Understanding and managing 'internal' and 'external' channel conflict in African markets: Learnings from Pakistan

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Abstract
The paper focuses on vertical conflict between the mega retailers/wholesalers and Fast Moving Consumer (FMCG) manufacturers in developing markets. To contextualize, the traditional distribution structures in the emerging markets are briefly described. The paper views the channel conflict from the perspective of FMCG managers working in Africa and other developing markets. By using examples from Pakistan, various challenges faced by FMCG manufacturers both internally (inside the organization) and externally (in the channel) are highlighted. Using Webb and Lambe (2007), general directions for managerial action are provided.
Keywords: Internal conflict, external conflict, African markets

Retail sector in African markets has been experiencing consolidation since the mid-1990s (Weatherspoon and Reardon, 2003). This is evident from the emergence of locally owned Western style super markets in the urban centres. Moreover, foreign investment in retail and wholesale, although slow in its progress, has been establishing its networks (Motsoeneng, 2015).

According to Weatherspoon and Reardon (2003), the factors that have led to emergence of supermarkets in developing economies are very similar to the ones that contributed to this trend in Europe and United States. The consolidation of retail or the proliferation of supermarkets can be attributed to both the demand of these formats by the consumers and the supply by supermarket entrepreneurs and foreign companies. On the demand side, rapid urbanization along with the entry of women in workforce outside the home created demand for supermarkets, as the opportunity cost for women to stay at home and cook increased, thus creating the demand for shopping convenience and ready meals. Moreover, the growing per capita income also contributed to this phenomenon. Families could now shop for groceries weekly or monthly as opposed to daily. Moreover, growing access to cars also contributed to this trend. On the supply side, the development of supermarkets in the developing markets was somewhat dissimilar to the pattern seen in Europe and United States, as a significant portion of supermarket emergence in these markets is attributed to foreign investments. Another factor in the developing markets that led to consolidation was the improvement in retail procurement logistics technology and inventory management. Inventory management practices were introduced that minimized inventories on hand. Moreover, use of computers and internet improved supplier-retailers coordination. After contributing to retail consolidation in developed markets in 1990s this factor played its role in the developing markets in 2000s (Weatherspoon and Reardon, 2003).

While this consolidation and modernization of retail complemented the increasingly globalized tastes and lifestyles of urban consumers, it also brought about new forms of tensions in distribution channels. These tensions can be seen in terms of understanding two classical channel conflicts, horizontal and vertical channel conflicts, as outlined by Stern and Reve in their seminal 1980 work. The horizontal conflict is known to occur between competing channels members operating at the same level of channel (e.g. between different retailers) whereas vertical conflict is understood to occur between channel members operating at different levels of the channels (e.g. between suppliers and retailers).

The Evolution of Channel Conflict

With the emergence and domination of supermarkets and chains in the United States from late 1980s to late 1990s, much of the academic literature in the West (predominantly in the field of economics) focused on the horizontal conflict in terms of the impact of Walmart's expansion on small retailers (e.g. Stone, 1995; Cotterill, 1986; Basker 2005a; 2005b; Jia, 2008). Much of this literature highlighted the trend of discount retailing and large retail chains in the last few decades in the United States. The discount retaining and chains were shown to be intertwined as the discount retailing sector was almost entirely controlled by chains. The rise of the super market and departmental store chains faced opposition from the other retailers, especially the small ones. The critics of this retail development tended to associate discount stores and chains with small town problems. It was argued that these stores resulted in closing down of small retailers and forms. This in turn, resulted in the decline of downtown shopping districts, erosion of tax base, decrease in employment and disintegration of closely knit communities. Thus the impact of big retailers on small firms and local communities was highlighted as an area for concern. Panle Jia in 2008 developed an empirical model that when applied on published data (available mainly in business directories) confirmed the media and critics concerns that Wal Mart's expansion contributed to a large percentage of net decline in the number of small firms over the sampled period.

In line with the proliferation of this literature in the field of economics in the United States, international scholarship in field of retailing (a sub field of marketing) also scrutinized the effects of supermarket chains on small retailers in the developing countries. Most of this scholarship developed through the Oxford Institute of Retail Management and Institute for Retail Studies at the University of Stirling in the UK (e.g. Arnold and Monika, 2000). It was established that the consolidation of retail channel translates into more bargaining power for the mega retailers and thus affects the smaller 'fragmented' retail, in the context of developing markets.

In terms of understanding the emergence of the vertical conflict with the rise of supermarkets the literature focused on the impact of supermarkets on the supply chain and the food suppliers (especially farmers), in the context of developing markets. Reardon et al. in their seminal work (2003) highlighted the challenges and opportunities the rise of supermarkets bring to small farmers in Asia, Africa and Latin America. In the specific context of Africa, Weatherspoon and Reardon (in 2003) pointed out a challenging scenario for the farmers. They asserted that the supermarkets influence the structure and coordination of the agri-food system in the Africa, thus determining the conditions and potential for small farms and firms to sell agri-food products to the urban market. The challenge was portrayed as two fold. First, it was stated that the supermarkets diffuse and then rapidly consolidate their procurement systems to gain economies of scale. This meant that the farmers are required to supply larger volume transactions to the supermarkets in comparison to the traditional market. This meant that the small farmers either had to expand their businesses or they had to have tighter coordination amongst themselves (i.e. between many small farmers) to aggregate their supplies to meet high volume demand over a full year. Second, it was asserted that the convergence between the export standards and domestic retail product standards could pose a challenge to small scale suppliers. This provided incentive to the retailers to buy from large suppliers who already adhered to export standards, since export standard products readily met the domestic standards. This also reduced the retailer cost associated with segmentation of products. Weatherspoon and Reardon (in 2003) while outlining these challenges for the small scale suppliers assert that the emergence of supermarkets oriented supply chain mechanisms raise the entry requirements for small farmers or even pose barriers to their entry. It is shown that organisation/coordination in the farming and supplying practices require hefty investments (e.g. for buying trucks, packaging etc.). Thus small producers and suppliers are shown to be at risk of exclusion from dynamic urban markets that are increasingly dominated by supermarkets. It is suggested that there is an urgent need for development programmes and policies to assist small farmers/suppliers in adopting new practices that are demanded by the supermarket oriented procurement systems.

Overall, as we can see from the literature reviewed above that the main focus of the scholarship, whether in the US/Europe or in the developing markets, has been on understanding and elaborating on the dominant position of the super or mega formats versus the small scale businesses, mainly the retailers (horizontally) and farmers (vertically). Very little had been written about the conflict that may occur between the mega formats and other large businesses in the network, for example the large suppliers (e.g. large FMCG manufacturers) in the context of developing markets. Though a strand of US based literature focuses on the relationship between Walmart and Fast Moving Consumer Goods (FMCG) manufacturers (e.g. Varadarajan et al. 1995; Grean and Shaw, 2002), but it predominantly focuses on 'partnership' between them. This paper contributes in this regard by outlining the nature of the conflict between the powerful FMCG companies and the mega retailing formats as they emerge, with special emphasis on developing markets.

FMCG companies have a rich history in the context of developing markets. Most of the global consumer companies have operated in the developing markets of Asia and Africa for more than half a century and have traditionally dominated the organization and structure of distribution in these markets. With the emergence of mega formats in these markets, the leadership position of these companies in the channel is somewhat challenged. Moreover, they increasingly find themselves in a difficult situation in which they have to manage and balance their relationship with both, the traditional channels comprising of small scale retailers and the modern supermarkets.

This paper discusses these challenges in terms of the channel conflict that takes place both 'inside' (internal) and 'outside' (external) the FMCG companies with the emergence of mega retail or wholesale formats in developing markets. This has profound importance for managers and decision makers in consumer goods companies operating in Africa and in other emerging markets, as the urban centres in the continent are experiencing retail consolation and foreign investment at a rapid pace.

Apart from being helpful for the managers, this paper can also be helpful for both the 'practitioner oriented' students who contemplate working in retail channels or in consumer goods companies in African markets and the 'research oriented' students who might want to explore the nature of this emergent conflict further in their post graduate research projects.

The paper illustrates internal and external channel conflicts as articulated by Webb and Lambe in 2007. This is done by drawing on examples of consumer goods manufacturers from the Pakistani and other South Asian markets. Published literature is used for this purpose (e.g. Aman and Hopkinson, 2010; Aithal, 2012; Polsa and Fan, 2011). This is supplemented by primary data collected in the form of interviews and ethnography with four national and multinational consumer goods companies over 5 year period (2008-2013) in Pakistan. As the time of data collection the retail sector in the urban centres of Pakistan was going through profound consolidation due to the entry of international wholesalers, Makro and Metro.

Much learning can be drawn from the experience of South Asian markets, as both South Asian and many African markets (particularly Nigeria, Egypt etc.) are at somewhat similar level of retail development at this point in time.

The paper, by using published literature, describes the extant or the traditional FMCG distribution systems in developing markets. It then discusses the entrance of mega formats and their implications on the overall channel. This is discussed in terms of the horizontal and vertical conflicts that emerge in the channel. The paper then focuses on the internal channel conflict that occurs within an FMCG company. At the end, strategies to manage the channel conflict are discussed using Webb and Lambe's 2007 and Webb and Hogan's 2002 work.

FMCG distribution structures in emerging markets

The retail trade in emerging markets (including African markets) is characterised by relatively long distribution channels and extreme fragmentation (e.g. Ghani, 2005, Aman and Hopkinson, 2010). The distribution structure in theses markets has long been constituted by different players namely, FMCG manufacturers, distributors, wholesalers and diverse types of retailers. This structure helps the manufacturers (usually the brand owners) to reach the fragmented retail outlets. The simple flow of goods through the channel is shown in the Figure I and a brief account of the role of these channel members is now given.

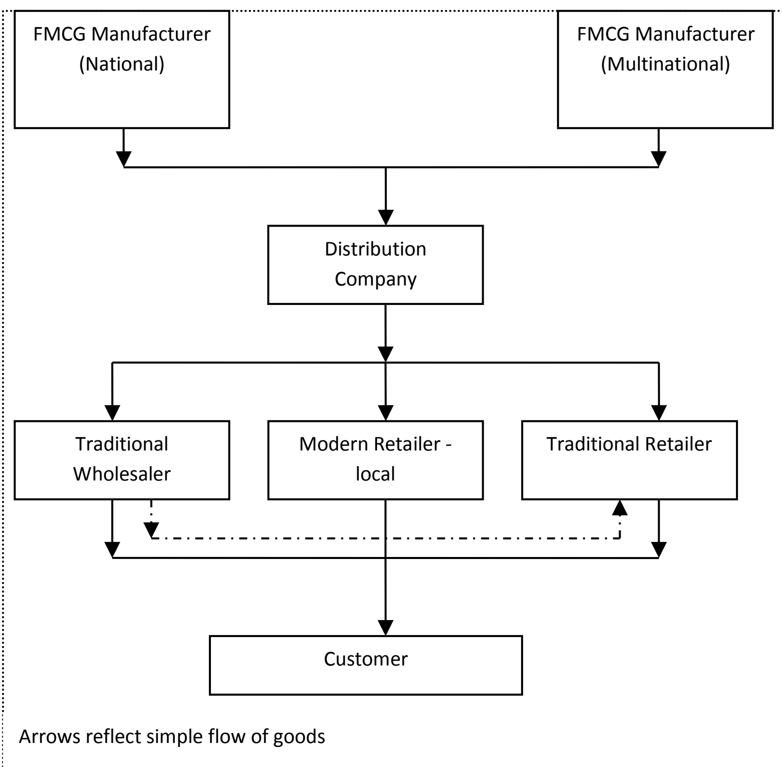

Figure I. The traditional distribution structure in emerging markets (Adapted from: Aman and Hopkinson, 2010)

FMCG Manufactures (or brand owners)

Most multinational and local brand owners operate through a similar channel structure and employ multiple distributors throughout the country they operate in. The extent to which the brand owner takes channel leadership depends upon the power of its brands. Mostly the multinational manufacturers (or brand owners) command greater power and thus determine the flow of product and funds through the length of the channel. The national brand owners may also command leadership depending upon the strength of their brand. The power of manufacturers in relations to retailers and wholesalers is much greater in the context of emerging markets due to the fragmented nature of retail. This is much different from the more developed markets where consolidated store formats like Walmart have much more power than the manufacturer brand owners.

Distributors

In developing markets, distributors are generally organised according to geographic territory. These territories may centre upon one small town including some outlying districts or it may relate to one defined area within the large cities. Thus the large cities may have more than one distributor. Each distributor acts as an intermediary between the FMCG brand owners and the wholesalers and retailers. Distributors sell and deliver manufacturer goods to retailers and wholesalers. Many distributors work with multiple non competing FMCG manufacturers.

The relationship between the distributors and the manufacturers is governed by legal contracts. These contracts require the distributors to implement various promotional activities for the manufacturer. The distributor is responsible for the sale and delivery of the manufacturer products to all the outlets in the territory. The distributor, in return, gets the exclusive rights to sell the manufacturer brands in a particular area. In the arrangement, the manufacturer is highly dependent upon the distributors but this is off set by the control of the manufacturer in terms of setting of margins for the distributors and the exclusive access to a geographic market with respect to popular and well supported brands.

Distributors also add value in the channel of developing markets through their local knowledge and relationships with local retailers and wholesalers. This local knowledge allows the distributor to extend credit to these local businesses.

Wholesalers

Wholesalers in developing economies play an important role as they bridge the gaps in the market and provide support to their fragmented retail base (Samli and El Ansary, 2007). The primary customers of these wholesalers are rural retailers. Urban retailers may also choose to visit the local wholesalers for lower prices as these wholesalers are known to undercut the manufacturer’s recommended price. Local wholesalers also trade with each other forming strong networks of relationships. This allows them to conduct cross territorial sales. This is usually done to take advantage of quantity based trade promotions in one part of the country. Here it is important to mention that the local wholesale network gives rise to a parallel distribution systems that operates alongside the official, territorially based distribution system established by the distributors and manufacturers.

Retailers

In the large cities here is considerable variety of retailers. Broadly they are categorized into 'traditional' and 'modern' or 'organised' retailers. The modern formats are western style smaller supermarket formats (over 100 square meters). The traditional category is offers accessibility but not one-stop shopping for consumers.

Value sales in both modern and traditional formats grow along with the expanding economy in the emerging markets, however, the pace of growth in modern retailing outstrips that of traditional (e.g. Ghani, 2005).

Both modern and traditional retailers are usually serviced directly by the distributors' sales forces at the retailer's premises. Some retailers in the cities and many in the rural areas of either category buy from the wholesalers either in order to obtain a more favourable price or because geographical constraints.

The margin structure: An example from Pakistan

In order for us to understand the channel conflict within a channel (external conflict) and manufacturer (external conflict) we must understand the margin structure in FMCG channels in emerging markets. We can, as an example, study the margin structures in Pakistani channels as articulated by Aman and Hopkinson in 2010. These are given in figure II.

Channel Member		*PKR**	*% margin*
FMCG Manufacturer	SP*	100	

Channel Member		*PKR*	*% margin*
Distribution Company	PP*	100	10%
	SP	110	

Channel Member		*PKR*	*% margin*
Traditional Wholesaler	PP	105	5%
	SP	110	

Channel Member		*PKR*	*% margin*
Retailer	PP	110	9%
	SP	120	

PP=Purchase Price
SP=Sales Price
PKR=Pakistan Rupee

Figure II – Trade margin structure of an FMCG product (125 ml liquid soap) in Pakistani Rupees (PKR). (Adapted from Aman and Hopkinson, 2010)

The emergence of mega retailers/wholesalers and the rise of vertical and horizontal conflict

This section of the paper discusses the emergence of mega retailers/wholesalers and the rise of vertical and horizontal channel conflicts from the perspective of FMCG manufacturer. The emergence of mega retailers whether through direct foreign investment, joint venture or local consolidation of retail brings challenges for the management of channels for the manufacturer, as being the leaders in emerging market channel context, the manufacturers have to ensure positive relationships between all members of the channel.

Vertical conflict is manifested in the disagreements between channel members at different levels of the channel, whereas the horizontal channel conflict is reflected in the disagreements between channel members at the same level of the channel. For example, any conflict between the manufacturers and the distribution companies would be classified as the vertical conflict and disagreements between the traditional and modern retailers would be classified as horizontal conflict (see figure I).

The facets of vertical conflict (external)

With the emergence of mega retailers and wholesalers several facets of vertical conflict can be observed from the perspective of the manufacturer. There are three main facets of this vertical conflict. First, the mega retailers/wholesalers, due to their power and volume, require the manufacturer to by pass the traditional distribution system, and to ship the products directly to them (see figure III). The manufacturer may or may not be willing to accommodate this request as selling directly to the mega retailer can put their relationship with the traditional channel especially the distribution companies in jeopardy.

Another facet of vertical conflict is reflected in the desire by the mega retailers to be offered the same sale price as that offered to the distribution companies (figure II). In figure II, we see that a unit of product is sold at PKR (Pakistani Rupee) 100 to the distribution company. If the same price is offered to mega format, this could give them a huge margin to disrupt traditional retail channel (Purchase Price for mega retailers would be PKR 100 whereas Sale Price to end consumer is PKR 120). This market disruption can facilitated by the presence of the unofficial distribution network as described in the section ‘wholesalers’. Thus offering the same price to the mega formats as those offered to the distribution companies can give the mega formats the immense power to disrupt the traditional distribution channel which can be harmful for the manufacturers, since most of the sales of manufacturers in earlier phase of retail consolidation come from the traditional channel.

The third facet of vertical channel conflict exists between the traditional distribution companies and their customers i.e. the traditional retailers/wholesalers and modern retailers (figure III). In this facet, the customers of the distribution companies demand better prices and/or enhanced service coverage from the distribution sales force in the wake of increase in their power with the existence of an alternate channel source (i.e. the mega retailers/wholesalers). While this may not be harmful for the manufacturer apparently as it only increases competition amongst the multiple channels, this, however can decrease power of the manufacturer vis a vis the distribution companies as the exclusivity previously offered to the distribution companies in their geographical territories is compromised through the availability of alternative channel course for their customers.

The facets of horizontal conflict (external)

Various forms of horizontal conflicts can also be observed with the emergence of mega retailers/wholesalers in the distribution channels of emerging economies. Three main facets of horizontal conflict will be discussed in this section of the paper. First major horizontal conflict arises with between the mega formats and the distributors (see figure III).

Since the mega retailers generally by pass the traditional distribution companies, they directly compete with the distributors for the same customers. With the emergence of mega wholesale formats in Pakistan it was widely feared by the distribution companies that these formats could disrupt and redefine the extant channels, gradually taking away the market share from the distribution companies. This however, was just a speculation since a decade after their arrival in Pakistan, the distribution companies and the mega wholesalers are working side by side.

The horizontal conflict between the mega formats and the distributors may be manifested in the promotional activities by the mega formats may undertake. Through undercutting the price offered by the distributors to the retailers, mega formats may try to take the market share away from the distributors. This can be a cause for concern for the manufacturers as it is in their interest to maintain a healthy traditional distribution channel that accounts for a substantial portion of their sales in the market.

Another facet of horizontal conflict exists between the mega formats and the traditional wholesale. Apart from the promotional undercutting by the mega retailers (like in the case of competition between mega formats and the distributors), enhanced service standards and availability of a range of assortments can be used to increase the market share of mega formats vis a vis the traditional wholesale. Thus business customers such as hotels, restaurants and cafés may appreciate the depth of assortment carried by the mega formats in comparison to the assortments offered by the local wholesale. Moreover, better customer service (including the options of self-service) may persuade the local businesses to purchase from the mega formats. On the other hand, the local knowledge about the customers and the consequent ability to extend credit to the local customers can be advantageous for the local wholesalers.

A third facets of horizontal conflict may exist between the mega formats and the traditional and modern retailers (figure III). Here it is important to note that in some cases these traditional and modern retailers can both be ‘competition’ and ‘customers’ for the mega formats especially for mega wholesalers. For example when Makro and Metro mega wholesalers entered Pakistan, they initially focussed on selling to the retailers, but over a period of time they expanded their customer base to the end consumers. Thus the middle class consumers in the large cities of the country would shop at these wholesalers in bulk for their monthly shopping.

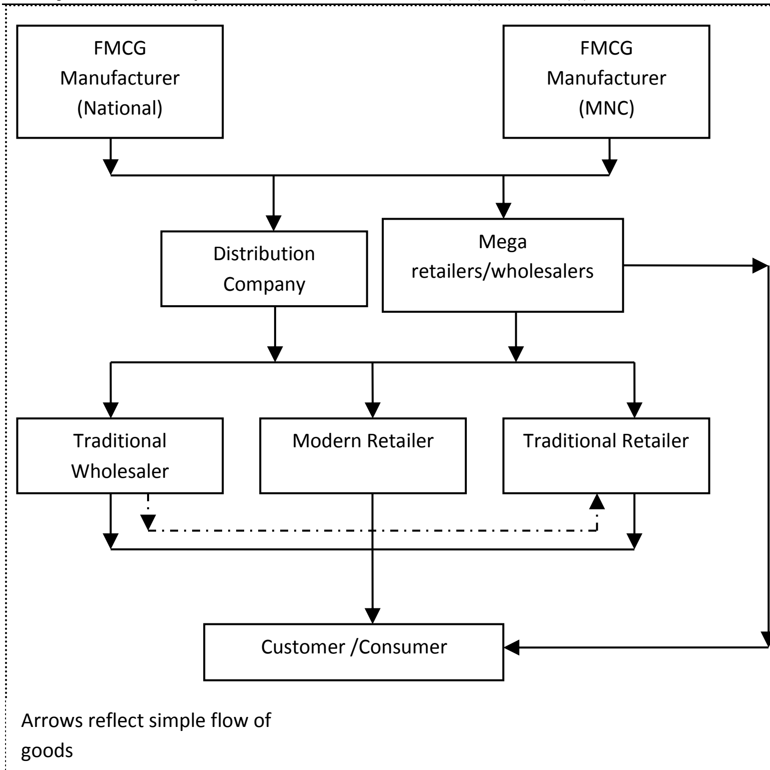

Figure III: Example of a distribution structure in emerging markets post emergence of mega retailers/wholesalers (Adapted from: Aman and Hopkinson, 2010).

The sales hierarchical structures within the manufacturer companies and the internal channel conflict

The emergence of mega formats in the channel requires re-organization of the sales force within a manufacturer. Since manufacturers sell their products directly to the mega formats (see figure III), a specialist sales force is needed to manage relationship with these formats. This sales force is created parallel to the extant sales force that comprises of Regional Sales Managers and Area Sales Managers (see figure IV).

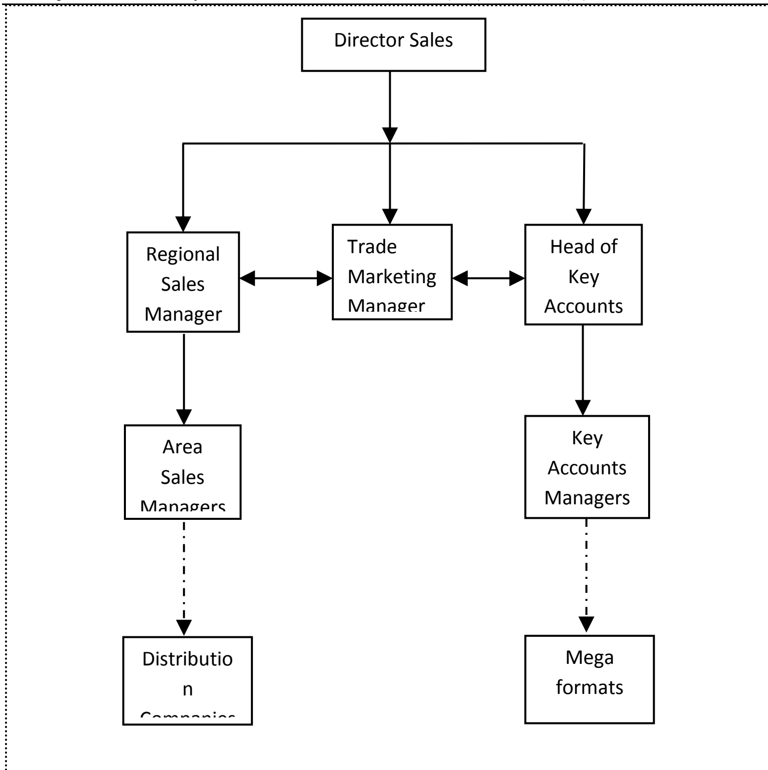

Figure IV: Example of a sales hierarchy within an FMCG manufacturer

While the Regional Sales Managers and Area Sales Managers manage manufacturer's relationship with the distribution companies dispersed geographically, the Head of Key Accounts and Key Accounts Managers manage relationship with the 'key accounts' i.e. the mega formats.

The working of two parallel sales structures also creates conflict inside the manufacturer organization. This is called internal channel conflict (Webb and Lambe, 2007). The two sales teams compete with each other for their quotas and targets and thus the channel conflict that is usually seen as external to the manufacturer, is manifested internally in the manufacture organization. Apart from the performance issues that create conflict different work settings and cultures also contribute towards internal conflict. For example, in one of the consumer goods companies in Pakistan the key accounts teams were given extensive trainings abroad in dealing with the mega retailers. The lack of such an opportunity while being less relevant for the Regional and Area Sales Managers, created discontent amongst these managers. Moreover, the actual work settings and skills required of the two teams are also quite different. The Regional and Area Sales managers have to visit different distributors geographically and have to visit the retail and wholesale markets on regular basis. Thus they require deeper understanding of the local culture and languages. The key accounts team, on the other hand, have to manage relationship with the purchasing managers of the mega retailers who are usually professionally qualified, mostly with MBA degrees. Thus, the key accounts managers require understanding and fluency in the language of 'management'. This difference in skills and work settings translates into two competing cultures than can exacerbate the internal channel conflict.

Managing the internal and external channel conflicts

This section of the paper will be dedicated to elaborating strategies for the marketing managers to manage these conflicts both internally and externally. Webb and Hogan in 2002, while commenting on the emergence of online channel gave example of Mattel who quite successfully launched the online channel for the sales of its toys (namely Barbie). While the existing retailers and dealers resisted this move, Mattel very carefully overcame the resistance by communicating the benefits of online sales on the brand image of the toys. The company also ensured that the price on its online stores was slightly higher than in the physical retail outlets, and that some of the products were only available instore (and not online). Mattel's example might be hard to replicate in the case of emergence of mega formats in developing economies as prices in the market have to be kept similar in the interest of the manufacturer and the two distribution system. Resistance from the traditional channel can be overcome by ensuring that the mega retailers or wholesalers are only given the normal wholesaler and retailer prices. This can ensure price stability and encourage healthy competition.

In terms of the internal conflict, Webb and Lambe in 2007 in their research conclude that some degree of internal conflict between competing sales teams is desirable. They comment that 'properly managed, internal conflict among the supplier's channel coalitions can actually enhance the performance of the overall distribution system' (Webb and Lambe, 2007). They however, point out that the major challenge lies in recognizing the point at which the level of internal conflict becomes dysfunctional, and thus harms the performance of the overall distribution system.

Webb and Lambe (2007) outline three key areas in which advancements must be made by the channel managers to manage the internal conflict. These are increasing goal compatibility, greater communication and coordination, and fostering market orientation. In terms of increasing goal compatibility, it is suggested that an overarching goal of improvement in the overall sales of the company should become a significant part of the performance measures of the sales teams. This will serve to mitigate the competition between the teams. In some of the consumer goods companies in Pakistan, the senior management introduced sales performance measures in which the overall company sales target (or quota) was given 50% of the weightage in the performance of an individual sales manager (whether Area Sales Manager or Key Accounts Manager).

Greater coordination and communication amongst the teams and between the teams and the senior management can also alleviate internal conflict. The top management, i.e. the CEO, the Sales Director and the Trade Marketing Manager (figure IV) have to ensure that ample opportunities are available to the competing teams to interact and share ideas with each other. Most of the consumer goods companies have regular sales meetings in which members of both teams are present. Moreover, annual sales conferences are organized to foster collective thinking.

Market orientation pertains to designing of trade promotions at the senior management level. This is usually done by the Tarde Marketing Managers (see figure IV). The Trade Marketing Managers have to ensure that any promotions designed for a particular channel are reciprocated in the other channel as well, due to the fluid nature of the market and prices in emerging economies. For example, if the Trade Marketing Manager designs a certain trade promotion for a mega retailer, he/she must ensure that promotion of a similar significance is also available to the traditional wholesalers, so that the equilibrium in the market and the channels is maintained. Maintenance of this equilibrium ensures that the conflict in internal sale teams remains at the desired levels.

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