Strategic relationships between manufacturers and distributors[1]

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Abstract

The aim of this research is to further investigate the strategic nature of the relationships between manufacturers and distributors (a.k.a. the industry and the trade world), in a context where traditional market relations are replaced with cooperation for the advantage of both the industry and trade.

After reviewing the existing literature, we will consider how manufacturers and distributors do manage their relationships and we will discuss the various conditions of said cooperation.

Our contribution will be concluded by the presentation of the distribution model recently introduced by Olivetti, which offers a significant case study of the development of relationships between manufacturers and distributors.

Key words: manufacturer-distributor relationships, cooperation, inter-organizational relationships

1. Foreword

If one carefully observes the relationships between manufacturers and distributors in the present market context, an extremely diverse picture of real cases and situations will appear, which make it very difficult and challenging to try and draw out principles or notions, and even more generalize on the matter. These relationships should be defined according to very different principles from those used in the theory of the literature inspired by neoclassical economics, that tends to track studies along the threads of the theory of markets, with the consequence of placing a dominant value on the bargaining-negotiation perspective of relationships between supplier and customer, and neglect any other aspect and problem.

To extremely simplify our argumentation, we may say that the structure and dynamic of relationships between manufacturers and distributors are affected by three different components: a *bargaining component, a competitive component* and a strategic component. Depending on the prevalence of either of these components over the others, relationships will take on different configurations and natures, up to the point of differing significantly in their very essence.

[1] This work is the outcome of joint efforts. However, Prof. Riccardo Varaldo took care of sections 1, 2, 5, 6, 9, in particular, and Dr. Daniele Dalli took care of sections 3, 4, 7, 8.

In the *relationships prevalently based on bargaining and negotiation* the interest of the parties is essentially focused on the mere exchange of products or services against payment of a given amount of money (price), so all efforts are aimed at maximizing short-term results by leveraging negotiation skills and the bargaining power of each contracting party. Under this perspective, which is typical of the economic theory of markets, exchanges are seen as occasional and separate actions that take place between independent entities who make autonomous decisions.

Competitive relationships, instead, are developed as a function of possible "field invasions" of manufacturers in the area of activity of distributors and vice versa, in contrast with the principles of specialization and mutual functional integration. In this context, the harmony of relations between players placed at different levels of the manufacturing-distribution-consumption chain is lost and situations of conflict occasionally arise about which areas or functions are within the jurisdiction of each player.

The pioneering research of Sergio Vaccà on the history of manufacturer-distributor relationships clearly indicates how they have evolved competitively over time (Vaccà, 1963). After the merchant-entrepreneur stage, characterized by the predominance of distribution, there has been a transition to the advent of branded products and advertising, where manufacturers tried to reappropriate a greater market power - intended as the capacity to influence the final choices of consumers - to later enter the stage of the predominance of large distributors, where the market power has moved downstream. This happened by virtue of a high bargaining power and an autonomous capacity of manoeuvre in the processes of formation and evolution of consumer preferences acquired buy large distributors, often in contrast with the objectives and interests of manufacturers. With the spreading of these phenomena on a larger scale, the *season of conflicts between manufacturers and distributors* opened up, as announced in our 1971 article (Varaldo, 1971), and, starting from the eighties, also characterized the Italian distribution market of consumer products - after characterizing the previous evolution of vertical relationships between manufacturers and distributors in the other economically developed countries.

Strategic relationships between manufacturers and distributors generally emerge in all the situations where the two parties recognize the appropriateness and convenience of managing the respective business activities in the medium-long term based on the consideration and recognition of the benefits of an interaction between the specific competencies and resources of the players in the approach to the market and competition. These advanced forms of regulation of vertical market relations mainly developed in the sectors where distribution and services for consumers/end users play a very important role for the success of a business, but simultaneously industrial operations imply high skills and specialised resources that are not easy to reproduce and replace. In these cases, there is usually a tendency for suppliers and customers to converge on considering their destinies mutually impacted and interrelated to the point of believing that only a strategic management of their relationships may lead both to success in the medium-long term.

On the other hand, a strategic approach to the regulation of manufacturer-distributor relationships may also be seen as the cause of a high level of conflict in vertical competition in the market, which may negatively impact on the profitability of the different sectors and create conditions of excessive uncertainty for both manufacturers and distributors.

In this research we decided to essentially focus on an analysis of the strategic aspect of relationships between manufacturers and distributors in an attempt at advancing the study of the subject matter that, in our opinion, has been too long affected by the consideration of the sole competitive aspects of said relationships. This was done to the detriment of the evolution and capacity of said research to explain and interpret real phenomena, particularly in the presence of a series of factors (development of innovative and problematic products, integration between products and services, computerized management of relationships, spreading of network distribution systems, and so on) that are characterizing the development of modern economic systems by giving a greater and different importance to the strategic content of vertical market relationships, i.e. the collaboration interests between the parties. On the other hand, the purpose of our work is also to supplement a review of manufacturer-distributor relationships under the typical perspective of the *industrial organization* with a micro-analytical approach that aims at investigating more in depth supplier-customer relationships and the incidence of business, managerial and organizational variables on those relationships.

2. Trends in the study of relationships between manufacturers and distributors

In Italy, the study of manufacturer-distributor relationships followed an economic-structural approach. In these terms, the manufacturing system and the distribution system are considered as two single, separated and usually opposed, entities, i.e. two industries per se, which come into contact with one another exclusively through exchange relationships regulated by the market.

We have already mentioned the research that initiated the thread of studies on this subject (Vaccà, 1963; Varaldo, 1971), where economic issues such as price levels in the supply chain, the degree of product differentiation and vertical market structures take on a paramount importance and the analytical approach selected mainly aims at highlighting the nature of the relationships between manufacturers and distributors. While the first study analyses the problems tackled by manufacturers to try and obtain a greater strength to influence the final market and defend this power against the rising of an countervailing power that is in the hands of large distributors, the second work focuses on the factors and conditions that specifically affect the degree of power of the different market players and the rising of conflicts in the distribution channel (intra-channel conflicts) and between different distribution systems (inter-channel conflicts).

Another significant contribution concerning relationships between manufacturers and distributors is Spranzi's work (1972), which provides a dynamic picture of the development of competitive relationships between industrial enterprises (manufacturers) and trade enterprises (distributors), particularly by trying to identify the effect of the progressive "modernization" of the distribution sector on manufacturers' market policies. This effect differs depending on whether the reference scenario is a "non-competitive pre-capitalist trade" or a "competitive capitalist trade". While, in the former instance, the industrial enterprise essentially leverages its bargaining and imposition power, in the former it is forced to reset its marketing policies on a substantially different basis.

The issue of the competitive confrontation between the manufacturer and the distributor, with the rising of conflicts and the differentiation of the commercial offer, become the guidelines of the subsequent analyses of manufacturer-distributor relationships.

Following the same economic-structural approach, the literature on manufacturer-distributor relationships developed in our Country simultaneously with the onset of the so-called "trade revolution", induced by the modernization of the distribution system and by the growth in the weight of the facilities of large distributors. More specifically, new contributions were added to the studies on this subject since the end of the Seventies (Lugli, 1976; 1978), which essentially moved into two directions. The first was a new thread of empirical analysis that was conducted with the purpose of somehow legitimizing the economic-structural approach to the study of the evolution of manufacturer-distributor relationships. These studies largely used synthesis, industry and national data concerning the concentration trends of the distribution system, and their purpose was to highlight how increases in the weight of large distributors tended to be matched by changes in the competitive scenario within which vertical market relationships took place and developed.

Secondly, a new research line on the relationships between manufacturers and distributors arose from the institutional area of marketing: while these *trade marketing studies* initially focused primarily on the problems of industrial enterprises, later on they became more autonomous and often also covered the investigation of themes such as retailing and merchandising, which more specifically concern the management of trade enterprises, for the use of strategic levers (*distributor's marketing*) that affect the nature and changes in the preferences of final consumers.

2.1 The analysis of concentration in the distribution system

The main purpose of this line of research is to demonstrate the progressive tendency of the distribution systems to move towards increasingly concentrated structures and to highlight how this, per se, significantly impacts manufacturer-distributor relationships, and changes the competitive scenario.

The theoretical and empirical contributions available to date on the evolution of the distribution system essentially focused on the study of grocery retailing, where concentration has increased more notably

(Zanderighi, 1986; Zaninotto, 1987), with an increase in the relative weight of the different types of modern distribution.

Due to a number of factors (the urbanization of the population, concentration of spatial markets, spreading of mass consumption and consumers, tendency to concentrate purchases over time and space, reduced request for trade services associated with products) the road of size development has been walked in the grocery sector both at site level, with the spreading of supermarkets, and at enterprise level, with the development of large corporate chains, buying associations and chain stores (Spranzi, 1986, 83 ff.).

The economic-structural approach to the study of concentrations in the distribution sector provides elements for the identification of the basic aspects of the evolution of the sector itself, and therefore to draw the competitive scenario where the vertical relationships are determined and change in the supply chain. On the other hand, the approach at issue does not seem to suffice in itself for an in-depth study of the changes that take place in the power of manufacturers and its means of action when the vertical relationships with distributors and horizontal competition change.

The paradigm highlighted in the studies on the distribution system is the triangular relationship between a) *concentration* b) *efficiency* and c) *power* of distribution. The increase in the concentration of distribution, associated with an increase in the size of the enterprises and business units, is correlated with a greater efficiency in the conduction of business functions. This seems to be the result not only of the effects of classical economies of scale, whose significance is rather limited (Lugli, 1983, p. 14), but also of the impact of the introduction of new management methods that affect the principles based on which the marketing function is organized, thus causing changes in the level and types of service the distributor associates to the sale of products (Spranzi, 1986, 63 ff.).

Modern large retailing seems to be more efficient than traditional retailing, as there is an inverse correlation between price levels and point-of-sale size[2]. So, at times of trade modernization, price levels may decrease[3] due to a growth in the efficiency of the entire distribution system.

As regards the relationship between distribution concentration and power vis-à-vis manufacturers, general studies are available, mainly conducted by industrial economists (Scherer, 1985; Chapter 8), while there are no empirical analyses with a larger scope aimed at considering management and organizational issues. The only exceptions are some studies (Lustgarten, 1975; La France, 1979; Gabel, 1983; Cowley, 1986) that used business-derived sources such as the PIMS database, and identified a significant inverse correlation between the profitability margins of manufacturers and

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2 Here we are referring to the empirical analysis conducted by Daniele Dalli in Tuscany in the spring of 1989 within the framework of the course in Retailing Management held by Prof. Roberto Sbrana of the Facoltà di Economia e Commercio of the Pisa University, the results of which are about to be published. The size variables considered are surface, personnel, and product range. Prices have been directly read on the items in various points of sale (POS).

3 This condition occurred, for example, in Great Britain in the Seventies, in the food industry (Baden Fuller, 1986).

the concentration indexes of their customers[4].

In our Country, the effects of the greater concentration in distribution on vertical market relationships have been more inductively considered than investigated; in fact, the deterioration of relationships with manufacturers has been directly and mechanistically explained by that phenomenon, while there is no empirical evidence regarding those effects.

Apart from this lack of empirical evidence of the effects of distribution concentration, we should point out that manufacturer-distributor relationships involve issues that are not quite captured by the economic-structural approach. This poses a severe limit to this literature if we consider that what matters in these relationships is not only the structural characteristics of the two sectors, but also the ways enterprises actually manage their relationships and behaviours in the changing conditions of vertical (between manufacturers and distributors) and horizontal competition (within manufacturers and within distribution). As a matter of fact, only a micro-analytical approach may help systematically grasp the essence of changes in the mutual power between suppliers and customers by investigating the factors that provide a competitive advantage in vertical market relationships and how these can be regulated.

2.2 Trends in trade marketing studies

Trade marketing or trade-oriented marketing studies developed significantly in our Country after the first years of the 80's and concerned consumer goods (Fornari, 1985) considered as a function of the changes observed in the business system and in the significance large distributors gradually acquired in the manufacturers' customer portfolio. Large purchasing organizations not only increased their weight in the manufacturers' turnovers, thus acquiring a greater market and bargaining power, but also developed more advanced management practices that required manufacturers to develop new strategies to cope with them.

It is well known that traditional distribution systems typically show an imbalance of bargaining power in the favour of large manufacturers, who can quite freely control the significant variables that influence preferences and the behaviour of final consumers by implementing specific consumer-marketing policies and reducing distributors to mere logistic and trading roles. Vice versa, when large distributors acquire a greater bargaining power vis-à-vis manufacturers, as well as an autonomous capacity of competing for the conquest of consumer preferences by using

4 However, additional variables are required to explain the variance of profitability in industrial enterprises as a function of the concentration of customers: in fact, this ratio seems to depend on many collinearity constraints. Briefly, we may mention, among positive components, the concentration on the sellers' side, the degree of use of the production capacity, the fact of operating in a young business, and, among negative components, the relevance of purchase costs for the customer over total costs and the wright of fixed marketing costs in the seller's cost function. The latter seems to be mainly connected with the size of the customer portfolio, for which reason they would increase profitability in case of a reduction in the portfolio, i.e. concentration.

their typical and specific levers (choice of product ranges, allocation of exhibition spaces in the point of sale, promotional policies, private labels), the marketing policies regarding products cease to be an area under the exclusive control of manufacturers and become ground for negotiation and processing within the framework of a sort of *contractual marketing* (Guatri, 1987). Under this perspective, customers' needs and requirements take on a greater importance in manufacturers' strategies, who try to meet them by offering customized "product-service packages" for the different types of commercial businesses.

All this leads to a greater economic and organizational commitment for manufacturers: more resources to be dedicated to the management of relationships with customers in general and with privileged customers in particular, and increasingly frequent cases of duplication/differentiation of facilities and operating systems due to the different requirements expressed by different customers[5].

The development of trade marketing as a specific approach to the study of manufacturer-distributor relationships allows for a more in-depth investigation of the operating and negotiation perspective of the interaction between the two categories of players, but this will probably not suffice to grasp the structural and organizational aspects of these relationships. In fact, in addition to outlining the principles based on which one should develop marketing, trade or consumer-oriented policies, it would be important to focus attention on how said policies are developed and managed, and keep into consideration the internal features of the organization that is implementing them, of the competitive scenario and of the type of external stakeholders involved (consumers and customers).

3. Innovative trends in studies on exchange relations

In order to look at manufacturer-distributor relationships under a wider perspective, we should first consider some important new trends in the approaches adopted by studies on customer-supplier relationships, which indicate that:

- marketing activities tend to be more and more considered based on their *exchange content*, that is their nature of "relationships", which characterizes interactions between market players;
- the typical relationships of competitive contexts are no longer the only aspect considered in the studies on business strategies; other factors regarding vertical relationships are also considered provided that they have developed in the context of "domesticated markets";
- within the framework of the marketing mix theory, the *Place tends to lose its traditional nature of tactical variable* to take on the role of strategic component for the different and greater relevance of distribution policies and trade relationships as competitive advantage factors.

The identification of the *exchange as a substantial aspect of the marketing*

5 For a global vision of the quantitative implications of differentiation and of the concentration of the customers of industrial businesses, see Marino (1988, Chap. 6).

function[6] is based on a notion of marketing as a frontier activity (Amdt, 1979), where relationships become particularly important. Looking at the relationships manufacturers entertain with their markets, many stakeholders can be identified: competitors, consumers, direct customers and intermediaries (Fiocca and Vicari, 1987). So, the negotiation and coordination of exchange activities are an important strength of the marketing function, particularly as regards channel relations (Frazier and Sheth, 1985; Arndt, 1983; Stern and Reve, 1980; Achrol, Stern and Reve 1983, Weitz 1981).

The number of partners interacting with each other in vertical market systems is to be associated, as is well-known, with specialization phenomena. According to some organization theoreticians, specialization is determined by the scarcity of resources (Levine and White 1961; Thompson, 1967; Jacobs, 1974; Aldrich, 1979), while, according to others, it is driven by the specificity of the manufacturing functions of the different products and services of the supply chain (Bucklin, 1966; 1972; Mallen, 1973; Stigler, 1951). In any case, the result is that the distribution chain requires many players to be involved, each with a different specialization, in mutual interactions. On the other hand, the opening of markets, the homogenization of needs and the increasingly rapid circulation of information keep widening the territorial and economic-competitive scope of business activities, thus increasing the weight of exchange relations with external entities, in addition to differentiating the types of relationships to be managed.

The tendency to *domesticate markets* mentioned in the second point above indicates that relationships between businesses tend to be less and less occasional and based on competition in the strictest sense of the word. In fact, situations arise where relationships between companies become a real cooperation and continue in the long term. According to Arndt (1979), the repetitiveness and non-conflicting nature of market relationships gives way to the so-called "domesticated markets", where the competitive spirit is following a decreasing trend and inter-company relationships are less and less based on aggressive practices and the traditional mechanisms of competition. Although the envisioned situation does not necessarily lead to the conclusion that the intensity of competition will decrease, it is at least possible to state that, in such a scenario, market relationships are managed by using new competition tools, such as cooperation[7]. As a matter of fact, the domestication of markets does not necessarily assume the emergence of "alliances", i.e. agreements implying a convergence towards common strategic objectives (Fiocca and Vicari, 1986), but simply makes it necessary to coordinate said relationships and exchanges between organizations because, in such

[6] According to Hunt (1983, 9) "the primary focus of marketing is the exchange relationship". Some basic references to this approach to marketing are: Kotler (1972), Kotlere Zaltman (1971), Luck (1969, 1974), Bagozzi (1975, 1979), Arndt (1979).

[7] As Goodman (1979) observed: "There is at least strong anecdotal evidence suggesting that voluntary groups, contractual supply arrangements, and buying contracts... are structured in order to compete with alternative systems, not to eliminate competition".

a context, the role of the market as an automatic structure for the governance of exchanges is progressively fading[8] to give way to organizational or quasi-organizational solutions.

As regards the third point, i.e. the emerging strategic content of distribution policies, a lot of work has been developed on the role of *relationships with customers in the planning and implementation of strategies*. The control of distribution channels may translate into cost savings, as well as opportunities of competitive positioning and development of strategic behaviours offering competitive advantages that are not easy for competitors to imitate or bypass (Valdani, 1986).

Giving a different and greater importance to the role of the Place in the marketing mix has led some manufacturers to change their approach to the market and pass from standardized policies to policies adapted to the specific economic contexts and environment where they operate. Just think, in this regard, of the relevance of that phenomenon for international corporations whose success is increasingly linked to the adoption of forms of flexibility and adaptation in order to keep into account the institutional, legal and socio-economic specificities of the different countries where they conduct their business.

On the other hand, distribution may be assigned a competitive role even in structural terms, beyond the constraints and opportunities it may create for individual companies. According to the extended vision of the competitive forces of a sector "customers, suppliers, substitute products and potential newcomers are all «competitors» for the companies" (Porter, 1982, 13). In these terms, the capacity to manage customers may have a strategic value because the distribution system is a competitive force of the context where the manufacturer operates. Under this structural perspective, changes in the distribution system must be constantly monitored because they directly affect the competitive relationships in the sector, and consequently corporate strategies.

4. The inter-organizational nature of manufacturer-distributor relationships: coordination structures

Day and Wensley's statement (1983, 83) that "... the marketing function initiates, negotiates, and manages acceptable exchange relationships with key interest groups, of constituencies, in the pursuit of sustainable competitive advantages, within specific markets, on the basis of long run consumer and channel franchises" is closely linked to the three assumptions highlighted in the previous point: the role of exchanges, inter-organizational coordination and the strategic role of distribution. According to the logic underlying this statement, the *structural dimension* of relationships between the enterprise

[8] The field of that issue is Williamson's "institutional economics", but interesting integrations to that approach have been progressively developed in the field of customer-supplier relationships. In particular, the economic-political approach, whose manifesto is Stern and Reve's article (1980), that integrates the economic-structural (Williamson, 1975) with the social-political vision (Perrow, 1970; Pfeffer and Salancik, 1978).

and downstream operators should be re-connected with the *relational and long-term dimension* of said relationships, which would show the *strategic component*.

Customer-supplier relationships are probably the main context where the relational dimension of the enterprise takes on a critical nature; in fact, the "physical" object of said relationships is the product or service rendered, to which the destiny of the enterprise is associated. Under a marketing perspective, therefore, the customer-supplier relationship takes on a definitely greater value than other, albeit significant, relationships.

In organizational terms, suppliers and customers have different structural or procedural alternatives available to start and manage an exchange relationship. Depending on the degree of structural integration/ centralization, these alternatives may be distributed along a continuum going from free market relationships to the integrated hierarchy (Williamson, 1979), as shown in the table below (Fiocca and Vicari, 1987) (Fig. 1).

Fig. 1: The continuum of inter-organizational relationships between suppliers and customers

independent organization	
occasional exchange relationships	Market mechanisms
supply relationships	
continuous customer-seller relationships	
collective actions	
voluntary unions	
consortia	Intermediate forms
exclusive agreements	
licence agreements	
continuous product development	
franchising	
joint-venture	Hierarchy
upstream/downstream integration	
integrated organizations	

All these forms are just alternative ways to manage and coordinate inter-organizational exchange relationships. This "management" characterizes integrated forms, where the allocation process is controlled in an authoritative manner, even though the market may also exercise a control function to the extent that it is through the market that the price of said exchanges is determined[9].

[9] The management and coordination dimension - and therefore the weight of the governance cost of transactions – is not the only explanation of the variability of the existing inter-organizational forms: Williamson (1986) explicitly refers to production costs, and particularly to economies of scale and scope. In fact, the model proposed by Williamson (1986) is in line with

The different forms of organization between companies may differ as to which mechanisms each of them uses to coordinate exchanges. Market based ones rely upon competitive mechanisms, as pricing is efficient in the presence of a high number of competitors and under conditions of information transparency. The other forms of coordination, instead, require a more or less significant use of the organization and their dissemination depends on the reduced role of the market as a tool regulating said relationships. These market "failures" occur when its players have a limited capacity to process information and are prone to shrewdly take advantage of favourable situations[10], or when the behavioural conditions apply (Williamson, 1981, 1544) for the establishment of alternative governance structures. As a matter of fact, bounded rationality and opportunism influence the uncertainty that characterizes exchange relationships, and consequently the level of transaction costs, and tend to pave the way to additional coordination mechanisms aimed at defending market players from the failures of the market. For the action of these additional regulatory tools, therefore, inter-organizational forms become increasingly complex and tend towards integrated and bureaucratic forms[11].

Closer exchange relationships emerge depending on the challenges and risks associated with uncertainty, but undoubtedly integration choices are not exclusively limited to structural elements and context. As we will see later on, the *strategic component* of manufacturer-distributor relationships may be a factor of the development of durable relationships and integration among channel partners.

Apart from the causes that originate integration processes, the *degree of integration*[12] of inter-organizational forms can be described by using three parameters:
- the intensity of vertical interactions;
- the degree of formalization of relationship;
- the degree of centralization of the decision-making process.

The *intensity of vertical interactions* concerns the flows of activities, resources and information between two players belonging to two subsequent stages of a distribution channel (Van De Ven and Ferry 1979). The high intensity of vertical interactions - such as joint programs, support services, information support and so on - involves a greater involvement of stakeholders and a higher degree of coordination of their activities. In other words, we may define participation as the extent to which the two contracting parties contribute to the decision-making process (Dwyer and

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the contents of section 5 of this article.

10 For a detailed analysis of opportunistic behaviours in distribution channels, see John (1984).

11 The "new institutional economics" goes much further than stated in the text. However, this is not the context for a further development of the theme of transaction costs economics, for which we refer to the work of its most representative author: Williamson (1975, 1981, 1983, 1986).

12 Integration is mentioned to describe the reunification of multiple organizations under the same decision-making authority. Within this definition framework, integration may take place at different degrees and may be pursued with different tools, as acquisitions are not the only way to obtain control over other decision-making units.

Oh, 1988, 23), meaning that objectives will be all the more interrelated as the contributions to their formulation by the two parties are equivalent.

The degree *of formalization of relationships* indicates the presence of rules, pre-established policies and standard procedures that regulate the customer-supplier relationship. Even in this case, increasing formalizations are assumed to correspond to increasing degrees of coordination.

The provides a measure of the degree of influence of either player on the other and describes a situation of asymmetric interdependence in the relationship. As we will see more in depth later on, interdependence relationships have significant effects on the management of customer-supplier relationships. When there is a high degree of centralization, a greater coordination is assumed compared to situations where the decision-making power is equally distributed.

The three variables of the inter-organizational structure that we find in all the intra-organizational literature[13] provide a measure of the degree of coordination in supplier-customer relationships. In other words, as interactions and formalization and centralization of their decisions increase, the structures at issue approach the hierarchical model, even though they do not necessarily use the tool of integration (John and Reve, 1982, 518; Heide and John, 1988; Stinchcombe, 1985).

The use of more or less integrated structures depends on several considerations that we will examine later on. At this stage, we would like to highlight that *different coordination structures will apply to different contexts, and their choice - in economic and structural terms – is based on a general principle of efficiency*[14].

The greater or lesser efficiency of coordination mechanisms is demonstrated in the real life by the progressive development of either form. This was the basis on which Williamson (1975, 1981) generally assigned a greater efficiency to integrated forms and followed a Chandler-style approach (1966), i.e. a historical assessment of the emergence of hierarchies in different fields of the economic activity.

Although further empirical investigations are necessary, we may say, as regards customer-supplier relationships, that a progressive increase is being seen in inter-organizational agreements, confirmed by the fact that the literature on the subject is developing faster and faster.

Consequently, as regards distributive functions, there seems to be a *tendency to a greater success of intermediate forms of coordination*. Agreements between companies - whether formalized or not, binding or not, signed for a long-term or not - are inter-organizational type of

13 There is a significant parallel between vertical interactions, formalization and centralization, on the one side, and mutual adaptation, standardization and direct supervision on the other side (Mintzberg, 1985, p. 40). More sources are found in Hall (1975) and Hage (1980).

14 Williamson (1986) indicates transaction costs as the primary elements on which to ground a check of efficiency. His theoretical construction is based on the assumption that transaction economies (or diseconomies) are often much more significant than production economies, so he states that "... economic institutions of capitalism have *the* main purpose *and* effect of reducing transaction costs.

relationships that have their own identity and can be perfectly adapted to the specific peculiarities of modern economic systems. And customer-supplier relationships, just like other relationships in the business world, seem to have such features as to make it convenient and functional to manage them through special coordination mechanisms that *differ* from the market and hierarchies and are not simply *intermediate*. On one side, coordination mechanisms used in inter-organizational agreements[15] like guarantees, formal clauses, consolidated business practices, and so on, tend to protect the contracting parties from the risks of uncertainty and opportunism, which remain, instead, or are even increased in market negotiations. On the other side, the "credible commitments" taken on by the parties in intermediate forms of coordination do not require "sacrifices... from the point o view of incentives and economies of scale/scope" (Williamson, 1986), as hierarchies do. In fact, if we look at economic rewards, the internal organization cannot reproduce the potential incentives implied in the entrepreneurial activity, which are guaranteed by inter-organizational agreements.

Admitting a certain degree of compatibility of the respective objectives - which can be admitted indeed in vertical market relationships (Varaldo, 1971, Chap. 4) - customers and suppliers are strongly motivated by subjective interests without this negatively impacting the interests of others, so there is no need to use complex control and incentive systems for operators to obtain a greater efficiency in the exchange processes activated in the channel.

From the point of view of economies of scale/scope, as we will see in the subsequent section, the use of a hierarchy may lead to a reduced efficiency, as the subtraction of a given set of transactions from the market may negatively impact the capacity to take advantage of said economies.

An example of "agreement" between customer and supplier is the franchising model, which generally allows the parties to obtain the typical advantages of intermediate forms of coordination. According to Sabbadin (1989), one reason for the success of the franchising model is the original and correct assessment of the aggregation of products in the assortment. Inter-organizational forms such as that of Prenatal and Benetton mostly owe their success to the criterion used for the choice of the types of product to be distributed, where the importance of economies of scope and aggregation is considered.

Another element worth considering (Sabbadin, 1989) is the effectiveness of the reward system. For example, the chain "Eleganza Veneta" uses an appropriate incentive system for its members, while, in other cases, shop managers are involved in activities aimed at sparking their entrepreneurial spirit.

In summary, the *diffusion of intermediate forms of coordination* in customer-supplier relationships seems to be favoured by the fact that they specifically respond to two kinds of needs: first of all, these solutions are more efficient than the free market because they protect the contracting parties from the risks associated with the uncertainty, opportunism and bounded rationality of the market; secondly, they do not lead to an excessive

[15] Williamson (1983, 1986, chapters 7 and 8) introduced the notion of credible commitments, which had already been analysed within the framework of law studies.

centralization, which, in integrated structures, negatively affects the degree of entrepreneurship and the competitiveness of operators.

As to the assessment of the efficiency of the different forms of coordination, the presence of virtually infinite forms of contracts and informal relationships to domesticate the market, and the simultaneous scarcity of downstream integration alternatives, down to the retail stage, or of absolute independence between channel operators, may provide an ex-post proof of the failure of the extremes of our continuum.

5. Assumptions and conditions for strategic developments in manufacturer-distributor relationships

As we have seen above, the downstream integration and the creation of long-term relationships with distributors are two organizational responses to the problem of coordinating channel activities. While, under certain conditions, it may be preferable to assign the distribution tasks to third parties with whom to entertain occasional relationships, in other cases a greater involvement of said operators could be necessary, even to the point of creating downstream vertical integration processes. To the extent that manufacturers establish interactive long-term relationships with their channel partners, the implications become a strategic value because they end up by affecting the behaviour of the enterprise in the market and its operating structure. There are multiple elements that define the most favourable conditions for the development of this type of relationships in the channel.

A first element is the *presence of economies of aggregation or scope*[16]. Economies of aggregation exist when the joint manufacturing or distribution of multiple different goods is more efficient than their separate manufacturing or distribution. Economies of scope exist when a company has excessive indivisible or non-fungible resources (Teece, 1982) that cannot be exchanged in the market and that can be used only for the production or distribution of other products by the same company. Economies of scope may be affected by the characteristics of both the company and the goods in question. As regards retail distribution, Williamson (1981, 1547) suggested that "Retail outlets that carry many products and brands ... presumably benefit from significant economies of scope in the retailing function". This may explain the emergence of large retailing facilities that distribute hundreds or even thousands of products.

We can find examples of these structures in the *grocery distribution*, where the product assortment has never shown uniform trends over time. In fact, while, until a few years ago, the primary objective was to increase the extension of the product range, today the focus is on the number of items available for consumers in each line of products (product range depth).

[16] There are significant similarities between economies of aggregation (Williamson, 1981) or scope (Teece, 1980; Panzar and Willig, 1981) or even joint production (Richardson, 1972).

Cleary, economies of scope are closely connected with the *characteristics of the marketed good* and with the *need to provide supplementary* services for that good. The "direction" (depth rather than width) of range expansion choices may change as a function of the goods for which consumers require a better and more qualified service and a higher number of alternatives. So, in the points of sale of large distribution stores, depth tends to considerably increase for those categories of goods that simultaneously require high levels of personal service, typically fresh food (foods and vegetables, dairy products, bakery, and so on).

Similar considerations may be developed for the distribution of other types of goods, such as the new products marketed by financial brokers. In this regard, we should point out (Mottura, 1988) the importance of both economies of scale and economies of scope in the diversification of the supply of financial services, but we should not neglect (Mester, 1987; Clark, 1988) the importance of demand characteristics if we want to state the possibility for both multi-product organizations (financial supermarkets) and single-product organizations (financial boutiques) to coexist in the market. Under this perspective, it is therefore possible to describe the importance of market segmentation even in connection with the distribution function, as the channel is defined as a further element used to adapt the product to varying demand patterns.

A further element that affects the aggregation of different goods during the distribution stage consists in the *need to adapt the product/service to the characteristics of the buyer/end user*. In the field of financial services, this sometimes translates into the distribution, for example, of life insurance policies by a bank. These products are basically standardized, which means that they cannot be modified and adapted to the request of each individual, so there is an advantage in combining these products with traditional banking products in the same retailing structure. Conversely, insurance policies, which have to be adapted to specific customer requirements, are distributed by a different channel, generally connected with an agent acting as specialized broker for a better efficiency in the placement of this kind of products.

It is worth pointing out that the services at issue are frequently offered by the same insurance company, which uses a bank office in the first case, with the necessary agreements with the bank, or a specialized agent in the second case. As regards this differentiation of the distribution channel, we should recall the problem of the choice of the vertical integration level introduced above. When an agreement is made with a bank, the insurance company uses the service of an operator that deals with other products and is assigned the task of distributing its services. When an agent is used, instead, the insurance company takes on a more definite commitment in the distribution function through the support and control exercised towards the agent, thus creating a sort of downstream integration.

Based on the considerations above, we can identify three levels of reasons for the creation of close relationships between manufacturers - or service providers - and distributors. Economies of scope, the need for auxiliary services for the marketed goods and the need to adapt goods to consumers or end users' characteristics identify the limits within which there is an advantage in aggregating different goods with each other.

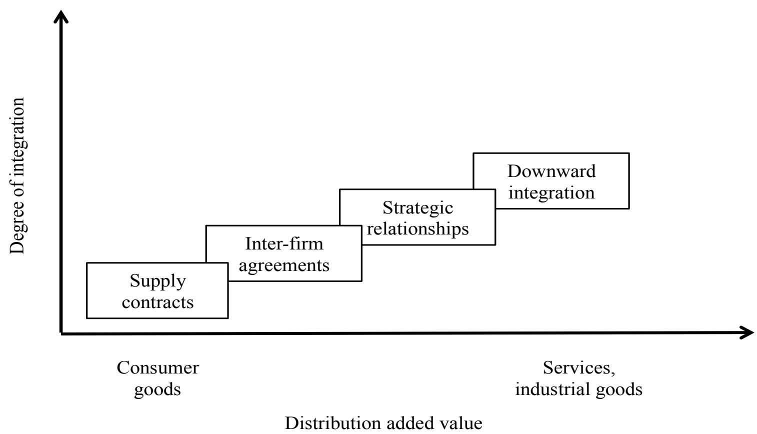
More specifically, we may observe that:

- the *intensity of economies of scope* is a measure of the development of multi-product agents, with whom simple supply relationships are established, often not long-term or strategic relationships;
- the *need for supplementary services for the goods to be marketed* increases the importance of the distribution function, particularly as regards the relationship with the final customer, and paves the way to integration or at least a closer cooperation with the intermediary or agent;
- the *need to adapt the good to the characteristics of the consumer/end user* requires a close relationship with the latter, and consequently appropriate marketing facilities to provide this type of service.

In summary, there are conditions that concern distribution structures, goods to be marketed and the related services that determine the development of multi-product or - alternatively - single-product distributors, capable of providing a different added value to the marketed product.

In practice, a positive relationship seems to exist between the added value provided by the distribution function and the creation of relationships with a strategic content, if not even downstream integration (see Figure 2).

Fig. 2: The distribution added value



In this context, one would expect the passage towards stable relationships and forms of integration with the channel to be determined not only by the greater degree of complexity or problematic nature of the product to be marketed, but also by the greater quantity and quality of the services offered by distributors, that play a more active and dynamic role in the final market. The advent of more advanced and modern forms of distribution may therefore favour, in some conditions, the development of interactive and strategic relationships between suppliers and customers and radically change the rules of the competition in vertical market relationships.

6. The "case" of consumer goods

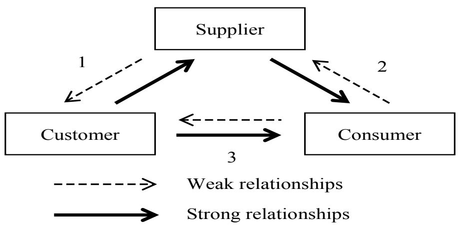
The theme of strategic relationships between manufacturers and distributors may appear to be typical of the sectors of complex and problematic goods, rather than that of food and non-food consumer goods, that is the grocery industry. In fact, the vertical competition between channel operators seems to be rather sustained in these markets, so much so that objectives of domination or rivalry seem to prevail over cooperation. For this reason, the focus on agreements and negotiations in exchange relationships ends up by prevailing over strategic contents.

The main cause of rivalry between suppliers and customers in the grocery industry lies in the fact that both are strongly motivated to establish stable and privileged relationships with the final consumer (see Figure 3). By leveraging brand loyalty, on one side, and store loyalty on the other side, interest becomes predominant in the market and ends up by being the priority objective of the strategies implemented by each player at the individual level.

In practice, as shown in the figure, a greater strength in the relationship with consumers is the tool through which the attempt is made at imposing some exchange condition to the other party, with the inevitable consequence of causing interest conflicts with the other competitor.

In the grocery industry, market-regulated relationships between manufacturers and distributors tend to easily reproduce highly competitive situations that are reflected in price pressures, and consequently on the depression of the profitability conditions of the industries. In particular, this happens because, in horizontal and vertical competition, the price variable plays a primary role and frequently leads to veritable "price wars".

Fig. 3: The triangle of supplier-customer-consumer relationships



Configuration	Probable consequences
# 1 is relatively strong, while # 2 and # 3 are relatively weak	Cooperative relationship between supplier and customer
# 2 is relatively strong, while # 1 and # 3 are relatively weak	Due to a strong brand loyalty, the customer retains the consumer if it replaces the supplier
# 3 is relatively strong, while # 1 and # 2 are relatively weak	Due to a strong store loyalty, the customer retains the consumer even if it replaces the supplier
# 1 is relatively weak, while # 2 and # 3 are relatively strong	There are competitive and conflicting relationships between supplier and customer
The three relationships are all strong	Strategic relationships are established between supplier and customer

If the regulation of exchange relationships is left to the prevailing bargaining power, the competitive game may degenerate to the detriment of the interests of both contracting parties. And it is precisely the consideration of the risks and costs of the excess of conflict that can push players to look for contract solutions and forms of integration that may evolve towards real strategic relationships where supplier and customer reach an agreement about their reciprocal benefits in leveraging their relationship with the consumer to achieve shared objectives rather than pursuing a dominant position in the market.

In the supplier-customer-consumer triangle, the perspective of strategic relationships may provide a possible exit from the "season of conflicts", particularly by virtue of the recent trends that are emerging even as regards non-problematic goods.

The present situation of vertical competition relationships highlights an excessively and permanently conflicting climate that triggers high competition levels in the distribution markets, with the consequence that profitability margins tend to considerably decrease. We may mention a significant example of this situation in the French distribution sector where the price war - between manufacturers and distributors, and among distributors - is connected to very low levels of profitability - approximately 2% versus 5.5% for Western Germany and the United Kingdom (Grasset and Mamou, 1989).

The Italian distribution industry is also starting to perceive the criticality of the conflict with manufacturers. According to the representatives of some of the largest Italian distribution chains, they should "avoid the French excesses … that is, to create conflicts between manufacturers and distributors" (Taino, 1989). The main reference point for the future relationships between manufacturers and distributors seems to be a correct identification of their mutual interests and how these could be taken care of by correctly setting exchange terms, so as to shift those relationships from the area of conflict to that of cooperation.

All this is progressively showing a need to push manufacturer-distributor relationships towards a passage from the "discrimination" to the "differentiation" of sales conditions in order to free the contractual field from distortions that fuel conflict and competitiveness beyond measure. The emerging logic of the differentiation of sales conditions as a new strategic behaviour does not exclusively lie in the recognition of the different bargaining power associated with the different sales intermediaries, but also considering actual differences between the services provided/requested by the different distribution channels and the companies involved. More specifically, there is a focus (Lugli, 1989; 39) on the requalification of trade services and the transparency of the services market, with the purpose of creating more stable and equal negotiation conditions, to seek better integrated performances between manufacturers and distributors. The prevalence of collaboration relationships inspired by a strategic vision seems to characterize the present situation of the two main non-European countries: while in Japan quality and service are the ground on which manufacturers and distributors fight their battle, leaving price at the stage of a second-tier variable (Lapone, 1989), in the United States distributors consider price as one of the possible tools for competition and not as the priority tool. This behaviour is explained by the fact that large distribution chains have now integrated marketing in their competitive strategy and assigned a critical weight to service in the marketing mix, by using market segmentation policies to upgrade in competitive terms the specificities of the demand for the different, appropriately identified customer groups through an offer of different product/service mixes (Clordjman, 1988).

7. Further developments in manufacturer-distributor relationships

7.1 The relational dimension of customer-supplier relationships

Customer-supplier relationships can be more or less strong and stable depending on the intensity and specificity of the factors that bind the two partners to one another and influence the degree of their mutual integration. On the other hand, the evolution - improvement or worsening - of the relationship depends on how the nature and intensity of said interaction factors may change.

In such a context, it is the presence of *idiosyncratic investments* in the customer-supplier relationship that initially takes on quite a significance. These are tangible or intangible elements that are assigned a high value as a function of the specific situation, but that value will be significantly lower if they are transferred to other relationships. For example, in the case of a manufacturing plant for the fabrication of a product meant for a single large customer, the supplier cannot use the facility for other receivers and simultaneously the customer cannot easily replace the supplier, so certain stabilization conditions are created for that relationship. The effect if idiosyncratic investments is that of "freezing" the exchange relationship and making it continuous[17] in an otherwise dynamic context where, on one side, the investments may increase in number, quality and intensity, thus ensuring the persistence of the relationship, and on the other hand, they may lose their aggregation power due to the disappearance of the conditions for their existence.

The typical stabilizing effect of idiosyncratic investments is also found in the accumulation of experiences, practices and habits that take place over time within a customer-supplier relationship. In fact, we should remember that the more operators interact and make long-term alliances, thus adapting their structures and management models to the characteristics of the partner, the more their relationship will tend to be transformed into something more involving and binding than a simple occasional supply

[17] Cf. Williamson (1986): "...1) the specificity of resources refers to durable investments made in support of specific transactions, whose opportunity cost is much lower than the cost of the best alternative uses or of an alternative user should the original transaction be concluded prematurely, and 2) in these circumstances, the specific identity of the parties to the transaction is clearly relevant, which is like saying that the importance of the continuity of the relationship is recognized.

relationship[18]. The human component becomes essential in this context: the habit to interact with a certain contact, the progressive development of mutual trust and the constantly increasing knowledge of the respective operating contexts will create close interpersonal connections that are often the basis of long-term business relationships. Within the framework of international relationships, for example, this component has been seen to be very important; in spite of the physical and cultural distance between operators, long-term business relationships are often developed. In addition to that, these relationships often affect new developments in the distribution activity. In this regard, Anderson and Coughlan (1987) identified the use of pre-existing integrated distribution (or independent) facilities as one of the main reasons for the use of integration (or decentralisation) in the distribution of new products abroad.

Based on these relationships, a sort of interdependence may be created between two business partners, up to the point that the underlying relationship tends to be prolonged even more in time[19]. According to the terminology used by Dwyer, Schurr and Oh (1987, 15), this means that the operators who have an interest may not only share objectives and programmes, but also show a high level of interest for the mutual involvement in the exchange relationship. This happens even more easily when the customer and the supplier are *both* strongly motivated to entertain common relationships.

Figure 4 (Dwyer, Schurr and Oh, 1987; 15) shows a comparative analysis of the reasons of two business partners during an exchange relationship. The characteristics of the relationship change as the interest of the two operators change. The more unbalanced that interest is, the more the relationship will be dominated by one of the two operators, and this will make it less likely to last for a long time. A classical example of an unbalanced situation is the case when a customer absorbs a greater percentage of the turnover of a supplier, but simultaneously the same supplier does not buy a significant portion of the purchases of its customer. In such conditions, the relationship is supported *by the seller*, who has an interest in not losing such an important customer.

The conditions for a stable bilateral relationship are placed in the top right section, where both operators have good reasons to preserve the business relationship over time.

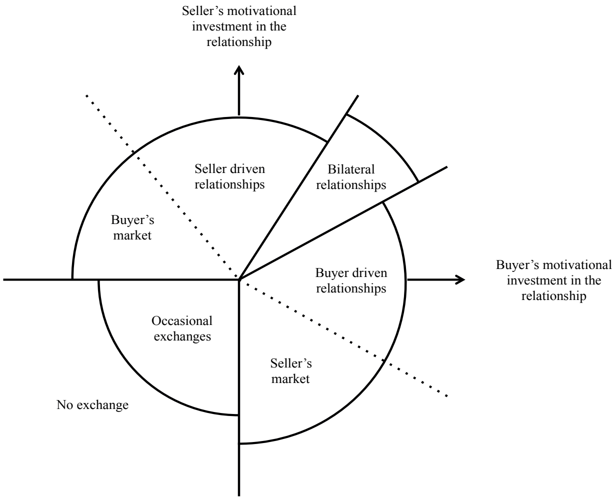
The greater or lesser involvement in the relationship may derive from structural, but also strategic considerations. As we will see later on, both manufacturers and traders can tribute certain competitive advantages that are precious for the business partner. Examples of these strategic resources are the ownership of critical information regarding the

[18] These substantially dynamic phenomena are those referred to by Williamson (1986) together with the fundamental transformation: even in the presence of ex ante "market" conditions (high number of suppliers), the relationship that is created between a customer and a seller can change over time ad be transformed into a bilateral supply relationship. This happens because investments in specific resources are made by the two operators over time that the other operators in the market do not make.

[19] Concerning power-dependence relationships, there is a specific literature that cannot be discussed here; for a survey, see Gasky (1984).

industry - large grocery chains often use this resource in their negotiations with suppliers - or of a well-known and well established brand. Similarly, reputable brand owners will leverage the appeal of their products in negotiations with retailers.

Fig. 4: Reciprocity of customer and supplier motivation to continue the relationship (Dwyer et al., 1987)



The behaviours adopted by the partners within inter-organizational relationships tend to play a key role in affecting the nature of channel relationships and their evolution towards conflict or cooperation positions. We are not going to further investigate the theory of power and conflicts in distribution channels here, as it has been analyzed in the last 10-15 years in the U.S. marketing reviews and in some isolated studies in our country (Varaldo, 1971). However, we should remember that, within the indicated perspective, the study of channel relationships even in the socio-political dimension takes on a particular importance in integrating economic-structural aspects with operation issues (Stern and Reve, 1980). This approach was formalized and checked in some studies (Reve and Stern 1986) and the most significant results of this theoretical approach concern the relationships that connect the inter-organizational form with the *trading climate*, where the latter is characterized alternatively by high levels of conflict or high levels of cooperation.

The notion of *trading climate* defines the degree of effectiveness-efficiency of both the inter-organizational structure and the way this is managed to achieve the objectives of the contracting parties. While the greater frequency and intensity of vertical interactions and formalization are associated with a climate of cooperation, centralization shifts the situation towards the area of conflict (Reve and Stern, 1986; 89 ff.) because friction is created by the excessive compression of the independence of either of the two contracting parties. For these reasons, *the tools used to obtain coordination – i.e. intensity of vertical interactions, degree of formalization and level of centralization –*

cannot be replaced as tools for the management of the customer-supplier relationship. In fact, depending on how exchange relationships evolve, a choice must be made between them. More specifically, in relationships where the negotiation issue is predominant, one must take care not to introduce the conflict components that stem from an excessive use of decision-making centralization, which might cause the business partner to be lost. These implications are typical of the hierarchic structures that sometimes replace the market, but seem to take on a certain importance even in the framework of intermediate forms[20].

The considerations above suggest the need to integrate a structuralist, and therefore static, vision with a socio-political and dynamic vision of interactions between customers and suppliers. This would be the only way to identify the full scope of the issues that determine the appearance and fields of validity of certain coordination structures rather than others, also offering decision and assessment criteria for the corporate choices on the matter.

7.2 Complex coordination structures: networks

The presence of several operators in the supply chain is explained in the literature by making reference to technical-economic efficiency (economies of scale/scope, economies of specialization). Another line of research has been developed in recent years, which tackles the problem of interdependence in more general - and probably more realistic - terms by considering the distribution channel as a network of companies.

According o the definition adopted here (Cook, 1977), a network is a cluster of two or more (individual or collective) players, each of whom provides/uses exchange opportunities with at least one of the other n-1 players. Interdependence, and therefore the "cohesion" of the network is the fact that each operator has its own distinctive competencies, which are the added value for the good to be distributed and indirectly for the other operators of the network. Under this perspective, the interdependencies between the members of the network will acquire a strategic content, so that having a certain critical resource for the sector or for the relevant operating context will be the requirement to enter and remain in the network of a given operator. Examples of strategic resources (Volpato 1984) may be, as applicable, cost leadership, technological superiority, the expertise and know-how related to a product, a process or a market.

The network logic is being extensively used within the marketing framework (Thorelli, 1986; Andersson and Soderlund, 1988), although it seems to be rapidly spreading in other fields as well. For example, some authors (Mottura, 1988) point out a progressive "de-integration" of the banking system due to the pursuance of strategic diversification objectives; "thanks to the network, individual entities can expand their product portfolios, access new customer segments, geographically extend their operating range, use precious expertise (...), based on a logic

[20] Other studies, albeit more limited in scope and extension, have been conducted on the relationships that link the inter-organizational form to the socio-political variables (Dwyer and Oh, 1988) and the latter to the efficiency of control (Etgar, 1976).

of systematic and preferential exchange of «distinctive competencies» ...” (Mottura, 1988; 36).

In practice, the network is like a new form of coordination of relationships between distributors and manufacturers, with bilateral relationships losing their individuality because they are set in a context of *multilateral exchange*, where each business entity contributes its own resources and makes them available for the other to receive, in exchange, portions of the others’ resources. Clearly, it is difficult to determine a value of these exchanges outside the network where they are implemented because they are “calibrated ” on the specific characteristics of the companies of that specific network.

The consistency and stability of the network over time affect its role as inter-organizational coordination structure and not as intermediate solution in the evolution towards other forms of coordination and integration. The conditions for the stability of the network may be either a *convergence of objectives* (Mottura, 1988, 35; Varaldo, 1971, cap. 4) or the *sharing of values and principles* among its partners (Ouchi, 1980). On these bases, and in connection with a context that, in itself, does not prevent the emergence of strategic relationships, the network may develop and stabilize over time as a complete organizational structure[21].

For example, the characteristics defined above - strong functional specialization and strategic diversification, community of objectives, sharing of values – characterize some franchising systems that are particularly representative for their success and dissemination. According to some authors (Gaeta, 1989), the Benetton system has many features that coincide with the stability characteristics identified; the fact, inter alia, that the system is shaped as an *informal agreement* seems to show the presence of ties based on mutual trust and shared objectives, with a managerial culture as the main control tool. In the second place, the system consists of *operators specializing in an extremely diverse range of functions and activities, such as* trade entrepreneurs – each of whom controls many points of sale – sales agents, large sub-suppliers, and so on. Finally, the cohesion of the system is ensured by the continuous *offer of opportunities to its members*, which positively affects their motivation to remain in the network and adapt their objectives and behaviours to those of the network.

In summary, the network may be considered as a specific answer to the typical inter-organizational problems of the operators involved in the process of production-distribution-consumption of goods. More specifically, when the coordination of exchange relationships is strongly connected with the strategic component of said relationships and the number of companies involved in exchange processes increases, then bilateral negotiation allows room for the network for the benefits it offers both at control and performance level[22].

21 As for other governance structures, networks may also be characterized by a variable degree of integration: in fact, strong forms (diversified groups) exist together with weak forms (quasi-markets). Generally, the strength (or weakness) of the network depends on the presence (or absence) of a leader that substantially affects the activities of the other companies.

22 In these terms, we may say that the network creates a situation of coordinated interdependence (Mottura, 1988; 33): interdependence has a selective nature

8. Resuming a corporate perspective

The characteristics of manufacturer-distributor relationships that have been dealt with in the previous sections of this article should now be seen from a corporate perspective to examine their explanatory power without forgetting that there are two more variables to be considered at single company level, which had previously been set aside, namely:

- the possibility and practice for companies to simultaneously manage multiple channels;
- the importance of customer attractiveness as a parameter for the choice of a sales structure.

In business practice, the process of selecting a distribution channel does not consist in identifying a single entity or distribution mode, but rather multiple channels. In this context, we will only try to see whether the variables considered above maintain their significance even in a multi-channel structure even in connection with the second point above, i.e. customer attractiveness, which often significantly affects the choice of a distribution channel, particularly by suggesting the use of more integrated organizational solutions to manage relationships with the most important customers.

We will examine the case of the company "Ing. C. Olivetti & C. S.p.A."[23], which has recently implemented a significant transformation of its sales organization to introduce innovative criteria reflecting the renewed requirements of a sector that is rapidly evolving from both a technological and commercial point of view. First of all, we should specify that the product portfolio of the company is very diversified, going from typing machines to the big computerization projects of large private and public organizations.

These products may be categorized as follows:

- *Volume products:* these are products with a lower technological content that are sold without an after-sale support service and could also be called "turnkey products"; typing machines, low to medium performance personal computers, standardized software packages, and so on.
- *Solution products*: they have a higher technological added value and their users require higher levels of service in terms of before- and after-sale consulting and support. They are advanced personal computers, mini-computers and dedicated software applications.
- *Support and consulting projects*: these cannot be strictly defined as "products" because the sale is more similar to a job order; for

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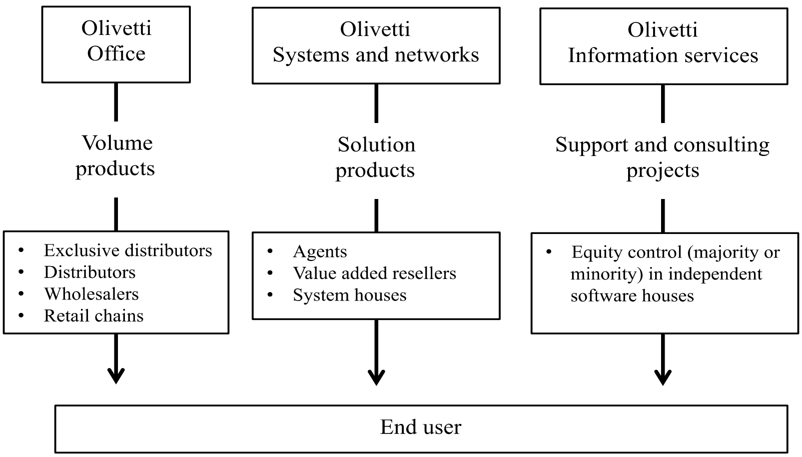
– not all the aspects of inter-organizational relationships have dependency constraints, so external alternatives are always available outside the network, if they are more efficient. In addition, coordination, which is characterized by reciprocity, cooperation and mutual adaptation, is not considered as a variable to be maximized because the strategic dimension can become increasingly important.

23 In this regard, we should thank Ing. C. Olivetti & C. S.p.A., and specifically the engineers Mr. Federico Di Trapani and Mr. Luigi Roux, for heir precious cooperation and assistance.

example, a bank orders a large number of hardware products and software applications for its various branch offices, for which supply very high specialization and professional skills are required from the sales function.

These three groups of products are managed by three separate divisions: Olivetti Office for volume products, Olivetti Systems and Networks for solution products and Olivetti Information Services for projects. The trade operators associated with each division are described in Figure 5.

Fig. 5: Olivetti's sales organization



The sales organization described is completed by the *branch offices* disseminated throughout the national territory, which directly depend on the headquarters and carry out administrative and support functions or the activities of sales operators. The branch offices have a certain degree of "strategic responsibility", although only at local level, where they take care of selecting the operators to be entered in the sales structure (agents, potential value added resellers, etc.).

8.1 The different characteristics of sales organizations

The products marketed by *Olivetti Office* are sold through operators who purchase the products and then take care of their distribution. Apart from the case of exclusive dealers, who have signed explicit agreements, we may say volume products are sold through the free market. In fact, the absence of the requirement of support services and adaptation of the product to the characteristics of each customer allows for the use of independent intermediaries who aggregate different types of products, thus allowing significant transaction economies.

The case of *Olivetti Systems and Networks* differs in the fact that there is a close correlation with the customer/end user, which increases the *added value of the distribution function*, and consequently the need for the manufacturer to integrate downward towards the market. This is why third parties are used, and the divisions entertain very close relationships with them, which are often formalized with an agreement. In this regard, we should immediately point out that the relationships with these contractors often become very important from a strategic point of view.

Agents distribute both the hardware and software of the company and invoices are issued as typically required in this type of channel. Beyond the strict sales function, the agent may also have other functions that increase the added value of the product, like that of installing and implementing the customer's systems, if necessary. This second part of the activity is carried out on a personal basis and is billed separately.

The *value added reseller* carries out the same functions as the agent, but differs in the fact that he buys and resells products. In addition to that, this professional may also be responsible for after-sale customer support.

System houses are considered as business partners and do not take care of the distribution of normal products, but they play a role when special sales conditions occur. In practice, they are operators with a specific competence in certain fields of IT applications and are used when the hardware and software alternatives available cannot meet the customer's requirements. Even in this case, however, these are formally independent organizations that have privileged relationships with Olivetti.

Software houses connected with *Olivetti Information Services* are companies that have acquired a specific state-of-the-art competence in the field of information processing, which are used on the basis of specific significant projects. In particular, these projects are:

- High unit price projects;
- Quite infrequent and long-term projects;
- High-technology and innovation content projects.

In such a context, the management of job orders requires a strong direct presence of Olivetti, which is implemented through the financial control of the connected software houses.

8.2 Multi-channel structure and significance of the customer

The issues dealt with up to this point have very interesting implications for the research of an empirical confirmation of the considerations developed in the previous sections.

First of all, we have seen a process of selection and assignment of distribution functions to different sales/marketing facilities and operators. *To the extent that the good to be marketed requires strong doses of service and processes of adaptation to specific customer characteristics, the exchange relationships are controlled by more integrated structures.* In other words, we may say that with increasing added value levels in the distribution function there is a passage to independent suppliers (competitive market) first, and then to forms of inter-organizational agreements and finally to quasi organizational forms of participation.

Said implications lead to the conclusion that, even within the framework of the same company, the choice of marketing facilities, and therefore the nature of relationships with distributors, may extend significantly within the market-organization range. This differentiation can be explained with the same variables that explain, ex-ante, the existence of different coordination facilities in the market.

The observed trends towards integration do not follow a uniform pattern, but rather have different degrees and structures. More specifically, it is important to highlight that there will never be a total integration, but *a trends towards an increase in the degree of control on sales operators through formal and informal forms of cooperation.* The formal component of agreements is often associated with a number of informal issues that contribute to make relationships closer. The practice of organizing periodic update meetings with intermediaries, for example, which can even be compulsory under the agreements signed, takes on a social value in the field of interpersonal relationships and serves the function of intensifying and enriching the contents of the exchange relationship.

Even within the same company, there seems to be a clear emergence of *the importance of intermediate forms of inter-organizational coordination*. In fact, the creation of strong and long-lasting relationships with independent operators with common objectives, without the complications of integrated structures, determines a capacity to control and coordinate the system, while preserving the economic independence and entrepreneurial thrust of the partners involved.

As regards the case at issue, we should point out that *as the unit value of the exchange item increases, the sales organization tends to be more integrated.* And if the company distributes products with a different value, a selection is made from among individual exchange relationships, so that those related to the highest value transactions are supervised with higher degrees of control by the company. Conversely, lower unit value transactions may be decentralized to subcontractors because the degree of economic dependence of the company on each individual transaction is reduced, and consequently a lower degree of control is required.

In the case we are discussing, large job orders are therefore supervised by dedicated facilities characterized by a greater specialization and expertise, which are also more directly controllable by the company.

8.3 Incentive and control systems

In the general discussion developed above, we highlighted the importance of the capacity of intermediate forms of relationships to develop a strong motivation and, at the same time, ensure the coordination of the activities of operators in inter-organizational relationships. As regards the case at issue, *incentives for distributors are perhaps the most direct method to achieve said objectives and ensure the development of long-lasting and profitable relationships*.

If we analyse, in particular, Olivetti's Systems and Networks division, we will see that high-potential incentives are used, such as those ensured by free entrepreneurial business activities. Commissions, determined as a percentage of the hardware turnover, vary from a minimum of 9% for sales until to 350/400 million ITL to a maximum of 20% for sales beyond one billion ITL. These data show the strong economic driver the company offers its collaborators.

In addition to quantitative considerations, it is important to mention the presence of qualitative incentives to cooperation that are particularly important for the maintenance of long-term relationships. This is due to the fact that *distributors (agent and VARs) and Olivetti Systems and Networks exchange resources with a strategic content* as a function of the specific requirements of the partner. While research and development activities, as well as the image policy of Olivetti, matter for distributors, Olivetti cares much more for the information input due to the proximity to the market of agents and VARs and the added value they give the distributed product.

The value of these resources is closely linked to the specific identity of the operator that owns them (agent or VARs, on the one side, and Olivetti, on the other), but also to the specific identity of the operator to whom they are offered. Therefore, that value tends to decrease if one of the players involved in the exchange tries to "recycle" its resources by activating relationships with other companies. In this regard, consider that distributors did not sign exclusive clauses and Olivetti ensures exclusive territorial rights, so there is a strong motivation in both categories of operators to develop long-lasting relationships. Clearly, the system of incentives and the importance of exchanged resources determines a sort of loyalty of partners even without explicit obligations to promote cooperation.

In such a situation, customer-supplier relationships are based on high levels of *idiosyncratic investments*. In the case at issue, both partners (the distributor and the parent company) made significant idiosyncratic investments, but of a relative homogeneous weight. This explains why the turnover of the new sales organization did not reach 10% during the first year over 300 agents and VARs in spite of the presence of over 5,000 operators in the market who may potentially have the same functions[24]. In practice, making proportionally homogeneous idiosyncratic investments determines a sort of *symmetry of the exchange relationship* that favours the creation of relationships between partners where long-term bilateral cooperation replaces market negotiations.

In summary, we must confirm the significance of certain aspects of coordination that have been introduced above, and particularly the role of *high potential incentives* - which are similar to motivation in the entrepreneurial activity - and *idiosyncratic investments* as drivers of success of intermediate inter-organizational models.

8.4 The Olivetti network

In the previous considerations we highlighted some aspects of the Olivetti sales organization that characterise it as a *network of businesses* both for the configuration and specialization of its members, and for the *nature of the relationships* between them, and from the point of view of the *strategic content* of the exchanges that take place within that network. In addition to that, we may describe a high level of *sharing of objectives*

[24] These data have been provided by Olivetti Systems and Networks.

in the different players involved to the extent that each of them is strongly motivated to contribute to the added value of the product.

A further condition for the stability of the network is *sharing values and principles*, an element that is not easy to measure, but the direct contacts we had with the management of the company allowed us to infer a strong predisposition to establish a dialogue with distributors, exchanging entrepreneurial culture and values in addition to products and services.

The configuration of the Olivetti sales network can be inferred from Figure 6, keeping into account that it refers to the structure called Olivetti Systems and Networks, because it is prevalently characterized as a network.

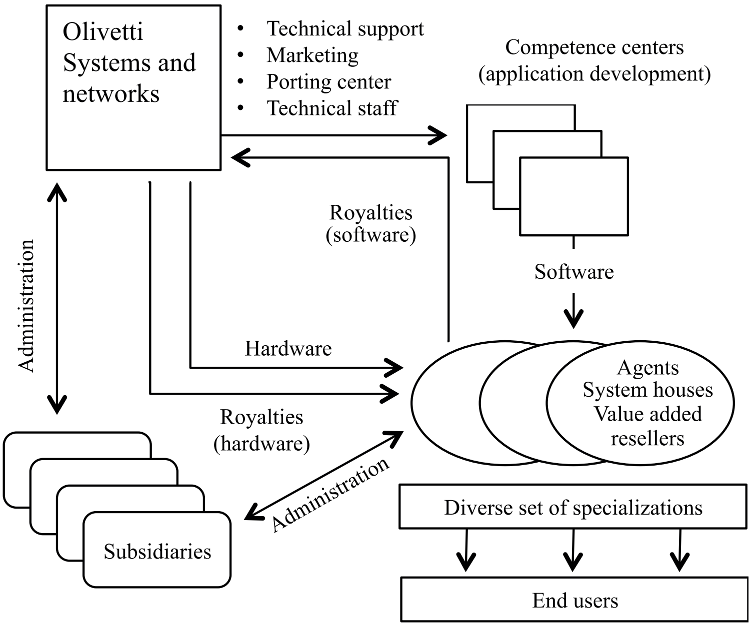
When we accurately examine the figure, we find further evidence in support of the nature of said structures, which are veritable networks, particularly due to the *diversification* of their competencies and resources. The Olivetti Systems and Networks division operates in close contact with some manufacturers of software applications (*competence poles*) specialized in specific fields of activity. These are given generous contributions and support for the development of the product against an exclusive supply of the product to the Olivetti distribution network and the use of the related trademark. Applications are then sent to intermediaries (*agents, value added resellers and software houses*), who will install them on Olivetti hardware under the framework of deep cooperation relationships between distributors and end users. Intermediaries pay a royalty to Olivetti on the sale of those applications.

Simultaneously with the distribution of applications, hardware products are sent to end users passing directly from Olivetti Systems and Networks to sales intermediaries and on which commissions are paid. The chart does not include the activities sales intermediaries carry out on a personal basis, which consist in implementing hardware and software products, but we should not forget that these also contribute significantly to the creation of the added value of the distributed goods and to increase the continuity and profitability perspectives of participating in the network.

Finally, the chart should include *branch offices*, which substantially play an administrative and technical-information support role for all distributors and have a geographical jurisdiction.

One last consideration concerns the *contribution of the different operators involved in the network to the development of corporate strategies*: they can affect the strategic choices of the company not only indirectly and ex-post through their own activity, but also ex-ante, during the preparation of the strategy. Obviously, strategic contributions differ depending on the functional specialization of the various players involved, so competence poles may contribute to product innovation and R&D policies, distributors may implement marketing strategies and branch offices will have strategic responsibilities at local level, because they will take care of selecting the new potential operators of the network. It is important to point out that *assigning a strategic responsibility does not stem from the recognition by* Olivetti of the power that is in the hands of the operators with whom it entertains these relationships, but is the result of a specific choice made within the framework of an operating and competitive context where interacting with partners does not mean losing one's independence; rather this is a precondition for success in the market. In this perspective, sales operators and the other parties involved are recognized an active role in making strategic choices in the light of the contribution each of them associates with the product in terms of support and auxiliary services.

Fig. 6: Olivetti's sales network



9. Concluding remarks

The perspective of strategic relationships between manufacturers and distributors seems to leave the field of pure theoretical speculation and offer ground for new experiments in the regulation of relationships between suppliers and customers in the markets of the present economy. In fact, the interest for cooperation toward more efficient and effective inter-firm arrangements in the field of marketing strategy seems to be a powerful driver in a condition in which the role of distributors is the more and more important in meeting consumers' requirements.

The demand of final consumers for a greater quantity and quality of services is enriching the distribution function, with a growth of its significance in the formation of the global added value of the various industries. For this reason, strategic relationships have become a priority in manufacturers' marketing strategies, in order to avoid the risk of reducing the competitive advantage of both parties due to the excessive importance assumed by pricing policies.

The dynamic environment and competitive context are pushing manufacturers and distributors to invest in strategic relationships and this trend implies innovative and complex management efforts. In fact, the perspective of strategic manufacturer-distributor relationships may realize only by adopting a *relationship management* approach where the systematic nature and consistency of relationships between partners must be an actual point of reference. In substance, for relationships to become strategic in nature, they must be controlled rather than left to the market, without this having to imply vertical integration processes that may have a negative impact in terms of economic results and competitive success in the market.

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