GOING TO MARKET:

CHAPTER 10 -- “Coping With Change”
Of all the elements in marketing strategy, the distribution system may be the hardest to change. Adjustments in the product line, in prices, in the promotional program, or in market focus cause far less upheaval than shifts in the ways the firm goes to market. Changes in distribution almost always disrupt existing relationships among suppliers, their salesforces, independent distributors, and agents. Further, they often seem to go against patterns of past marketing success. Even when marketing managers acknowledge the need for change, many questions attend a move to new modes of distribution. What new strategies are needed? How will customers, competitors, distributors, and company sales personnel react? How should changes be implemented?

In forming distribution systems, manufacturers make certain commitments. These include understandings between manufacturers and distributors about territorial bounds, the intensity of distribution in a trading area, discount schedules, and the role of the manufacturer's salesforce. Investment in a highly trained salesforce is itself a major commitment, as are distribution schemes specifying where, when, and how the manufacturer's line may be purchased by and serviced for users. Such commitments, while essential for success, tend to limit the supplier's ability to restructure distribution systems as product technology evolves and markets change.

Our purposes in this chapter are to review (1) the factors that create the need for change, (2) the reasons that change is resisted, and (3) the kinds of changes that manufacturers make in distribution (in the context of two case studies).

The two case situations we consider involve significant changes in the market environment, which created great pressure to restructure the distribution system. At General Electric's Component Motor Operation, a market characterized by intensifying
competition and downward price pressure raised questions about whether this division could afford to—or could afford not to—continue to sell through its powerful master distributor channel. At Honeywell Information Systems, managers seeking entry into the burgeoning minicomputer market recognized the need for a transition from direct selling to multichannel distribution. Their concern was how best to minimize interchannel conflict during the reorganization. In each instance, we present the facts of the case and then comment, using the conceptual framework developed earlier in the chapter.

THE IMPERATIVES OF CHANGE

The factors that create market ferment and lead sooner or later to the restructure of distribution systems include the following:

- growth and maturation of existing product-markets
- the emergence of new product-markets
- significant market decline
- escalation of competition and intensification of cost/price pressures
- changes in customer demographics and modes of buyer decision making
- changes in the channels infrastructure—some reseller institutions growing in market power, others declining
- corporate mergers and the resulting opportunities for integrating the channels systems of two or more businesses
- “one-shot” opportunities to increase market share by taking over competitors’ distributors

Factors such as those listed above, which create either the need or the opportunity for constructive change, are often related to product-market changes and, in particular, to the product life cycle phenomenon. In the early stages of market development for many industrial products, it is essential to stress the development of new product applications and the education of new users. Often this requires direct selling or selling through agents. In a second stage, the imperatives of making the product widely available at competitive prices tend to reduce the value of highly technical selling and increase the need for building a distribution network. The direct sales program may continue with some narrowing of focus, generally a concentration on those customers which have emerged as large and important sources of sales revenues.

In the later stages of the product life cycle, declining market growth rates, the increasing priority of price considerations in customer purchasing behavior, and the escalation of price competition—both interbrand and intrabrand—combine to put a premium on sales cost efficiencies. This, in turn, may force a change in distribution strategy, such as adding or dropping certain levels of distribution, redefining the respective roles of the direct salesforce and resellers, reallocating the responsibility for distribution functions across channels, and restructuring discount schedules.

Throughout the product life cycle, changes in market structure can trigger strategic response, an important element of which may be a change in the distribution system. Thus, for example, new government restrictions on Medicare reimbursements to hospitals fostered the rapid development of multihospital buying groups to negotiate for supplies at the most favorable prices. This in turn led manufacturers of hospital supplies to intensify their direct sales programs, leaving to distributors the order fulfillment role for these accounts.

Finally, marketing managers are often confronted with the need to rationalize two or more networks, either when companies have merged or when the possibility exists of annexing part of the distribution network of a weakened competitor. The potential exists here for gaining additional share of local markets. However, the transition entails a two-part challenge for the supplier: assimilating the new distributors is one part; the other is dealing with the resentments of existing channels members as the supplier’s distribution system becomes more intensive.

IMPEDIMENTS TO CHANGE

While the pressure for change in response to market and competitive factors is often compelling, the deterrents to taking effective, and especially timely, action can be equally powerful. Resistance forces include the following:

- the uncertainty of the outcome
- the fear that change will invite retaliation from those who perceive themselves to be the losers
- the potential costs of lost sales revenues or increased sales expenses
• the fear of losing distribution in certain market sectors and leaving opportunities for competitors
• the loss of customers that may prefer sourcing arrangements available to them through the existing system
• a lack of urgency—in the absence of crisis, the tendency may be to accept the slow erosion in competitive position rather than to "bite the bullet"
• unwillingness to write off investments in the existing system—a technically trained direct salesforce, a strong reseller network—and in the personal relationships that have developed around these institutions
• a psychological commitment to past success and an inability to assess objectively the need for change

Many of these conditions are evident in the two case situations that we consider in the following discussion.

GENERAL ELECTRIC—COMPONENT MOTOR OPERATION*

General Electric's Component Motor Operation (CMO) was the largest domestic manufacturer of electric motors in both integral and fractional horsepower sizes. Manufactured in thousands of different models, these motors were used in commercial/industrial applications as well as in consumer appliances such as furnaces, air conditioners, washing machines, dishwashers, ranges, and refrigerators.

In consumer sales, the focus of this case history, CMO sold its line of fractional horsepower (FHP) motors both directly to appliance manufacturers as components in original equipment and through distribution for replacement use. FHP aftermarket motors went through distributors, wholesalers, and electric motor shops to more than 50,000 repair shops, dealers, and contractors providing appliance repair service.

Aftermarket Distribution

CMO used four channels to serve the FHP motor consumer aftermarket: (1) industrial distributors; (2) OEM service centers selling via OEM-franchised distributors; (3) three master distributors selling to wholesalers, which in turn sold to dealers and service shops; and (4) a master wholesaler selling primarily to service shops and dealers but also to other wholesalers (see Exhibit 10.1).

The three master distributors accounted for half of CMO's sales to the FHP aftermarket. They were the primary source of supply for 1,250 heating, air conditioning, and appliance wholesalers, which accounted for 45% of total FHP consumer aftermarket motor sales. Most wholesalers carried GE motors.

The newest and fastest-growing channel to the FHP aftermarket was Addison Electrical Supply (AES). This channel, classified as a master wholesaler, accounted for 20% of all FHP aftermarket sales to service shops and dealers and 15% of GE's aftermarket consumer FHP sales. AES combined the functions of the master distributor and wholesaler, buying directly from manufacturers and selling directly to wholesalers, dealers, contractors, and service shops.

Evolution of the Channels System

During the post–World War II era, original equipment manufacturers served the aftermarket for consumer motors through their dealer and service shop networks. Prices in the consumer aftermarket were high, and demand was growing for appliance parts and repair services. GE's three master distributors emerged to supply the growing network of independent dealers and repair shops. GE in effect put the master distributors in business and supplied the great bulk of their consumer FHP motors for the aftermarket. The three master distributors resold GE motors to wholesalers, which provided a broad line of motors and other items for the independent appliance service dealers and contractors. In utilizing master distributors, CMO was able to eliminate the need for a direct salesforce calling on wholesalers and thus economize on selling costs. We can speculate, too, that CMO managers did not want to compete directly with their OEM customers serving the appliance motor aftermarket through franchised distributor networks.

* Quantitative data used in this case are disguised but serve, nevertheless, to illustrate the issues.

1 The 1,250 wholesalers together operated approximately 4,000 branch locations.

2 Disguised name.
The 1970s and 1980s saw increasingly competitive pricing in the FHP aftermarket. At the same time, OEMs began to reduce the number of their suppliers. The major suppliers, GE and Emerson, became much more price competitive. Second-tier manufacturers, which lost market share in the OEM segment, turned to the aftermarket, competing for large wholesaler accounts by quoting prices comparable to GE's prices to its master distributors. Under intense pressure, master distributor prices for aftermarket motors declined markedly, dropping 13–20% in the three-year period 1983–1985.

Direct Distribution Study

In a study undertaken in 1978, GE marketing managers found that (1) GE's competitors sold motors to wholesalers at prices 5–17% below the price that GE's master distributors could sell and (2) the three master distributors were losing market share of sales to wholesalers. The study concluded by recommending a "change in sales coverage of the wholesaler aftermarket from master distributor to direct GE sales to the wholesalers for all General Electric [motor] products." Replacing the master distributors would mean an additional cost of sales of approximately $2 million dollars in the first year. This forecast also anticipated a drop in GE's profitability for the first two years. However, in all but the worst-case scenario, profitability was expected to exceed the no-change option after two to three years.

In September of 1978, the recommendations of the study were rejected by CMO management because implementation would be risky. A second study, completed in January 1979, recommended direct sales only to the top 30 wholesalers, with the master distributors serving the remaining ones. The incremental marketing costs for this plan were estimated at $9 million. This plan was rejected in favor of yet a third plan calling for direct sales only to the top 10 wholesalers. These 10 wholesalers operated 567 branch locations covering 40% of the FHP motor aftermarket.

CMO's management approved the "top ten" program and announced it to the master distributors in 1979. The reaction of the master distributors to the announced program was predictably adverse. "We'll make you bleed," said one. Another indicated that it

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*This amount included the cost to GE of assuming functions previously handled by the master distributors, for example, administration, selling, order service, warehousing, inventory, credit and collections, merchandising, interest expense, and warranty.
would find a second source for FHP motors, as well as other product lines currently supplied by GE. Still another threatened to go out of the consumer motor aftermarket business.

The program met with enthusiastic support from the 10 wholesalers chosen to participate. These wholesalers felt that GE had been “living in the past” and made comments like “The master distributors won’t allow you [GE] to be competitive.” They felt that the move was inevitable and expected GE to offer them “substantially lower prices.” Smaller wholesalers, on the other hand, were critical and resentful, concerned that they were likely to experience poor master distributor service and higher prices. It appeared that while the small distributors would probably remain loyal to GE, the supplier should expect some initial sales loss. In addition, many suggested that the small distributors would form buying co-ops to qualify for direct sales attention and lower prices.

Six weeks after announcing the program to the master distributors, CMO’s management dropped it. No further changes were contemplated over the next several years, and consumer aftermarket motor sales continued to decline.

In 1985, sales to the master distributors were down, and the consumer FHP motor aftermarket continued to change. As the market became even more price competitive, it was not clear which FHP motor suppliers would survive. Many of the issues raised in the three distribution studies were still very much alive. GE was losing share to niche manufacturers selling direct to wholesalers. The product was increasingly perceived as a commodity, and the strategy of many GE competitors was to price below GE. CMO’s vice president of component motor marketing, however, was sanguine: “We haven’t solved the problem yet, but we’re making progress.”

Commentary

Because the major channels for consumer aftermarket motors were appliance OEMs during the postwar period, the costs of direct sales to independent wholesalers—supplying appliance dealers and service shops—were likely to have been prohibitive. By franchising master distributors as an intermediate level of distribution, which carried broad lines of appliance components and spare parts, GE was able to reach appliance service shops through wholesalers, both effectively and cost efficiently, and not depend on its OEM customers to get to this rapidly growing market.

By the late 1970s, however, the installed base of appliances had grown large enough to make the market for repair motors an important battleground for both appliance manufacturers and appliance motor manufacturers. The aftermarket was also highly contested turf for resellers in the multitier chain of distribution. In this intensely competitive market, distribution cost efficiency became a key determinant of market share position.

The master distributor, well suited to serve a much thinner postwar appliance service market, soon became a costly level of distribution between GE and its 1,250 wholesale customers. With the so-called second-tier motor manufacturers selling to large wholesalers at prices equal to those at which GE sold to its master distributors, the latter could remain competitive only by accepting considerably reduced margins or getting significant price reductions from GE—or both. In the meantime, the emergence of large-scale wholesalers operating nationwide so altered the economics of selling costs that the motor manufacturer could go direct to these businesses and thereby eliminate the master distributor discount.

Why, then, did GE’s Component Motors business unit, even after successive studies, not move to break away from its three master distributors and sell direct to wholesalers, at least to the larger ones? These are the principal reasons:

- **Uncertainty.** With 50% of its consumer aftermarket motor business tied up with only three resellers, CMO’s managers might well have been concerned about their ability to offset any loss of sales to the master distributors with sales direct to wholesalers. In addition, master distributors’ threats fed apprehension as to the possible nature and extent of the punishment that these important customers might mete out.

- **Transition costs.** With predictions of lost business and additional marketing costs for selling direct to wholesalers, CMO studies forecast a 50% drop in this business unit’s profitability during the first two years after the change in distribution. That was a formidable prospect for profit center managers whose performance was judged not just annually but quarterly.

- **Fear of leaving openings for competitors.** Any actions that alien-
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Information Systems Division (ISD) salesforce. In 1978, recognizing that the market for minicomputers was growing rapidly, ISD managers had begun to develop "alternate" channels of distribution for Honeywell's minicomputer line to reach small- to medium-sized accounts. By year-end 1985, 15% of ISD's small systems sales were through value-added resellers (VARs) and manufacturers' reps (MRs). Both VARs and MRs developed and marketed information systems combining microcomputers and applications-specific software.

In an attempt to accommodate the change from selling direct to going through multiple channels, ISD managers had gone through three reorganizations between 1977 and 1981. As might be expected, conflicts developed at the field level between ISD's direct sales reps and the VAR accounts served by ISD's Indirect Sales Operation (ISO). According to two ISD managers,

Our indirect business is an absolute must. It's also essential that it be integrated with the field sales operation, but it is slow in evolving because the branch managers do not yet see the benefits...

The issue is harmony. As prices come down and costs go up, it is important to bring the product to market through alternate channels. Traditionally, the direct sales rep has had a territory which he has regarded as his domain. Now when the product moves into the territory through other channels, the rep gets nervous.

ISD Organization

As of 1986, HIS's Information Systems Division (ISD) was organized into 3 field areas, 8 regions, and 45 branches covering the United States. Each branch manager typically supervised the work of a national account manager (NAM) and two resident marketing managers (RMMs), each of whom had three to five direct salespersons reporting to him or her. In 30 of the 45 branches, there was also an indirect sales specialist (ISS), who called on Honeywell's VARs and MRs. The ISD headquarters organization, headed by Frank Jakubik, included the National Sales Operation (NSO), which directed field sales activities; a National Accounts Program Office (NAPO), to which the national account managers in the field had a dotted-line reporting relationship; and the Indirect Sales Operation (ISO), headed by an ISD staff manager, James

HONEYWELL INFORMATION SYSTEMS

In 1985, Honeywell Information Systems (HIS), a division of Honeywell, Inc., made and marketed a line of computers that ranged in price from $5,000 (PC) to $8 million (DPS-88). The DPS-6 line, priced between $5,000 and $400,000, included offerings in the micro-, the mini-, and the superminicomputer categories.

In this size range, Honeywell competed with IBM, Digital Equipment Corporation (DEC), Hewlett-Packard, Wang, Data General, and Prime Computer. As of 1984, all Prime held share positions larger than Honeywell's. Data General, DEC, and Wang had traditionally marketed through resale channels. IBM, traditionally reliant on direct selling, had recently moved toward the development of VAR, agent, distributor, and retail networks to broaden its market coverage.

Throughout most of its history, HIS, like IBM, had focused its product line, service support, and sales organization on users of large mainframe computers, to which it sold directly through its

are substantial sources of revenue run the risk of these accounts—the master distributors—being quickly and easily taken over by competing manufacturers.

- *Lack of urgency.* It is important to put the consumer aftermarket motor distribution issues in the context of CMO's overall mission, the manufacture and sale of motors of all sizes to a wide range of markets. Appliance motors represented only a part of the line, and of this product group, FHP aftermarket motors was a relatively small portion. As the leading supplier of motors, certainly in the domestic market, GE managers might well have been concerned about channel efficiency in this small segment of their business but not to the extent of disrupting its larger marketing program. Further, any loss of share in the aftermarket motor channels would have been gradual and not a reason for taking precipitous action.

The pattern is not uncommon. Though the signs of channels erosion may be clearly recognized, changes are not easily implemented and indeed it is not always clear what new directions the distribution strategy might usefully take.
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Commentary

Honeywell's experience is typical of the organizational turmoil that attends the transition from a monolithic direct sales operation to a multichannel distribution system in many industrial companies. In this case, as in others, the impetus for restructuring came with changes in the market. Like IBM and other early developers of the markets for computers, Honeywell had relied on its direct salesforce first to lease and then to sell large mainframe computers to business and government customers. In the beginning, computer applications were largely generic or "horizontal" in nature, serving such purposes as payroll accounting, credit and collections, and order processing. With the development of information system technology, applications became increasingly customized in accordance with the specific needs of user industries, for example, airlines reservations, hospital records maintenance, retail store checkout systems, and manufacturing process controls. Honeywell Information Systems participated in this market, counting as a key competitive strength its strong technical support capabilities.

HIS managers, of course, followed the development of the minicomputer market in the 1960s but at that time elected not to participate, because "it would have required a very different distribution mode" and would have meant selling "raw iron" to systems houses that would add software programs. The comment itself implies an aversion to being postured in the market as simply a producer of standard equipment for others to customize.

However, the phenomenal growth of specialized applications markets for computerized information systems combined with the declining contributions from its large mainframe product lines ultimately led HIS to develop its DPS-6 minicomputer line, which was first introduced in 1977. Another factor influenced the decision to broaden the line: HIS's clientele, like most computer users, was moving from centralized data processing to distributed data systems in which mainframes, mini-, and microcomputers were linked to provide integrated knowledge networks. Hence, it was important to offer a full line of computers if only to meet the evolving needs of the large user market.

By the 1970s, though, the most rapidly growing segments of the computer market were not the large companies but the many small- to medium-sized users with a wide range of specialized needs.
that could only be satisfied by combining hardware and applications-specific software. Because of the myriad of both potential customers and innovative new uses for information systems, it would be impossible to cover the market with a direct salesforce supported by internal software development and technical service units. In addition, declining product prices and margins and rising direct sales costs combined to make direct selling alone an increasingly unattractive distribution option. As one HIS manager commented, "As the prices for the [computer] technology decreased, and as vertical applications became more important, it was essential to sell via some channel that had expertise in a given industry or with a given application."

As evidenced by Jakubik's comments, however, the addition of VARs and MRs to the distribution system created considerable culture shock. With past success attributable to direct selling and a strong support service system, the sales organization could not easily accept the need for so-called alternate channels. In businesses where technology and technical selling has acquired a high value, and where technically trained personnel enjoy high status, it may be difficult to acknowledge the need for outside technical support, much less market coverage. One HIS manager's reference to resellers as the "Vietcong" conveys not only a sense of scorn but of distrust, as well.

Gaining acceptance internally for adding VARs and MRs to the distribution system was one problem. Perhaps a greater challenge was redefining, and in effect constraining, the role of the direct salesforce in terms of the size of potential orders that salespersons might pursue. As the discussion in Chapter 8 indicated, this boundary was difficult both to define and to enforce. It left HIS field sales personnel with a distinct sense of having to compete, not only with other computer manufacturers but also with their own resale network, in making sales and meeting quotas.

Related to the boundary challenge was the task of restructuring both the headquarters and field sales organization to accommodate a multichannel strategy. HIS went through three major reorganizations in five years in attempts to integrate the reseller and direct channels, to take a coordinated approach to a wide range of customers, and to utilize each channel in a way that was both cost efficient and competitively effective. Not only structure but management processes, as well, were at issue. The lead referral system,

quotas and performance measurement routines, and sales compensation all came under scrutiny.

By year-end 1985, 15% of HIS's revenues from sales of small systems, the DPS-6 line, came from its reseller channels, which had now become well assimilated into sales operations. As James Murphy, HIS vice president and head of the indirect sales program, commented,

When the market changed so radically on us, we had to respond strategically and organizationally. What made that so difficult was that to adjust we had to significantly change the culture. Not easy! Now we've developed a strategy and a structure based on product specialization. We've altered the compensation system to make product specialization work. We have put a lot of teeth in our lead referral program, and put heavy emphasis on personal selling, telemarketing, and advertising to build our reseller program. We've developed a highly capable and specialized ISO organization to build and manage the reseller network. We've added the Porting Center4 to make ourselves more attractive to our customers. The result: overachievement! By the end of the third quarter, we will have made our targets for the year!

At least two factors were crucial to coping with a changing market environment at Honeywell. One was top management's conviction that it was essential to compete in the market for small applications-specific information systems, along with their willingness to do this through whatever means necessary and to accommodate the transition with a new strategy. The other was a willingness to try different modes of organizing and managing a multichannel system until the desired results were achieved. In transitions of this order, it is often difficult to see clearly what new modes of management and what new structures will serve to implement new strategies, and a tolerance for trial and revision may be essential to adjust constructively to change.

SUMMARY

In both cases, the impetus for change was a growing and evolving market environment. The market for FHP appliance replacement motors had become intensely price competitive, forcing major suppliers to vacate this sector of the motor industry and forcing General Electric to reexamine its use of master distributors as an intermediate level of distribution. At Honeywell, the explosion of markets for information systems using mini-
computers, combined with applications-specific software prompted its move to a multichannel system using VARs and MRs to reach the myriad of potential customers.

For both GE and Honeywell, change generated strong resistance from those channels constituencies which perceived themselves as being threatened and, in all likelihood, disadvantaged. From GE's master distributors came the reaction, "We'll make you bleed!" At Honeywell, the direct sales reps' resentment of the VARs invading their turf is captured in "Vietcong" symbolism.

It is often difficult to assess the extent and power of resistance and to determine whether the retaliation strength of disadvantaged channels members is such that its cost would exceed any benefits to be gained by restructuring the distribution system. This uncertainty, coupled with what may be termed the paralysis of past success, often results in resistance to change. Change runs the risk, as well, of violating the strong personal ties that build up around supplier-salesforce-reseller relationships almost as implicit contracts based on each party's expectations of the other. Such relationships are the cement that holds a system together—and change becomes difficult as the cement hardens.

It seems, then, that the restructuring of distribution systems comes only if the costs of preserving the status quo in terms of sales revenues, market share, and profitability are high and the need for change is compelling. The costs of making no change were judged by the Honeywell management to be sufficiently great as to lead to reformulating distribution strategy. At GE that was not the case. Because the potential costs of realigning an obsolete channels system seemed too high in terms of transition investments and possible loss of revenues, managers in the Component Motor Operation backed off.

When significant change is implemented, the chances of success seem to depend on three factors. First, it is important to see the move in the context of a total marketing strategy intended to address specific market segments with defined product lines. In this context, what roles different elements in the channels system will play, what types of accounts each will serve, and what parts of the product line each will carry need to be planned so that any change in how the firm goes to market is consistent with the overall strategy.

Second, success is often contingent on the supplier's leading from strength, strength vis-à-vis both its competitors and its channels network. Honeywell did not have the market strength of such competitors as IBM or DEC, and while Honeywell did in fact undertake a major restructuring of its distribution system, it was not easy to recruit VARs and MRs to carry out a market segment entry strategy on the scale that its managers would have liked.

Third, effectively implemented change almost always has an organi-