel coordination.

Beyond *Marketing Science*, the topic of managing channel profits that mentions our early work continues to grow with recent publications in many journals, including the *European Journal of Operational Research* (Sarmah et al. 2006), the *European Journal of Operational Research* (Zhou 2007), *Industrial Marketing Management* (Chen et al. 2006, Zerbini and Castaldo 2007), the *International Journal of Integrated Supply Management* (Joglekar et al. 2006), the *International Journal of Production Economics* (Xiao et al. 2007), the *Journal of Marketing Research* (Chu et al. 2007), the *Journal of Operational Research* (Lau et al. 2007), the *Journal of Operations Management* (Barratt and Oke 2007), the *Journal of Optimization Theory and Applications* (He et al. 2006), the *Journal of Production Economics* (Qin et al. 2007), the *Journal of Retailing* (Dong et al. 2007), *Management Science* (Ghosh and Balachander 2007), *Marketing Science* (Moorthy 2005), *Production and Operations Management* (Cattani et al. 2006), *Quantitative Marketing and Economics* (Bhardwaj and Balasubramanian 2005), and *Systems Engineering Society of China* (Xu et al. 2003)

We are very proud to have contributed in a small way to making channels of distribution one of the most active areas of research in marketing today. Theoretical work abounds using the powerful methodology of equilibrium analysis, but empirical work is increasing as well. The past 20 years in channels research have been a wonderful intellectual voyage.

References

- Anderson, E. 1985. The salesperson as outside agent or employee: A transaction cost analysis. *Marketing Sci.* 4(3) 234–254.
- Arya, A., B. Mittendorf. 2006. Benefits of channel discord in the sale of durable goods. *Marketing Sci.* 25(1) 91–96.
- Barratt, M., A. Oke. 2007. Antecedents of supply chain visibility in retail supply chains: A resource-based theory perspective. *J. Oper. Management* 25(6) 1217–1233.
- Bhardwaj, P., S. Balasubramanian. 2005. Managing channel profits: The role of managerial incentives. *Quant. Marketing Econom.* 3(3) 247–279.
- Caldieraro, F., A. T. Coughlan. 2007. Spiffed-up channels: The role of spiffs in hierarchical selling organizations. *Marketing Sci.* 26(1) 31–51.
- Cattani, K., W. Gilland, H. S. Heese, J. Swaminathan. 2006. Boiling frogs: Pricing strategies for a manufacturer adding a direct channel that competes with the traditional channel. *Production Oper. Management* 15(1) 40–56.
- Chen, M.-S., H.-J. Chang, C.-W. Huang, C.-N. Liao. 2006. Channel coordination and transaction cost: A game-theoretic analysis. *Indust. Marketing Management* 35(2) 178–190.
- Chu, J., P. K. Chintagunta, N. J. Vilcassim. 2007. Assessing the economic value of distribution channels: An application to the personal computer industry. *J. Marketing Res.* 44(1) 29–41.
- Dong, Y., V. Shankar, M. Dresner. 2007. Efficient replenishment in the distribution channel. *J. Retailing* 83(3) 253–278.

- Ghosh, B., S. Balachander. 2007. Competitive bundling and counterbundling with generalist and specialist firms. *Management Sci.* **53**(1) 159–168.
- He, J., K. S. Chin, J. B. Yang, D. L. Zhu. 2006. Return policy model of supply chain management for single-period products. *J. Optim. Theory Appl.* **129**(2) 293–308.
- Jeuland, A., S. Shugan. 1983. Coordination in marketing channels. D. A. Gautschi, ed. *Productivity and Efficiency in Distribution*. North Holland, New York, 17–32.
- Jeuland, A., S. Shugan. 1988a. Channel of distribution profits when channel members form conjectures. *Marketing Sci.* **7**(2) 202–210.
- Jeuland, A., S. Shugan. 1988b. Reply to: Managing channel profits: Comment. *Marketing Sci.* **7**(1) 103–106.
- Joglekar, P., M. Tavana, J. Rappaport. 2006. A comprehensive set of models of intra- and inter-organisational coordination for marketing and inventory decisions in a supply chain. *Internat. J. Integrated Supply Management* **2**(3) 251–284.
- Kuksov, D., A. Pazgal. 2007. The effects of costs and competition on slotting allowances. *Marketing Sci.* **26**(2) 259–267.
- Lau, A. H. L., H.-S. Lau, J.-C. Wang. 2007. Pricing and volume discounting for a dominant retailer with uncertain manufacturing cost information. *J. Oper. Res.* **183**(2) 848–870.
- Li, X. 2005. Cheap talk and bogus network externalities in the emerging technology market. *Marketing Sci.* **24**(4) 531–543.
- McGuire, T., R. Staelin. 1983. A industry equilibrium analysis of downstream vertical integration. *Marketing Sci.* **2**(2) 161–191.
- Moorthy, S. 2005. A general theory of pass-through in channels with category management and retail competition. *Marketing Sci.* **24**(1) 110–122.
- Qin, Y., H. Tang, C. Guo. 2007. Channel coordination and volume discounts with price-sensitive demand international. *Internat. J. Production Econom.* **105**(1) 43–53.
- Raju, J., Z. J. Zhang. 2005. Channel coordination in the presence of a dominant retailer. *Marketing Sci.* **24**(2) 254–262.
- Sarmah, S. P., D. Acharya, S. K. Goyal. 2006. Buyer vendor coordination models in supply chain management. *Eur. J. Oper. Res.* **175**(1) 1–15.
- Shaffer, G., F. Zettelmeyer. 2004. Advertising in a distribution channel. *Marketing Sci.* **23**(4) 619–628.
- Shugan, S. 1985. Implicit understandings in channels of distribution. *Management Sci.* **31**(4) 435–460.
- Xiao, T., X. Qi, G. Yu. 2007. Coordination of supply chain after demand disruptions when retailers compete. *Internat. J. Production Econom.* **109**(1-2) 162–179.
- Xu, M., X. Qi, G. Yu, H. Zhang, C. Gao. 2003. The demand disruption management problem for a supply chain system with nonlinear demand functions. *Systems Engrg. Soc. China* **12**(1) 82–97.
- Zerbini, F., S. Castaldo. 2007. Stay in or get out the Janus? The maintenance of multiplex relationships between buyers and sellers. *Indust. Marketing Management* **36**(7) 941–954.
- Zhou, Y.-W. 2007. A comparison of different quantity discount pricing policies in a two-echelon channel with stochastic and asymmetric demand information. *Eur. J. Oper. Res.* **181**(2) 686–703.