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Article

How traditional manufacturers succeed in D2D: A strategic framework for assortment and pricing to solve channel conflicts

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Marketing Review

St.Gallen

Assessing Marketing Performance

Schwerpunkt

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Spektrum

«Man muss bereit sein,
ein bewusstes Risiko einzugehen»
Interview mit Boris Dolkhani,
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How Traditional Manufacturers
succeed in D2C – A Strategic
Framework for Assortment and
Pricing to Solve Channel Conflicts



How Traditional Manufacturers Succeed in D2C

A Strategic Framework for Assortment and Pricing to Solve Channel Conflicts

D2C offers the chance for traditional manufacturers to gain independence and reduce margin pressure by bypassing retailers. A differentiated assortment and pricing approach is a key lever for mitigating the resulting risk of channel conflicts. Our research helps manufacturers succeed in D2C by delivering a framework that provides actionable differentiation strategies within a four-phase maturity model.

Constantin Götsch, Simon Rupprecht, Tobias Kuntner, Eva Anderl

In 2021, the sporting goods manufacturer Nike reached its highest turnover in history with a total revenue of 44.5 billion USD. A stunning 38,7% of this revenue originated from direct sales. Bloomberg (2017) describes this development as: “Nike Cuts Out the Middleman.” The middleman is a long-standing concept of retailers taking care of the distribution of goods from the manufacturer to the end consumer (Dornberger, 2021).

Today, Nike’s break with this tradition appears to be just the peak of the iceberg. Digitalization allows manufacturers to directly access the consumer via touchpoints like electronic shops or marketplaces (Vadgama et al., 2022). Manufacturers active in D2C can control prices and earn the complete product margin. By communicating directly with consumers, they can react to changing consumer needs and provide tailored product offerings (Haertlein et al., 2021).

The COVID-19 pandemic accelerated this development by showing manufacturers that retailers could be shut down overnight (McKinsey, 2021). It also pushed the behavior of consumers towards a more digitized shopping experience (Sheth, 2020).

However, it should not be neglected that most manufacturers still rely heavily on the consolidated, strong retailers (Matsui, 2022). Their evolution towards independent direct sales channels will likely create conflicts with retailers, especially in the fields of assortment and pricing. Offering the same assortment for lower prices will start a direct competition between manufacturers active in D2C and partnering retailers (Moretti, 2019). This could pose a risk to the manufacturer-retailer relationship that still remains crucial for the success of most manufacturers.

Existing literature does not provide enough insights for manufacturers to effectively cope with these challenges in D2C assort-

ment and pricing. Thus, this article focuses on the main question: How can traditional manufacturers, with a history of selling via B2B channels, define their D2C assortment and pricing strategy to avoid channel conflicts and succeed in D2C?

The article first outlines possible decision options in D2C assortment and pricing. Subsequently, differentiation is presented as a strategic crux to reduce channel conflicts. Ultimately, the article combines identified assortment, pricing and differentiation strategies in a four-phase maturity model. The first inter-related D2C framework leads to recommendations for action to help marketing managers and pricing directors exploit the potential of D2C.

Manufacturers in Charge: Their New Role as End-to-End Distributor

In a traditional distribution chain the competence of a manufacturer is focused on product creation (Moretti, 2019). In D2C, the manufacturer bypasses intermediaries by organizing direct touchpoints with end consumers (Donna et al., 2021). Those touchpoints encompass online channels such as web shops or 3rd party marketplaces, but also manufacturers’ own offline channels (e.g., brand stores) and 3rd party channels such as agency models (Heinemann, 2021).

According to Lienhard et al. (2021), it is difficult for manufacturers to go into D2C as a new skill set needs to be acquired. With indirect distribution, manufacturers solely focus on the production of goods, whereas with end-to-end distribution, they are responsible for all operations from production to marketing to sales (Moretti, 2019). Manufacturers thus become partners as well as direct competitors to retailers for similar offers (Dornberger, 2021).



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Management Summary

This article shows how traditional manufacturers, with a history of selling via B2B channels, can define their D2C assortment and pricing strategy to avoid channel conflicts and succeed in D2C. Offer differentiation, the strategy of taking a homogenous marketing mix and making it appear different in the mind of the buyer, is key to reducing the risk of channel conflicts. Using the framework presented in this article, manufacturers can align their assortment and pricing strategy with their level of D2C power, i.e., brand value, product substitutability and prior D2C experience.

The focus of this tension is on the assortment and pricing strategy. If manufacturers are engaged in indirect and direct sales, they need to decide which products to offer at which prices to which channels (Jelassi & Martínez-López, 2020; Pasirayi & Fennell, 2021). If a brand provides the same product in both channels, retailers and the manufacturer are competing over the same offer. This is exacerbated when a specific product is offered for a lower price in manufacturers' direct channels because retailers may perceive this as an attack against their market position (Webb & Didow, 1997). Therefore, a strategy to balance assortment and pricing decisions between both channels is required.

Managing Assortment and Pricing Between Competing Channels

The level of competition between channels depends on the level of channel integration, i.e., the level of similarity between them (Jelassi & Martínez-López, 2020). The higher the level of channel integration, the greater the extent of a channel conflict, as manufacturers and retailers compete over the same offer (Vinhas & Anderson, 2005). To avoid such conflicts, manufacturers could simply offer a fully integrated portfolio with identical products for a higher price. This strategy most probably leaves a manufacturer with fewer sales as their offer is not attractive for consumers

(Tripp, 2019). Offering their products for a lower price would create an unbeneficial channel conflict. Manufacturers could also offer a new, exclusive D2C assortment instead. This reduces the risk of conflict. However, the development of an exclusive D2C portfolio is costly, creates consumer confusion and adds complexity in internal processes (Bertini & Wathieu, 2011; van der Veen, 2015).

Main Propositions

- 1 The higher the level of channel integration, the higher is the risk of channel conflicts.
- 2 Offer differentiation is the key to easing the risk of channel conflicts.
- 3 D2C power, comprising brand value, product substitutability and prior D2C experience, is the main factor shaping D2C strategies for manufacturers.
- 4 The greater the D2C power, the more extensive and aggressive the D2C assortment, pricing and differentiation strategy can be.
- 5 The greater the D2C power of a manufacturer, the higher the likelihood of D2C success.

Easing Channel Conflicts with Offer Differentiation

The core option for solving these conflicts is to differentiate the offer between direct and indirect channels (Vinhas & Anderson, 2005). Offer differentiation is „the strategy of taking a homogenous marketing mix and making it appear different [...] in the mind of the buyer“ (Hawes & Glisan, 2015). What can manufacturers do to achieve such differentiation?

One possibility is to limit the sales of a product to only one channel to avoid competition with retailers. Manufacturers can also assign D2C products a new stock keeping unit (SKU) to avoid comparability (Roeloffs Valk, 2020) or position a retail product under a new D2C brand (Witek-Hajduk & Napiórkowski, 2017).

A further option is to develop completely new products that are exclusively offered in D2C channels. By making those products exclusively available via D2C, manufacturers can avoid price competition (Lessard, 2021). Manufacturers that offer exclusive D2C products can price their products based on value or the prices of horizontal competitors (Bashkin et al., 2017). Yet, creating exclusive offers can be costly and time-consuming (Bertini & Wathieu, 2011; van der Veen, 2015). Therefore, manufacturers can apply other types of differentiation strategies that change the offer characteristics and make comparisons between retailers and D2C more difficult. One approach is to add services such as extended warranty periods or product maintenance (Baxter et al., 2021). The service level in general can also be differentiated, e.g., via delivery and return policies or free samples (Arora et al., 2020). Customization is another way of creating exclusive products (Winkler, 2019), and personalization is a way of adding extra value compared to retail offers (Heinemann et al., 2019; Detscher, 2021).

Another option for non-exclusive D2C offers is to create bundles (Jelassi & Martínez-López, 2020). By combining two or more products, the comparability of prices and products in comparison to retail is reduced (Simon & Fassnacht, 2019). Prices of differentiated non-exclusive D2C products should reflect the added value (Bashkin et al., 2017).

Products which are not suited for any kind of product differentiation and are fully integrated into both channels carry a high risk of competition. As product characteristics do not differ, prices should be set carefully to avoid conflicts.

To succeed in D2C, manufacturers need to find a beneficial mix of all strategies – exclusive D2C products, differentiated non-exclusive ones and non-differentiated ones. How can manufacturers decide on the right differentiation strategy? And how should they set prices to succeed in D2C, but preserve retail relationships?

A Qualitative Mixed-Methods Approach

The research results presented here are derived from a mixed-methods approach (for a detailed outline [see the online Appendix](#)). First, the authors conducted six interviews with experts from various backgrounds from academia and practice. Their insights enhanced the understanding of the D2C strategies presented above. The interviews were conducted using a semi-structured guideline and analyzed using qualitative content analysis (Kuckartz, 2018).

Second, the authors conducted a multiple case study analysis that followed the three-step procedure of Yin (2009). Twelve traditional manufacturers with either a high brand value, like Apple, or

lower brand values, such as Victorinox, Leifheit or Samsonite, were analyzed regarding offer differentiation and D2C price markup. For five focus cases (Apple, Dyson, Nike, Lego and KitchenAid), D2C price markups (%) compared to retailers as well as the level of offer differentiation and channel integration were analyzed in detail. A summary of the five focus cases is shown in table 1. The results of the multiple case study analysis were based on company websites, brand ranking, financial statements as well as online shops of retailers for price comparisons. Within the case study, D2C-exclusive offers were identified as such when products were explicitly labeled as exclusive or when they could not be found in any retail assortment.

The D2C Maturity Model

It was found that various manufacturers just passively offer the same products as in retail for the recommended retail price (RRP). Others show a differentiated portfolio with partly D2C-exclusive products and direct price competition. How can traditional manufacturers decide on one of these strategies?

The results show that the level of channel integration, price competitiveness

Lessons Learned

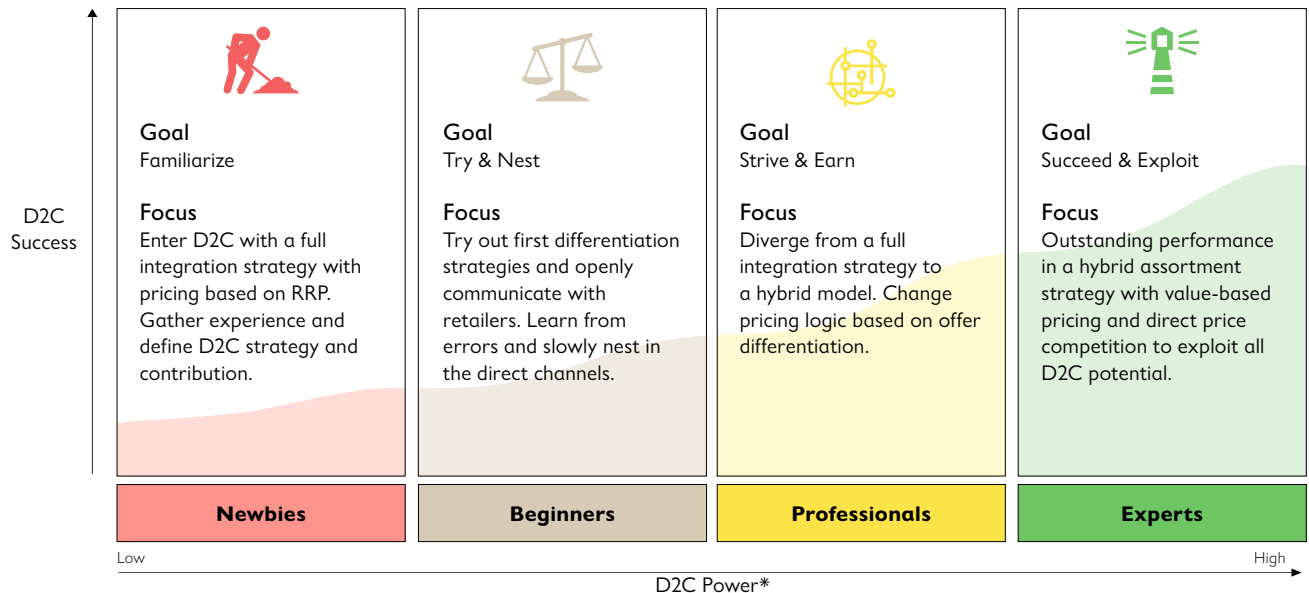
- 1 Assess the importance of your retailer relationship as well as the risk of channel conflicts for your business when planning to get involved in D2C.
- 2 Before going D2C, use the Maturity Model to assess your level of D2C power and align your assortment and pricing strategy according to your maturity stage and business case.
- 3 With low D2C power, start offering an integrated assortment in D2C. With increasing maturity, evolve to a hybrid assortment with D2C-exclusive products.
- 4 With low D2C power, price your products based on the RRP. With increasing D2C power, slowly start to price competitively.
- 5 Use differentiation instruments to avoid channel conflicts. The greater your D2C power, the more complex differentiation instruments can be applied.

Table 1: Overview of the Five Focus Case Studies

Case	D2C Markup (%)	D2C Offer Differentiation	Assortment Strategy	Assortment Volume	Product Type
Apple	2.7%	Low	Full integration	Low	SMCG
Dyson	-0.4%	High	Full integration	Low	SMCG
Nike	14.2%	High	Hybrid	High	FMCG
Lego	21.9%	Medium	Hybrid	High	FMCG
KitchenAid	15.1%	High	Hybrid	Medium	SMCG

Source: Authors' illustration.

Fig. 1: The D2C Maturity Model



*Factorial equation of = brand value & D2C experience & product substitutability. Source: Authors' illustration.

and differentiation mainly depends on three factors: (1) brand value, (2) product substitutability and (3) prior D2C experience. These three factors will summarily be referred to as D2C power. The results

indicate that the higher the D2C power of a manufacturer, the more advanced can be the pricing and differentiation strategies. To visualize the impact of D2C power and align it with actionable

strategies, the results are incorporated into a D2C Maturity Model (figure 1).

The level of maturity is defined by the D2C power. Manufacturers with low D2C power are called Newbies. The ultimate goal of Newbies is to familiarize themselves with the new channel and gather first experiences. They enter D2C with a fully integrated assortment and offer their undifferentiated product for the recommended retail price (RRP). An example of this type is the sporting goods manufacturer Wilson, which offers their products for the RRP without any differentiation.

Next, Beginners are manufacturers that show an increased D2C power. Their strategy is to try out some first differentiation measures such as added services and slowly settle down in the direct sales channel. They learn from their D2C activities by receiving feedback on them. The Swiss knife manufacturer Victorinox differentiates its D2C channel by offering personalization as well as special edition colors. Due

The Case of KitchenAid

KitchenAid, a manufacturer of household appliances such as blenders or cooking machines and other kitchen gadgets, is a good example of how D2C Professionals (and Experts) can use differentiation to justify higher prices and avoid channel conflicts. As a household appliance manufacturer, KitchenAid finds itself on rank three of the most valued brands (Prophet Consultancy, 2021). They offer innovative products in a premium price segment (KitchenAid, 2022).

KitchenAid charges a comparably high markup of approx. 15% plus an additional charge for personalized goods. They use a wide range of differentiation strategies including bundling (allowing them to partly undercut retailer prices for selected products), personalization (by engraving), free extras such as gratis bowls or extensions and a 90-days money-back-guarantee. Additionally, KitchenAid also provides exclusive and limited products that are offered only via their D2C channel.



Fig. 2: Strategy Board for the D2C Maturity Model

	Newbies	Beginners	Professionals	Experts
Goal	Familiarize	Try & Nest	Strive & Earn	Succeed & Exploit
Pricing Strategy	RRP to avoid price competition with retail	Slightly undercut RRP and justify markup with first differentiation value-adds	Low D2C markup with additional markup for differentiated offers	Value-based pricing as markup on top of retail price level
Assortment Strategy	Full integration undifferentiated	Full integration differentiated	Early hybrid	Hybrid
Differentiation Strategy	None	e.g., services, personalization	Phase 2 strategies plus e.g. variations, limited eds., bundles	All strategies incl. exclusive products & customization
Revenue	Low due to RRP	Low to medium due to differentiation	Medium due to markups for differentiation	High
Channel Conflict	Not existent due to RRP pricing	Possible - differentiation needed	Probable - differentiation is a must - strong brand required	Certain - D2C management with a top brand needed

Source: Authors' illustration.

to a higher product substitutability as well as limited brand value, Victorinox remains conservative in their pricing by offering their products for the RRP.

Brands with medium to high D2C power are referred to as Professionals. With a better market position, they strive for success and can earn higher margins in D2C by moving away from the RRP. With increasing experience, they diverge from a fully integrated assortment into a hybrid assortment model with some first D2C-exclusive products. For example, KitchenAid's D2C experience and brand value allows them to price independently from the RRP. On average, KitchenAid charges an extra 15% on retail prices. Their differentiated assortment with exclusive products, customization and personalization clearly differentiates D2C from retail (Prophet Consultancy, 2021).

Manufacturers of innovative products with a top brand value and extensive D2C experience are designated as Experts.

The higher the D2C power of a manufacturer, the more advanced can be the pricing and differentiation strategies.

They know how to handle channel conflicts between direct and indirect channels and fully concentrate on exploiting direct sales channels. Their hybrid assortment is differentiated, with exclusive and customizable products. Experts price their products increasingly value-based and with comparably low D2C markups (or even none). For example, Dyson's innovative products, powerful brand and experience in D2C allows them an aggressive pricing strategy. In some cases, Dyson even undercuts the price of retailers. Their extreme D2C power is complemented by differentiation strategies such as services with free extras or seasonal

D2C-exclusive products to avoid channel conflicts (Prophet Consultancy, 2021).

The maturity of a traditional manufacturer correlates with D2C success. D2C success is shown on the y-axis of the D2C Maturity Model. It correlates with the level of value a manufacturer is generating in direct sales. It is assumed that turnover or profit may be suitable metrics. However, the model does not give any specific definition of D2C success as cases may differ.

Each of the four phases incorporates specific pricing, assortment and differentiation strategies. To align these with manufacturers' D2C strategies, a clear and dedicated guide is needed. Such a guide is given by the D2C Strategy Board depicted in figure 2.

The Strategy Board provides strategic details for the four maturity phases with regard to pricing, assortment, differentiation as well as revenue and channel conflicts.

- Newbies with low D2C power are advised to integrate their whole portfolio in D2C on the basis of the conservative RRP to reduce complexity and the risk of conflicts. Due to the passive approach, revenue is expected to be low and channel conflicts should not be existent.
- Beginners differentiate their fully integrated assortment, e.g., with added services. Due to the reduced comparability, they can slightly undercut the RRP. As the offer is gaining in attractiveness, revenue in D2C is expected to rank at low to medium levels. Differentiation strategies need to be applied to avoid channel conflicts.
- Professionals use their increasing D2C power to earn higher revenues. By starting to implement some D2C-exclusive products and using advanced differentiation strategies, they manage to bypass channel conflicts without risking their D2C success. With their

differentiated channel offerings, professionals move away from RRP pricing. They add a low D2C markup compared to retail, justified by added value.

- Experts show D2C excellence by utilizing complex differentiation strategies, a differentiated hybrid assortment with exclusive products and direct price competition where suitable. They exploit the direct channel with increasing revenues. As price competition might trigger channel conflicts, Experts must employ an excellent channel management, paying attention to their retailer relationship and utilizing diverse differentiation strategies.

As part of the D2C Maturity Model, the Differentiation Board in figure 3 goes into detail on when to apply which differentiation strategy. It further elaborates on the specific pricing method to be used when differentiating an offer.

The Differentiation Board shows manufacturers three ways of entering D2C with their portfolio:

- The basic offer type is undifferentiated and existent before going D2C. This strategy is available in all phases of maturity. Depending on the D2C power and aggressiveness of a manufacturer, pricing can range from RRP to low markups in D2C. Products are offered with the same characteristics in both channels.
- The second type is represented by those products that keep their core characteristics, but are enhanced through differentiation, such as services. The more mature a manufacturer is, the more price competitive their differentiated existing offers can be. Through simple differentiation, these strategies are a start to avoid channel conflicts over offers that are price competitive.

Fig. 3: Differentiation Board for the D2C Maturity Model

Maturity Phases	Offer Type	Channel Type	Differentiation Strategy	Pricing
1 2 3 4	Undifferentiated, existing offers	Hybrid	None	RRP ≈ RRP ++ Markup + Markup
2 3 4	Undifferentiated, existing offers	Hybrid	Service Subscription Membership Ext. Content Free extras Product Samples Ext. Warranty	Value-based ≈ RRP + value markup Individual ++ markup Individual + markup
3 4	Undifferentiated, existing offers	Hybrid	Product Bundling Personalization Limited editions	Bundle < Retail price Value-based markup Value-based markup
3 4	Differentiated, new offers	D2C-Exclusive	Developing new SKU Customization	Competitor-based markup Value-based markup

Source: Authors' illustration.

- The third type of offer is differentiated to such a degree that it is not comparable to an offer in retail. Through new product development or customization competition between manufacturers and retailers is avoided. Manufacturers can further use this strategy to move away from the RRP and earn their full margin based on the value of the product or prices of horizontal competitors. As the high level of differentiation creates complexity, it will mostly be manufacturers in phases 3 and 4 that will successfully manage to deploy these strategies.

Conclusion

This article underlines the importance of strategic excellence when going D2C as a traditional manufacturer. The risk of channel conflicts or failure in D2C can be addressed by aligning the assortment, pricing and differentiation strategies with the existing D2C power. With an increase in maturity, a manufacturer can become more aggressive in D2C activities, enter into price competition with retailers and financially exploit the direct channels. By using the presented differentiation strategies in the appropriate maturity phase, channel conflicts can be reduced to realize D2C success.

Besides practical implications for traditional manufacturers, the results at hand show ample opportunities for further research. Future research could quantify the impact of the three D2C power variables (brand value, product substitutability and prior D2C experience) on channel conflict and D2C success as well as complement them with so far unidentified variables. Furthermore, the identified differentiation methods such as exclusivity should be examined in more detail.



Weitere ergänzende Grafiken zum Artikel finden Sie unter: unisg.link.MRSG-Goetsch-et-al

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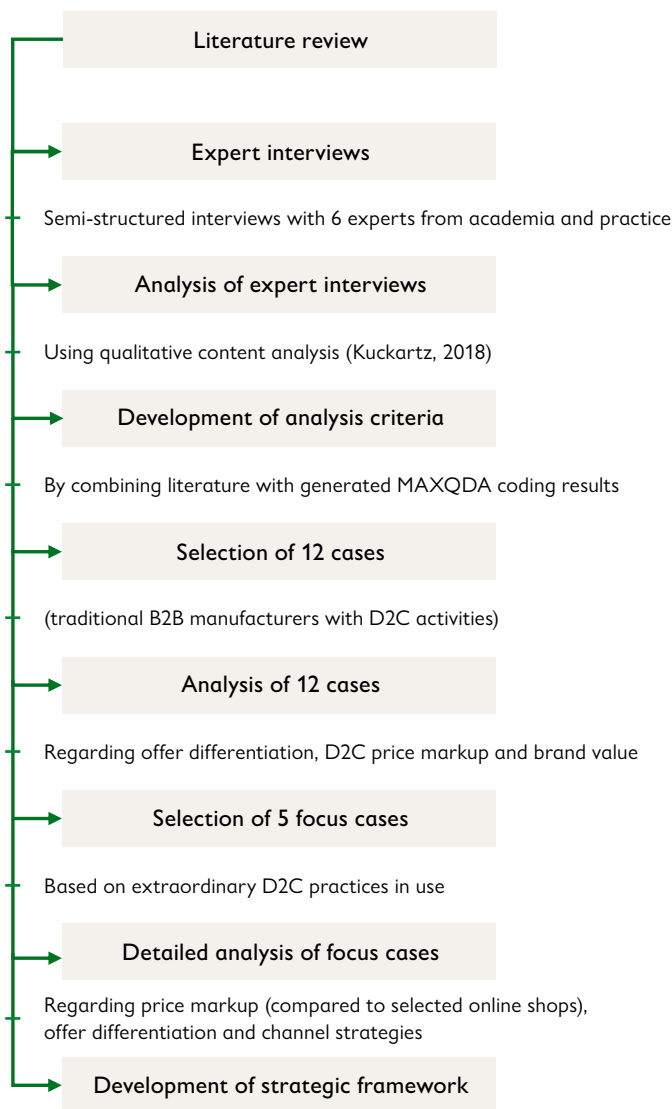
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Going D2C – How Traditional Manufacturers Can Solve Channel Conflicts

A Strategic Framework for Assortment and Pricing

Appendix: Mixed-Methods Approach



Source: Authors' illustration.