CHANNEL MANAGEMENT STRATEGIES THAT OPTIMIZE SALES CONTROL

VORYS eCONTROL

Commerce has been irrevocably transformed in the age of online marketplaces. The online marketplace explosion has plagued brands with countless unknown marketplace sellers who are neither loyal nor accountable to the brands they purport to represent. These anonymous sellers obtain and handle products in mysterious and oftentimes nefarious ways, causing significant consumer confusion in the process. Unsuspecting shoppers frequently believe these sellers legitimately represent the brand, but are extremely frustrated when poor quality products arrive at their doorstep.

BRANDS OFTEN EXPERIENCE TREMENDOUS PRESSURE — BOTH INTERNALLY AND EXTERNALLY — WHEN THEY LACK SUFFICIENT CONTROL OVER ONLINE MARKETPLACE CHANNELS.

Commercially, unauthorized third-party (3P) sellers cause significant issues. Brands with a first-party (1P) Amazon.com relationship may suffer erosion of brand value, margin chargebacks, CRAPed out products, and reduced profitability in their 1P relationship as a result of the massive intra-brand competition that can be created by numerous marketplace sellers.

Unauthorized sellers interfere significantly with brands' crucial efforts to maximize the return on advertising, SEO and content enhancement investments. Making matters worse, the poor quality products often sold by unauthorized sellers result in negative product reviews causing further reputational and economic damage to the brand.

At the same time, the brand's longtime brick-and-mortar retailers are negatively impacted when consumers decide not to buy the product after seeing bad reviews online, or from the showrooming phenomenon, where consumers use stores to browse and get information only to purchase lower-priced products online. In response, brick-and-mortar retailers are increasingly incorporating price-match policies for consumers and chargebacks for the difference to brands, and may even reduce shelf space or refuse to carry brands that lack sufficient control over their online channels.

UNMANAGED BUSINESS PRACTICES EXACERBATE SALES CONTROL CHALLENGES

Brands often experience tremendous pressure — both internally and externally — when they lack sufficient control over online marketplace channels. As an initial matter, there are countless examples of poor consumer experiences associated with unprofessional third-party (3P) sellers on marketplaces involving late shipments or unresponsiveness. Worse, brands are at risk of 3P sellers shipping poor-quality products to consumers. Because

Amazon names the brand more conspicuously than the seller, consumers are likely to attribute these quality problems to the brand and leave poor product reviews. These reviews hurt the brand's reputation and image in each of its channels.

Further, these sellers often acquire products at deeply discounted prices without having to make the investments other sales channels have to make to productively bring the brand's products to market. This can lead all sales channels to stop investing in the brand because they cannot effectively support the brand and maintain a viable business.

More often than not, the root cause of these pain points is the business practices of the brand itself, which feed a range of harms across all sales channels. This cycle creates substantial downward pressure on revenue and profit for both brands and their channel partners. Brands seeking to maximize their brand equity and commercial growth have no choice but to develop a strategy for holistic channel control that includes addressing some key business practices.

The remainder of this paper will focus on business strategies your company can use to protect and grow in today's online marketplace environment. Brands seeking long-term success will inevitably have to evolve their business practices to account for the realities of online commerce. Specifically, brands must take a fresh look at and begin to evolve their efforts regarding: (1) sales channel strategy; (2) channel pricing and promotional practices; (3) internal misalignment; and (4) internal quantification and sales control advocacy.

Channel strategy

At the extreme, many brands still sell to and through as many sales channels as possible without putting any expectations or limitations on those resellers. Today's brands must evolve to ensure that they have a defined route-to-market strategy, including clear expectations regarding how their products should be sold and represented by authorized parties. This strategy and related expectations must be clearly communicated to authorized channels and enforced by the brand. Some key aspects of a channel strategy that merit focus include:

Marketplaces. Brands must give considerable strategic thought as to how they will sell on online marketplaces like Amazon. It is best practice to limit sellers on Amazon, ideally to just one who deeply understands how to optimize growth on the platform. Without a defined strategy, brands are likely to face a chaotic reseller

TODAY'S BRANDS MUST EVOLVE TO ENSURE THAT THEY HAVE A DEFINED ROUTE-TO-MARKET STRATEGY, INCLUDING CLEAR EXPECTATIONS REGARDING HOW THEIR PRODUCTS SHOULD BE SOLD AND REPRESENTED BY AUTHORIZED PARTIES.

environment with multiple unknown 3P sellers, resulting in poor service and products in the channel, significant harmful intra-brand competition, and an overall disincentive for sales channels to continue to invest in the brand.

Authorized sellers in remaining channels. Brands must also have a strategy for defining and managing authorized sellers in other channels, as well as communicating their expectations and plans to these companies. Authorized sellers are a frequent cause of product diversion, as they can (knowingly or unknowingly) sell products to unauthorized resellers. Brands should create strong policies that clearly define how, where, and to whom authorized sellers may sell. Brands should communicate their policies and expectations to their authorized sellers, explaining the problems caused by product diversion and the importance of preventing it. In our experience, most downstream customers take such policies or contracts seriously. Brands should also assist their authorized sellers with best practices for detecting and stopping product diversion, and publish "do not sell" unauthorized seller lists to distributors. Brands often experience significant improvements just from implementing appropriate policies, contracts and processes with their authorized sellers prior to any legal enforcement.

Monitoring and business enforcement. Although many authorized sellers will comply with the brand's policies, some may not. To effectively deal with recalcitrant authorized sellers, brands should continuously monitor their channels to identify likely sources of diversion and take appropriate action against violators. These actions range from limiting product, reducing trade allowances or terminating the relationship altogether.

Pricing and promotional practices

The various ways that brands manage and incentivize their customers can also promote diversion. Brands should look critically at each of the components below to determine whether what was once standard operating procedure may now be doing more harm than good in the age of eCommerce.

Some common traditional pricing and promotional practices that can create significant brand harm in today's market include:

Channel pricing differentials. Without channel controls and an appropriately constructed, legally vetted pricing structure, pricing differentials between similarly situated channels can facilitate product diversion as products intended for one group are diverted into another. Indeed, many brands — whether they know it or not — are underwriting diversionary behaviors, causing harmful outcomes. Brands should carefully scrutinize those channels

where such differentials may exist and determine if alternative structures can be implemented, consulting with legal counsel that has expert knowledge of anti-trust laws.

Excessive channel margins. Brands should pay their authorized sellers fairly for the work they do, but must be careful to avoid overpaying. When margins are too high, especially when the brand lacks sufficient control over its other channels, unauthorized sellers can acquire product at discounted prices and resell it on marketplaces. Because these sellers make no investment in the brand, they are content to trade at margins far below those at which invested channel partners are able to compete. As a result, it's important to analyze what margin is available for each product you sell and which part of it should go to each layer of your sales channel, including your brand, based on the cost of the work each does to bring products to market. Pay no more than what it takes to do the work involved and provide a reasonable margin. Take care to ensure you are conducting these assessments with expert legal counsel.

Learn More About Channel Management

Distributor volume discounts and incentives. Brands frequently try to increase revenue by offering volume-based discounts to distributors. Additionally, brands often provide distributors growth rebate programs that provide payments based on purchase level targets, which further enrich wholesale margins for distributors. Such incentives, independently and collectively, can cause distributors to purchase at levels beyond that which natural demand supports. This overstock becomes the primary source of diversion for many brands. Given their better initial margin levels, distributors can sell inventory at low prices and still make an attractive return. These practices are especially difficult to detect with larger distributors where incremental purchase increases escape scrutiny in the context of traditionally large ordering patterns. Worse yet, without channel controls in place, distributors can establish their own retail storefronts on Amazon and other marketplaces, which given their margin structure, can foster significant channel conflict for the brand. One useful tactic is to potentially structure the receipt of rebate incentive benefits on sales only to authorized channels and the receipt of distributor sell-through data to validate these sales.

Promotions. Promotions are also a frequent cause of product diversion, especially when unlimited quantities and/or compounded couponing are at play. Brands should carefully

BRANDS OFTEN EXPERIENCE SIGNIFICANT IMPROVEMENTS JUST FROM IMPLEMENTING APPROPRIATE POLICIES, CONTRACTS AND PROCESSES WITH THEIR AUTHORIZED SELLERS PRIOR TO ANY LEGAL ENFORCEMENT.

structure and tailor promotional programs to the target audience. For example, they should ensure that channel promotions are carefully directed toward the appropriate retail or dealer sales channel and that guardrails are in place for subsequent resale on marketplaces. Further, brands should (i) ensure that consumer promotions have quantity purchase limits: (ii) have a deliberate strategy regarding compounded couponing; and (iii) only pay sales channels for the promotion based on proof of sale, in order to mitigate these issues.

Liquidation. Liquidation is also a frequent source of product diversion. Before the rise of eCommerce and online marketplaces, liquidated inventory was typically sold in special liquidation stores or clearance sections, where consumers would know that they were purchasing "as-is" liquidated product. Today, however, liquidated product is often resold on Amazon under the same ASIN as the brand's new products, and consumers often have no way of knowing whether or not they are buying liquidated inventory. Some possible strategies to improve management of this include:

1. A disciplined inventory management process in place between supply chain, sales and stocking channels to mitigate overstock.
2. A stock rotation program with stocking channels that enables them to rotate inventory overstock and/or slow moving inventory for other products. This allows the brand to make decisions on how that rotated stock will be handled.
3. A buy back program that enables the brand to purchase overstock at discounted rates. This will need to be evaluated for profitability relative to the disruption of diverted product.
4. Establish relationships with liquidators who will abide by your selling policies and programs and identify these entities as authorized members of your distribution network.

Internal misalignment

Many unauthorized sales issues can be traced back to a lack of internal alignment.

Independent, siloed geographic strategies. Brands often sell products to distributors for resale abroad. These products are often sold at lower prices than U.S. products in alignment with the economic dynamics of the intended foreign market. Such pricing differentials can present an alternative arbitrage opportunity, with such products never leaving port — or even traveling around the world and back — and ending up on Amazon. Brands should carefully evaluate and monitor their international distributors to ensure that products are being sold where intended. If this is not possible, brands can look into regional or national product segmentation or variation strategies so that it is clear that the products at issue were manufactured for foreign markets, or look into means of enforcement through customs.

Internal sales and front office alignment. A brand's sales team may be selling to known diverters at the same time that its eCommerce team is attempting to enforce against existing unauthorized sellers. Indeed, cooperative sales teams are a key factor for sales control success. Brands should thoughtfully consider whether its current sales incentives are a catalyst for diversion. If so, some potential corrective options to consider include:

- Basing sales incentives on sales to authorized channels only
- Penalizing sales teams if products are later resold in unauthorized channels
- Rewarding sales teams for complying with do-not-sell lists
- Requiring sales teams to identify suspicious transactions for higher-level review
- Hiring a specific channel manager familiar with diversion issues to manage sales teams
- Training sales teams on the problems of product diversion
- Basing incentives for both eCommerce and traditional sales teams in part on the health of the Amazon channel

Learn More About the Elements of a Holistic eControl Solution

In addition to sales teams, customer service and marketing teams should implement protocols designed to educate consumers about both the harms caused by unauthorized sales and also the benefits of purchasing from authorized sellers, including superior quality controls and product benefits that only accompany products purchased from authorized sellers (i.e., warranties or satisfaction guarantees). Order processing and finance teams should also implement procedures pursuant to which new accounts are vetted and existing customer order deviations are flagged for further review prior to processing. Finally, C-suite buy-in for an anti-diversion and eControl program exponentially increases its chance of success and should be obtained at the outset of any effort to assert greater control over online sales.

Collaborative theft. Unauthorized sellers can also obtain products through simple theft, sometimes with the cooperation of a brand's own employees. Brands should regularly audit their supply chains to ensure that any anomalies are not a result of a theft ring — whether internal or within a channel customer's operations.

Quantification and sales control advocacy

A brand's efforts to assert greater sales control and stop diversion are more likely to be successful if internal champions are able to measure key metrics and tie their efforts to overall business success. While some of the harms caused by unauthorized sellers are difficult to quantify precisely, such as broad based brand erosion and product quality issues, there are quantifiable metrics that should be tracked. Such metrics may include the percentage of revenue captured by authorized and unauthorized sellers on marketplaces. While some may argue that the brand has captured unauthorized seller revenues at some initial point through its authorized channels, these "junk food" sales work in opposition of healthy ecommerce revenue, which is realized as follows:

Revenue = Traffic x Conversion x Price

In short, any activities that misdirect traffic, subvert conversion and impact price will cause significant cost and aggravation for any seller to overcome and eventually lead to disinvestment in the brand. Therefore, it's wise for brands to determine the best metrics to monitor for their business that ensures this equation is optimized as much as possible. By agreeing upfront on what metrics are meaningful and will be measured, internal champions can evaluate and report on the effectiveness of their programs, making any necessary adjustments along the way to increase program effectiveness.

Leveraging Sales Control for Growth

Once brands establish a solid foundation for control, like eControl, and address business practices that could run in opposition to their sales control goals, they are optimized for growth.

By establishing control over who is authorized to represent them on marketplaces, brands will have stronger oversight over quality control and customer service, which will positively impact the consumer experience. Only then can companies begin to position their brands as effectively on marketplaces as they do in brick-and-mortar locations, specifically as trusted brands with product

standards and the customer service levels their consumers expect from them.

Additionally, brands that allow only one or a very limited number of authorized marketplace sellers are best able to benefit from the key growth levers in the online channel. "Channel coverage" is best established in this manner. When a limited number of sellers are authorized for marketplace sales, the incentive to invest in the needed promotional tactics to drive traffic and conversion dramatically increases.

When control is achieved over online marketplace channels, brands can have far better growth conversations with their traditional brick-and-mortar channels. Combative discussions between brands and brick-and-mortar customers caused by a lack of online control begin to dissipate as brands demonstrate to distributors and retailers that they are getting control of online marketplace sales, and that they are creating a better business environment in which to operate. Improved margins can begin to be invested in demand-generating activities, including non-promotional marketing and brand-building tactics.

Brands that successfully achieve control over their online presence will enjoy the added reach and sales of the online marketplace channel without further suffering from the ills resulting from a lack of control. The brand's authorized sellers will be fully incentivized to invest in the brand, take good care of the brand's products, provide good service to the brand's customers, advertise the brand, and compete vigorously with other brands, both online and offline. Ultimately, control-enabled growth will lead to more consumer demand and improved financials for both the brand and its sales channels.

To further discuss how your brand can benefit from a channel management strategy, please contact Daren Garcia at dsgarcia@vorys.com.

WHEN CONTROL IS ACHIEVED OVER ONLINE MARKETPLACE CHANNELS, BRANDS CAN HAVE FAR BETTER GROWTH CONVERSATIONS WITH THEIR TRADITIONAL BRICK-AND-MORTAR CHANNELS.

About the Authors

DENISE ZMUDA
Denise is the head of channel management products and services on the Vorys eControl team who specializes in developing a wide range of channel management strategies, for which she has more than 20 years of experience in the U.S. and across the globe.

DAREN GARCIA
Daren is a partner in the Vorys Cincinnati office and dedicates his practice to the development and implementation, both domestically and internationally, of strategies and enforcement systems designed to protect brand value in the digital world. Daren has counseled hundreds of brands and manufacturers confronting unauthorized sellers, channel conflict and other online sales challenges. Daren also regularly leads litigation matters against grey market sellers disrupting brand value for Vorys' clients.

Learn more about eControl

Data-Driven Precision Enforcement

Achieving Brand Control and Stopping Unauthorized Sales

How Brand Manufacturers Can Manage Messy Online Marketplaces

VORYS eCONTROL