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IMPROVING MANUFACTURER-DEALER RELATIONS IN THE OFFICE FURNITURE INDUSTRY

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FOR DISCUSSION PURPOSES ONLY

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As a result of research undertaken to forecast the future of the office furniture industry, a unique opportunity was presented to investigate the state of current trade channel relationships and the identification of the trends likely to impinge on these relationships in the future.[1] Three key questions were considered in the trade relations part of the study: (1) What is the extent of conflict in the channels at present, (2) What are the principal causes of the conflict, and (3) What actions can be taken to lessen conflict and to increase the willingness and ability of resellers to perform their tasks?

Data upon which this article is based were collected during the last half of 1982 and the first half of 1983 by means of mail responses from two Delphi[2] panels; one composed of 88 dealers, 12 wholesalers, and 15 manufacturer representatives, and the other composed of 48 manufacturers. In addition, 35 personal interviews were held with executives representing all levels in the channels.

Findings

The trade channels which distribute office furniture from points of manufacture to points of consumption are for the most part quite traditional in design and mode of operation. The dominant channel in terms of dollar

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[1] The Future of the Office Furniture Industry, C. Merle Crawford, Martin R. Warshaw and Robert M. Tank. Alexandria: National Office Products Association, 1983.

[2] Delphi is a systematic, iterative survey method for forecasting based on independent inputs from a group of experts.

volume is the manufacturer-dealer channel. In 1982, 73 percent of the $4 billion of manufacturers' domestic shipments of office furniture moved through dealers to end users. The second most important channel is manufacturer direct to end users which in 1982 accounted for 23 percent of total sales. A wide variety of resellers, including wholesalers, mass merchandisers, architects, designers, and independent specifiers, accounted for the remaining 4 percent of sales volume.

The dealer channel share of the market has declined over the past five years and is forecasted to continue to decline through 1988 as seen in Figure 1. Dealer loss of share over time is explained by two trends. First, large buyers of systems furniture are increasingly dealing directly with manufacturers, direct selling manufacturer reps, or wholesalers. Second, new types of distributive alternatives (limited function dealers, catalog sellers, architects, designers, and specifiers) have evolved and are competing with the traditional dealer.

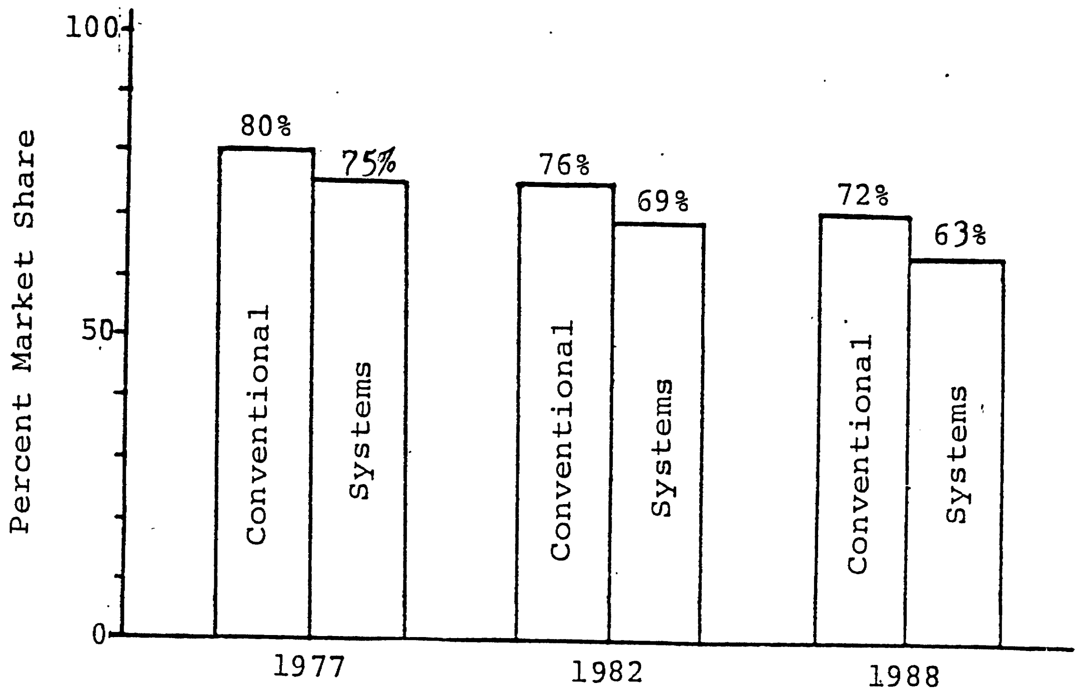
As a growing number of manufacturers deal directly with customers the risk of higher levels of interchannel conflict increases. Because the manufacturer direct and the dealer channel rarely serve segments of the market on an exclusive basis, friction between the manufacturer and the dealer is unavoidable. Dealers can usually rationalize competition from other dealers in their market areas or even competition from nontraditional sellers. It is very difficult for them, however, to face competition from the same manufacturers whom they are attempting to serve.

Manufacturer-Dealer Relations

Delphi data as illustrated in Figure 2 indicate that 88 percent of responding dealers and all of the responding manufacturers perceived minimal to moderate levels of conflict in their channel. Only 12 percent of

Figure 1

Dealer Share of Office Furniture Sales
1977-88



Source: The Future of the Office Furniture Industry, op. cit. p. 135.

responding resellers believed that channel conflict was substantial. Field interview data support these findings. Frictions are present but in most cases do not exceed moderate levels. As one dealer noted:

> Channel relations in this industry are moderately good. They are better than one might find in other industries but they could deteriorate fast if certain practices continue such as manufacturers giving their lines to specifiers who then sell directly to the end user.

As seen in Figure 3, direct selling activities by manufacturers, manufacturer reps, and wholesalers are the major sources of conflict in the manufacturer-dealer channel. A secondary source of friction is manufacturer enfranchisement of nondealer resellers, especially architect/designers or independent specifiers. The third major area which causes channel friction is the nature of the functional and compensatory split between dealers and manufacturers in negotiated contract sales. Dealers complain that manufacturers do not adequately compensate them for the portion of the marketing job they are expected to perform.

The study upon which this article is based predicts that the share of office furniture sales going through the manufacturer-dealer channel will decrease moderately from 73 percent in 1983 to 68 percent in 1988.[3] Market shares accounted for by the direct channel as well as the nondealer channels will increase. Such changes in patterns of distribution, even though modest, will raise the level of friction between manufacturers and dealers unless adaptive action is taken.

Motives for Direct Sale

The principal motive for manufacturers' increased use of direct sale or for the franchising of nondealer resellers is to gain access to the market. Four trends have made it increasingly difficult for manufacturers to gain

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[3] Op. cit. p. 132.

Figure 2

Delphi Panel Responses

Trade Channel Relations Questions

Percent of Responses

Based on your experience, please assess the level of trade channel conflict for as many of the channel relationships listed below that you feel competent to assess.

(R = Resellers, n = 115   M = Manufacturers, n = 48)

	Minimal Conflict		Moderate Conflict		Substantial Conflict	
CHANNEL RELATIONSHIPS	R	M	R	M	R	M
Dealer-Manufacturer	44	57	44	43	12	0
Dealer-Manufacturer's Rep	53	52	34	36	13	12
Dealer-Wholesaler	65	43	27	50	8	7
Manufacturer-Wholesaler	47	64	43	31	10	5
Dealer-Architect/Designer	19	16	43	44	38	40
Dealer-Independent Specifier	16	16	44	54	40	30
Manufacturer-Arch./Designer	49	58	40	35	11	8

Source: The Future of the Office Furniture Industry, op. cit. pps. 43b, 64b.

Figure 3

Delphi Panel Responses
Trade Channel Relations Question
Percent of Responses

R = Resellers' Responses (n = 115)

M = Manufacturers' Responses (n = 48)

Based on your experience, please indicate the extent to which each of the following is beneficial or detrimental to trade channel relationships.

A = Very Beneficial
B = Moderately Beneficial
C = Neutral
D = Moderately Detrimental
E = Very Detrimental

	A		B		C		D		E	
	R	M	R	M	R	M	R	M	R	M
DIRECT SELLING BY										
Manufacturers	1	0	2	7	0	7	15	24	82	62
Wholesalers	0	0	1	0	2	7	6	32	82	62
Mfrs.' Reps	0	0	2	5	0	7	7	21	91	67
Arch/Designers	0	2	4	5	8	8	42	41	46	44
MANUFACTURER POLICIES RE										
Billing	2	7	7	12	60	60	24	21	7	0
Pricing	5	2	16	27	54	55	21	16	4	0
Returned Goods	3	4	9	29	47	38	36	29	5	0
Inventory	9	10	25	50	34	21	28	19	4	0
Promotion	12	33	40	47	31	18	11	2	6	0
Product	10	16	31	60	50	22	8	2	1	0
Franchising	20	12	18	28	25	35	32	23		
Communications with dealers	31	35	22	41	19	7	24	15	4	2
Supervision of independent reps	15	16	22	35	30	26	25	16	8	7
Supervision of own salesforce	20	48	36	33	24	14	15	5	5	0
DEALER POLICIES RE										
Inventory	19	19	35	36	30	19	15	19	1	7
Pricing	15	9	33	37	34	28	15	21	3	5
Promotion	18	26	36	43	33	10	13	19	0	2

Source: <u>The Future of the Office Furniture Industry, op. cit.</u>

retail distribution: (1) There are more manufacturers seeking entry to the market than there are qualified dealers to serve them; (2) established dealers are reducing the number of lines carried because of high inventory holding costs or pressures from their manufacturer sources to concentrate on fewer lines; (3) some dealers have reacted to the squeeze on their margins by shifting functions such as inventory holding or financing back to wholesalers or manufacturers or installation functions to independent specialists. This functional shifting further erodes the value of the dealer and tempts the manufacturer to do the whole job alone or in combination with a specifier or designer and an independent installer. And (4), especially in the contract market the purchase decision for office furniture has assumed greater importance to management. Thus the decision takes place at higher echelons within the firm. To obtain the maximum discount for quantity purchases, top management often demands to deal directly with the manufacturer. Dealers resent strongly the competition from their manufacturer sources for business which had formerly been theirs.

Negotiated Sales

Another area where potential for increased conflict between manufacturers and dealers is high concerns dealer involvement in manufacturer-user negotiated sales. Manufacturers and resellers were asked to estimate the percentage of contract sales that fell under each of three categories: total contract sales, limited contract sales, and psuedo contract sales. Responses indicated that manufacturers were involved with dealers in well over half of current contract sales. This level of involvement is forecast to continue at least through 1988 as can be seen in Figure 4.

Most dealers recognized that in many cases they would be unable to make

Figure 4

Current and Forecast Distribution of Contract Sales,

By Type of Sale

TYPE OF SALE	1983	1988
Total Contract Sale		
(Dealer designs office, negotiates sale, installs furnishings and provides service)	43%	42%
Limited Contract Sale		
(Dealer does not design office, does negotiate sale, installs furnishings and provides service)	38	34
Pseudo Contract Sale		
(Dealer neither designs office nor negotiates sale but does install furnishings and provides service)	19	24
	100%	100%

Source: The Future of the Office Furniture Industry, op. cit. p. 140.

the sale without the intervention of the manufacturer. The demands of financing, designing, staging, and so forth are so great that the manufacturer's resources are often indispensable if the sale is to be made. In other cases the customer is a national account of the manufacturer and the dealer is brought into the sale to provide installation and after sales service.

Dealers understood the need to negotiate with the manufacturer to determine how the functions performed and the payments are to be divided.

Dealer dissatisfaction arose not from the need to share the sale with the manufacturer but rather from the nature of the functional and trade margin split. Dealers complained that manufacturers assigned functions to them which were costly to perform without providing adequate compensation.

Some dealers had a more philosophical view of the problem. They believed that dealer-manufacturer participation in a sale, even at low profit margins, was better than pursuing the business on a bid basis where margins would come under even greater pressure. Others held that the dealer had to show what he was worth; he had to get involved in the sale early, "substantiate" his value and attempt to play as large a role as possible. These dealers suggested that extent and quality of functional performance rather than position in the trade channel, should be the basis for compensation.

Recommendations

Although there is no evidence that channel frictions have risen to a level that seriously hinders the effective distribution of office furniture and related services to all segments of the market, members of the industry cannot afford to become complacent. Such trends as the increasing incidence of sales direct from the manufacturer to end-user and through nontraditional reseller channels could cause channel relations between manufacturers and dealers to deteriorate very quickly. Industry cooperative action is needed to mitigate some of the more sensitive problems which exist at present and to prevent the development of new situations which might lead to higher levels of channel conflict in the future.

Where the manufacturer is the channel captain because his economic power is much greater than that of the individual dealer, the responsibility for policy reevaluation and possible change is mainly his. When wholesalers or dealers dominate a channel, the responsibility for appraisal and adaptation is more widely shared. Policy areas especially amenable to change by the manufacturer or other channel captains include those associated with product, distribution, inventory, service, promotion, pricing, and communication.

Product Policies

The product policies of manufacturers should be guided by the needs of the marketplace. Consumer research and R&D activities are indispensible if the manufacturer is to design the product line to meet the everchanging requirements of customers. Product development policies will not be discussed here as they have, at best, an indirect influence on channel relations. What is important, however, is how product line policy may be used to reduce channel conflict.

One such policy worthy of consideration as a means of reducing or heading off channel conflict is the development of differentiated lines each of which are carried on an exclusive basis by a single channel of distribution. For example, one line for dealers and another for architects/designers. Although the goal of such a policy is to reduce direct competition between channels, it is not cost free. It can be justified only if the benefits derived from lowered levels of interchannel strife are of greater value than the costs associated with the development, sale, and distribution of different lines.

Distribution Policies

Manufacturer's decisions regarding distribution policies affect the levels of inter- and intrachannel competition and thus the willingness and ability of resellers to support the manufacturer's line. Thus any policy change that can reduce the level of conflict within the channel and/or between channels should result in increased promotional activity on the part of resellers.

Dealer involvement. One constructive policy might be for a manufacturer to sell directly to large users only with dealer involvement in the sale. This policy would reduce interchannel friction of the most damaging type. For example, forecasts of sales for open plan systems in 1988 indicate that 29 percent will be direct by manufacturer. Inasmuch as the Delphi data indicate that such sales are the major cause of channel conflict between manufacturers and dealers, adoption of a policy that changes direct sales into manufacturer-dealer negotiated sales would be most effective in reducing interchannel conflict.

Market delineation. Another policy deserving of consideration is splitting the market between manufacturers and dealers by the use of criteria such as type of customer served or size of sale. For example, manufacturers could adopt a policy to reserve for direct sale (with or without dealer involvement) sales to government or to national accounts which place orders in excess of a present dollar figure. In return, manufacturers would agree to turn over to dealers all contacts for nongovernment sales below the cutoff figure with the dealer deciding whether or not manufacturer involvement is desirable. A related gain from such a policy would be the early involvement of the dealer in a manufacturer-dealer negotiated sale with the increased profitability that dealers will be satisfied with the functional and margin split.

The recommendation to restructure channels of dual distribution so that one channel is direct and the other is the dealer channel is equally valid for wholesalers. Here the criterion of a volume cutoff is especially useful. Customers who buy in quantities below the cutoff level, for example, would be referred to dealers. On the other hand, those who buy in quantities above the cutoff point would have the option of specifying whether they wanted to do business directly with the wholesaler or through a dealer.

Another option might be to allow customers who have grown large after years of dealer support and cultivation to buy at wholesale prices through the dealer but to have the goods drop-shipped from the wholesaler. Dealer margins on this business need only reflect the costs of selling and billing plus a modest profit. Such an arrangement will reward the dealer for past activities in building customers and will raise his morale.

The problem of conflict between dealers and nontraditional resellers such as limited-function dealers, architects/designers, and independent specifiers is extremely difficult to resolve. Given that buyers are increasingly using these sources, the manufacturer is faced with the choice of not covering a growing segment of the market or of protecting relationships with the existing dealer organization. Each manufacturer should evaluate the trade-offs involved on the basis of the nature of the specific environment in which he operates.

Dealer response. The most effective course of action for a dealer faced with competition from nontraditional channels is to redouble his efforts to become a more effective partner in the selling process. The dealer must exploit his differential advantage over competition by stressing knowledge of local conditions, ability to provide a well-trained salesforce, possession of design resources, breadth of line, inventory holding and staging facilities, installation capabilities and so forth. Those dealers who can perform a wide array of functions well will have less to fear from interchannel competition than do those who are ineffective performers or who have reduced their service capabilities.

Intrachannel competition. With respect to rivalry among dealers in a given market area, manufacturers must periodically reevaluate the number of dealers franchised. If market coverage is too limited, sales opportunities will be lost. In contrast, if too many dealers are franchised in relation to market potential, price competition will be so intense that the value of the line to each individual dealer will be diminished. Given the nature of the buying process in which a great deal of input is required of the dealer, the manufacturer is wise to err on the side of restricted distribution to minimize intrachannel rivalry and to gain maximum dealer support for his line.

Inventory and Service Policies

Closely associated with distributive policies are those manufacturer policies which determine the amount of inventory to be held in the channels and the service levels provided resellers and thus end users. Holding inventories of office furniture is very expensive because of the space required. Any policy alteration which can reduce this burden will increase the profitability of the line to resellers and thus should gain added cooperation from them. Quick ship programs, shipments in knock-down form, and the like are examples of worthy efforts. Any changes which can reduce the time required between receipt of order and delivery at the customer's place of business must also be considered in terms of total costs of holding inventory at all levels in the channel. If it appears that reductions in delivery times are not feasible, then attempts must be made to reduce variability in delivery times.

Uncertainty about when shipments will arrive from the factory is more damaging to manufacturer-dealer relations than is the length of the delivery time. Whether the answer lies in better sales forecasting, production scheduling, or in using more reliable modes of transport, the evidence points clearly to the conclusion that reliable delivery dates will reduce frictions in the channel.

Promotion Policies

Recommendations in this area are limited. The major deficiency noted by reseller Delphi panelists was sales training at all levels in the channel. Although interview data indicate that all channel members do engage in training, the general consensus is that more and better training is needed. Because sales personnel have a rather high rate of turnover, training must be continuous. Although manufacturers and wholesalers appear to be bearing most of the cost of current training activities, dealer contributions in terms of employee time and associated travel expenses are considerable.

Pricing Policies

Manufacturer pricing policies have a large impact on channel conflict. The margins paid resellers, for example, not only pay for their functional performance but also reflect the competitive pressures which they face. In other words, when a dealer complains to a manufacturer that the margin payment is too small, he may mean that it does not cover his costs of functional performance and/or it does not allow him to compete on a price basis.

The margin problem. Before the manufacturer (or the wholesaler, if such is the case) can address the problem of margin adequacy the following questions should be answered:

* Do manufacturer (or wholesaler) direct selling activities put pressures on the prices dealers can receive from their customers?

* Does manufacturer franchising policy put so many dealers in a territory that intrachannel competition is affecting price levels?

* Does manufacturer division of task and margin payment in negotiated sales allow the dealer to recover costs and make a profit?

* Does manufacturer delivery service level or inventory policy require dealers to incur heavy holding costs?

* Does manufacturer variability in delivery times place unreasonable cost burdens on dealers or their customers?

* Does manufacturer pricing policy reflect reseller position in the channel rather than the extent and quality of functional performance?

It can be seen from the above questions that many manufacturer (or wholesaler) policies can influence the "effective" margin received by dealers. Perhaps alteration in these policies either to reduce competitive pressures or cost burdens or both may be a cheaper and more effective way of resolving the dealers' complaint of margin inadequacy than would be a direct increase in the margin payment.

With reference to those frictions which arise from price competition between dealer and nondealer channels it might be useful to set prices based upon extent of functional performance rather than upon position in the trade channel. For example, the trade discount could be subdivided into payments for each element of functional performance such as selling activity, design activity, inventory holding, and installation. If such an approach were costed out it would meet the test of legality and be a more equitable way of reflecting the fact that different resellers perform different functional mixes.

Communication Policies

Regardless of the nature of manufacturer policies, many dealers believe that they are not well communicated either in writing or by manufacturer salespersonnel or reps. Lack of knowledge of policy can be a source of friction in channel relationships. Improvements in policy development, clarification, and communication should go a long way toward reducing misunderstandings and resultant channel frictions.

Concluding Remarks

In the last section of this article an attempt has been made to consider some courses of action which might reduce conflict either within or between the channels of distribution in the office furniture industry. Although the article was limited, its main purpose was to indicate that many of the causes of channel conflict can be removed or attenuated by actions that are feasible for the parties involved.

Business relationships can never be totally free of conflict. The goal should be, therefore, to reduce conflict to tolerable levels by adjusting policies where feasible and by emphasizing areas of common interest. Only by keeping channel relationships healthy can the industry evoke the cooperation among channel members needed to exploit fully the great opportunities which have been forecast for the future.