From Channel Diversity to Channel Strategy

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Abstract: The strategic design of sales and service channels has become a key determinant of competitive performance in an increasing number of industries. Based on data collected in thirty companies in a range of product and service industries, this paper presents a simple, three step method to help managers use their sales and service channels strategically. Step one of the method is to review existing channel options to select a set of channels with the functionality needed to fully meet target customers' requirements. Step two is to integrate the selected channels into a channel band strategy that brings a company's business strategy effectively forward into the marketplace. Step three is to develop techniques for proactively managing customers within and across channel bands.
After nearly a decade of spectacular profitability, Charles Schwab’s profit machine hit a glitch at the end of 1997. Competitive pressures from discount brokers had eroded margins on commissions, the source of 50% of Schwab’s revenue. The defection of high net worth customers to full-service brokers was robbing the company of opportunities to build new, higher margin sources of fee income. The continued acquisition of new, but low margin customers sent operating costs soaring by 16%. The overall result: revenue growth slowed, profitability dipped, and the company’s stock dropped by 20% to become the only major brokerage stock with negative returns for 1997. But just as quickly as the crisis appeared, it went away again. By the end of 1988, Schwab was again realizing records profits.

How did Schwab stage this turnaround so quickly? The simple answer is through diversification. Not through diversification of its product offerings, but through diversification of the sales and service channels it uses to deliver products to its customers. The company that made its name by offering a no-frills alternative to established brokerage houses began to entertain financial service “relationships” and to actively encourage customers to come into its 279 branch offices to discuss financial plans and receive investment advising. This shift towards a relationship focus helped Schwab sign up more high asset customers and lead mutual fund service fees and net interest income on assets to become the two fastest growing revenue areas. At the same time Schwab reversed expense growth by migrating more customers to the Web for trading and other routine servicing. Schwab committed to making the Internet a core element of its business model by dropping the price on Internet trades to $29.95 for all it customers not just those with “e.Scwhab” accounts. Changing the pricing on its electronic channel helped Schwab to increase the percentage of trades conducted over the Internet from 37% to 54% in just twelve months.

Schwab’s experience is not unique. In a growing number of industries, the design of sales and service channels is an increasingly central driver of business performance. Companies that are succeeding are using channels strategically to carry their business model forward into the marketplace. While the right channel strategy varies from company to company, the Schwab experience highlights three general lessons on using channels strategically. The first is the need to embrace channel diversity. Over the past
decade, there has been an explosive growth of channels, with discount, electronic, and
person-to-person channels joining face-to-face channels as viable channel options.
These channels co-exist because each has unique strengths and benefits. Rather than
narrow channel choices, successful companies draw on the strengths of multiple
channels.

The second lesson on using channels strategically is the need to not let channel
diversity degenerate into channel chaos, but to integrate diverse channels into coherent
channel bands. Channel bands bring together several channels with complementary
functionality to create a specific value proposition for customers. Schwab is using its call
centers, retail branches and the Web in unison to target value-oriented customers that
want a cost-effective financial service relationship. The third lesson on using channels
strategically is the need to develop mechanisms to manage customers within and across
channel bands. Companies that remain passive about customer channel choices risk
causing several types of misalignments between channel choices and optimal channel
use. The pricing scheme used by Schwab is one of many strategies that can be used to
align channel choices with optimal channel use, but there are others.

These conclusions emerge from research into thirty companies that are trying to
build and strategically use a broader range of channels to reach their customers. These
companies were concentrated in the banking, financial service, insurance,
telecommunications products and services, computer and network products, logistics
services, and travel service industries. In addition to our company research, we also
review a large number of other studies on channel design and customer targeting.

**Embracing Channel Diversity**

The past decade has seen an explosion of the sales and service channels available
to companies. Traditionally almost all customer interactions took place through high cost
and personnel intensive sales channels. *Retail sales channels* gave customers person-to-
person access to in-store sales agents who could help with and give advice on product
purchases; *dedicated sales* channels drew on dedicated account representatives to take
products to a customer's place of residence or business. Both the retail and dedicated
account management models assumed that face-to-face customer contact was an essential element of the sales process.

The massive corporate restructuring of the late 1980s and early 1990s brought the logic of face-to-face sales into question. Needing to reduce costs wherever possible, companies began experimenting with discount wholesale and call center-based remote sales and service channels. Massive consumer receptivity to these “no frills” channels led channel options to quickly become an institutionalized feature of customer management in many industries.

The growing focus during the mid-1990s on mass customization and developing “learning relationships” with customers in turn brought the logic of discount channels into question. While reducing costs and supporting price competitiveness, discount channels also reduced customer interactivity, making it difficult to use the sales transaction to gather customer information or to create a personalized customer experience. Reacting to the shortcomings of discount channels, companies began in the mid-1990s to build Web-based electronic channels and remote account management channels to achieve interactivity at a lower cost.

Each of the available electronic, discount, person-to-person, and dedicated channels options makes a different and unique contribution to reaching customers (Table 1). A first step in using channels strategically is to assess the full range of channel functionality that a company needs to serve its target customers. This assessment can be structured by considering four questions about a company’s customer base:

- are our customers Web-enabled or do they prefer traditional channels?
- are our customers price-oriented or interested in value-added service delivery?
- do our customers demand unique systems solutions around our products?
- do our customers conduct a high-volume of account maintenance activities?
Table 1. Channel Types and Distinctive Channel Features

<table>
<thead>
<tr>
<th>Channel Types</th>
<th>Cost</th>
<th>Interactivity</th>
<th>Distinctive “Customer Facing” Features</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Discount</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remote Sales and Service</td>
<td>Low</td>
<td>Low</td>
<td>• low barriers to access • proactive targeting</td>
</tr>
<tr>
<td>Wholesale</td>
<td>Low</td>
<td>Low</td>
<td>• low barriers to access • “one-stop” convenience</td>
</tr>
<tr>
<td><strong>Electronic</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>World Wide Web</td>
<td>Low</td>
<td>Moderate</td>
<td>• geographic reach • richness of information exchange</td>
</tr>
<tr>
<td><strong>Person to Person</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remote Management</td>
<td>Moderate</td>
<td>Moderate to High</td>
<td>• product education • information brokering</td>
</tr>
<tr>
<td>Retail</td>
<td>High</td>
<td>Moderate to High</td>
<td>• product education • personalized sales experience</td>
</tr>
<tr>
<td><strong>Dedicated</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dedicated Management</td>
<td>High</td>
<td>High</td>
<td>• customized solutions • personalized sales experience</td>
</tr>
</tbody>
</table>
**Targeting Price-Oriented Customers.** In market segments with relatively little product differentiation more than 50% of customers are normally pure price purchases.¹ These customers view their relationship with a product or service provider as a transactional exchange. They are willing to invest time and energy to search for the lowest cost product and move happily from one provider to another in search of discounts. Pure price purchasers can only be served cost-effectively through low-cost channels.

At first blush, the Web seems a natural channel for serving the cost conscious market segment. By removing the costs of a sales force and retail distribution and more effectively managing the supply chain, on-line vendors are able to offer products at steep price reductions. Amazon.com and Princeton Watches, an authorized on-line dealer of Citizen's watches, for example, both sell their products for 40% less than retail prices. The geographic reach of the Web creates natural economies of scale. Additional customers can be added at a very low marginal cost. The information richness of the Web can also be an advantage in serving the cost-conscious market segment. Customers can collect information on and compare a large number of products before making a purchase decision.

In reaching price conscious customers, however, the Web has one major limitation. Very few mid- to low-income consumers, the target customers for companies dealing in discounted goods and services, are Web-enabled. According to Forrester Research in 1998 only 29% of homes in the U.S. had an on-line connection and only 10% of homes had made an on-line purchase. More telling, just 3% of the households making an on-line purchase had an income below $35,000. In contrast to the low penetration rates of Web, telephones have achieved nearly universal penetration making almost all low- and middle-income customers accessible from remote sales and service channels. Similarly, nearly all middle- and low-income households have a car and so can access wholesale outlet stores typically located in the suburbs.

Differences in channel access suggest that companies targeting the price-oriented segment need to consider additional or alternative channels to the Web. Wholesale channels are one option. Wholesale channels achieve operational savings by

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rationalizing the distribution chain and inventory management, utilizing cheaper real
estate, and minimizing sales and service staff. Price discounts at wholesalers such as the
Price Club or Good Guys are 30-50% under retail, which compares favorably to the 40%
price discounts offered by on-line vendors. In addition to the price competitiveness, an
additional strength of wholesale channels is the convenience of “one-stop” shopping.
Wholesalers typically bring a whole category of steeply discounted products into a single
shopping environment, allowing customers to purchase all their cheaply discounted food
stuffs (Costco; Tesco), office supplies (Staples, Office Max), electronics (Good Guys),
sporting equipment (Sportsmart), home building supplies (Home Depot), furniture
(IKEA), etc at a single site

Remote selling is another channel that can be used to reach the price conscious
consumer. Remote sales channels achieve operational savings by using labor more
efficiently (e.g. focusing on small range of products and take a production-oriented
approach to sales) and utilizing cheaper real estate than retail channels, but have less
impact on the rationalization of the distribution chain. As a result, price savings
achieved through remote selling are less substantial than Web or wholesale channels. But
they can still be significant. Geico Direct, for example, sells automobile insurance
through its call centers at just 10-15% less than brokers offering face-to-face service
through a retail office space. The main advantage compared to other low-cost channels
is the ability to proactively target customers. AT&T and First USA have each achieved
considerable business success in commodity markets by using remote selling to
proactively target finely defined customer sub-segments of price conscious consumers
within the long-distance and credit card markets.

Adding Value to Product and Service Delivery. While Web, wholesale, and
remote selling channels are good for targeting price-conscious consumers, they are less
effective channels for reaching value-oriented customers. Even in commodity market
segments, as much as a quarter of the market will pay for value-added service delivery.
Another third of the customers are highly price sensitive, but may alternate between
being price- and value-oriented. Value-oriented customers expect more than the simple
delivery of products or services; they expect their product and service providers to add
value to the sales exchange. There are three key strategies companies can use to add
value to the sales exchange. They are product education, information brokering, and creating a personalized sales experience.

Production education is different than simply making product information available to consumers. It involves engaging customers in a dialogue about their product requirements and available product offerings. This dialogue should help customers structure the purchase decision to choose the right product offering to meet their needs. Product education can be a particularly useful strategy for engaging value-oriented customers who are first-time purchases in industries with rapidly changing product features and functionality. Gateway Inc., for example, has established a chain of retail outlets to complement its direct selling channels. Called Gateway Country, these retail outlets provide consumers who are first-time purchasers or are interested in making a substantial upgrade with the opportunity to discuss their computing needs and to experiment with different product features before making a purchase.

Information brokering shifts the costs of information search and retrieval from a customer to a company employee. It means providing one-stop sales and account servicing to make it easier for customers to conveniently complete a range of sales or service transactions. Information brokering can be used to engage professional and small business customers that have broad and sophisticated product needs but are short on time. To see how the information brokering works, take the example of Southwind Travel. Southwind specializes in putting together customized vacations to South America. All of the information on flights, accommodations, local tours and outdoor adventures that Southwind draws on in customizing vacations is available to their customers via the Web or a telephone directory.

The customer willing to download information from the Web, make calls to hotels and tour operators in South America, and to comparison shop for flights from the US to South America can reduce the cost of their entire tour package. But to bring this information together has a heavy cost in terms of the customer’s time. By making this hard to assemble information readily available to its travel agents through an on-site database, Southwind can help its customers plan a vacation to an exotic and out-of-the-way places conveniently and cost-effectively.

Personalizing the sales experience is a third way to add value to the service.
exchange. Personalizing the sales experience can be used to appeal to those customers for whom the shopping experience in itself has value. For example, rather than competing with Amazon.com and Barnes and Noble for on-line book purchases, Border’s Group is concentrating on that customer segment that would like to make most of their book purchases in a retail setting. To capture this customer segment, Border’s is investing in retail shops and concentrating on making the shopping experience pleasurable. At a typical Borders store customers can buy books, music, and videos, purchase a coffee at the espresso bar, and sit down to read the newspaper before finalizing their book purchase.

Personalizing the sales experience through person-to-person contact can also be used to raise a customer confidence in their purchase decision. A study of the life insurance industry by McKinsey and Company found that 87 percent of consumers rate trust as very important in their purchase of life insurance products and that 81 percent of consumers would rather buy their life insurance products in a face-to-face encounter. An executive at travel service provider we spoke with suggested, similarly, that few of their customers were willing to buy high-end cruises over the phone or the Web – “they can download information on our luxury cruises over the Web, but few are willing to buy plunk down $10,000-$12,000 dollars without an in-person testimonial on the quality of the cruise.”

Companies targeting the value-oriented consumer need to develop and effectively use retail and remote management channels. Each type of value-added delivery relies on a person-to-person exchange. Retail channels achieve person-to-person contact in a traditional retail setting. Remote account management channels are call center based but create a person-to-person feel by bringing customers together with a sales representative in a consultative rather than a production-oriented environment. Drawing on information systems that provide detailed information to product offerings and options as well as a customer’s account information and history, sales representatives in remote management centers are able to provide comprehensive product advising and servicing. Charles Schwab was an earlier adopter of the remote account management concept. A host of service and goods-producing companies are now following suit using remote management centers to attract professional and small business customers in the
telecommunications (AT&T, GTE), insurance (Hartford, Aon), business equipment (Xerox) and financial services industries (Citibank, Fidelity).

**Supporting Unique Systems Solutions.** Customers that demand unique systems solutions want more than value-added service delivery, they want a product or service provider to develop a customized business solution around this product or service. Edison International, for example, does more than just sell its corporate customers electricity. It helps these customers identifying avenues for changing their operations to cut back on their energy consumption. To develop unique systems solutions, companies need to draw on dedicated sales channels. It is only through a dedicated account manager that they can gain the detailed knowledge of a customer's individual product requirements and business operations required to create a unique business solution.

The importance of dedicated account managers in creating systems solutions can be illustrated by look at Cisco's Systems business model. Cisco is often touted as a company that has mastered Web sales. In 1997, $5 billion of their Cisco’s $8 billion in sales or 62.5% of its total sales were on-line. While indeed impressive, the success of Cisco’s Web sales effort is based on working through value added resellers and system integrators as distributors of Cisco’s products to final consumers. Well over 90% of Cisco’s on-line sales are purchases made by value-added resellers and systems integrators. VARs and systems integrators use their dedicated account managers to design and configure Cisco’s products for business customers. Cisco has made limited efforts to use its electronic channel to sell directly to end users recognizing that most small business customers are not sophisticated enough to purchase and integrate Cisco’s network products into their own operations. Selling directly to small and even medium-sized business customers would create the risk of a poor product fit and resulting customer dissatisfaction with Cisco’s products.

**Managing Account Maintenance Activities.** In designing channel strategies, companies need to consider not just whether they want to compete on price, value, or systems solutions in the initial sales exchange, but also on how they want to manage ongoing account maintenance activities. Account maintenance activities may involve either repeat purchases or routine service requests. In serving customers that conduct a high volume of account maintenance activities, companies must place a very high priority on
developing an effective Web channel.

The Web excels in helping companies managing account maintenance activities for a number of reasons. First, the information richness of the Web allows companies to provide customized information to geographically dispersed customers, allowing customers to manage their own accounts remotely. Second and related, the Web substantially reduces the costs of routine account maintenance. A study of Internet Banking by the consultancy Booz Allen Hamilton, for example, estimated the cost of a standard service transaction at $1.07 in a retail branch setting, $0.54 over the phone and $0.01 over the Internet. A provider of package and logistics services we spoke to estimated that they can do an on-line order for corporate account for half the price of a physical purchase order ($20 vs. $10).

Third, corporate customers have the highest volume of account maintenance and a very high percentage of corporations are Web-enabled. Fourth and perhaps most important, surveys of Web users repeatedly show higher levels of consumer receptivity to gathering information and processing transactions over the Web than making purchases over the Web. In a study of North American insurers on the Internet by Booz Allen Hamilton, 68% of insurers reported that customers wanted on-line quotes and about 60% reported that customers wanted to be able to make policy changes on-line but only 32% reported that customers wanted to be able to make policy purchases over the Web. A study by Interactive Media, similarly, found that 90% of Web users look for product information on a company’s home page, but only 34% used a company’s home page to shop for products.

Dell Corporation has harnessed the power of the Web in supporting account maintenance to significantly reduce the labor intensity of doing business with its corporate customers. Dell creates what it calls a Premier Page for each of its corporate accounts. When a corporate purchaser is ready to make additional product purchases, they can use the Premier Pages to review product selections and configurations in their last order and compare these to Dell’s most recent offerings before finalizing a purchase. Having made a product selection, the customer may well consult a dedicated sales representative to ask about terms and negotiate conditions. But by reviewing information on-line ahead of time the customer can complete the order with just one phone
conversation rather than three to four extensive conversations. After placing the order, moreover, the customer can see their up-to-date order, purchase, and shipping information on their account via the Premiere Page.

Despite the powerful functionality of the Web, there are a number of reasons account maintenance activities may need to be directed through other channels. First, customers may not be Web-enabled. For customers that are not Web-enable remote service and remote account management channels create a lower cost alternative to retail and dedicated channels for managing account maintenance activities. Second, a company may want to use a remote account management channel rather than the Web to ease account maintenance activities for valued, high-margin customers. Several of the banks and telecommunications companies we spoke to used remote management centers as a way of creating more personalized service experience for their most profitable customers. Representatives in a remote management center were able to provide an information brokering function that improved the quality of service delivery to these customers.

**Integrating Channels into “Channel Band” Strategies**

Having identified the appropriate range of channel functionality to meet target customers product and service requirements, the next step in using channels strategically is to combine diverse channels into a coherent “channel band” strategy. A channel band strategy brings together two or more channels with complementary functionality to effectively bring a company’s business strategy into the market. Thinking in terms of channel band strategies can provide a useful check on the initial assessment of channel needs. It helps managers make sure that in selecting channels, they are thinking through the issue of strategic alignment and not being unduly influenced by industry trends or competitor decisions. Our research has identified three classes of channel band strategies that are to be applicable to a range of different industries (Figure 1). There may be others that we have not identified.

**A Transactional Band Strategy to Compete on Price.** A transactional band strategy brings together two or more low cost channels to a help a company compete for pure price purchasers in commodity market segments. The use of multiple
low cost channels give customers with different levels of technological sophistication and different preferences over channel use access to a company's product. It allows a company to grow its revenues and support a price leadership position by continually adding more low-margin customers.

Consumer Bank* has developed a transactional band strategy to support its bid to become a leader in low-cost, convenient banking in the retail banking market. The strategy brings together wholesale channels, electronic channels, and remote selling to give consumers with basic banking needs a spectrum of low-cost channel choices. Mirroring typical customer channel usage in the retail banking industry, Consumer Bank has pure electronic relationships with about 20% of its retail customers. The bank has made a major push to transition more customers to electronic banking by waiving fees on
ATM checking accounts and enhancing the functionality of its home banking. It expects
to significantly increase the number of customers that primarily use electronic
channels in the next several years. In the meantime to reach price conscious consumers
that are not currently on the Web or who do not use ATM’s as their primary channel
vehicle, the bank is building low-cost wholesale and remote channels.

Consumer Bank has been a leader among banks nationwide in redefining the
branch banking experience. It has moved aggressively away from self-standing, full-
service banks towards scaled back mini-branch that integrate easily into supermarkets
and drugstores. Outfitted with ATM machines and telephones directly linked into remote
service centers, the mini-branches allow customers to complete a range standard
transactions quickly and conveniently. The mini-branch concept targets customers that
have become accustomed to the ease of wholesale shopping. They allow customers to
conveniently complete their banking transactions as part of running errands. Like
wholesale channels, the mini-branch concept reduces operating costs by economizing on
real estate and personnel. In the first business regions to adopt the mini-branch concept
Consumer Bank was able to cut annual operating costs by as much as 20% while
expanding its customer base and improving customer satisfaction.

The bank is also targeting the price and convenience oriented customers by
making remote sales and service channels convenient and easy to use. A sales or service
transaction completed though a call center costs the bank 25% of the same transaction
complete through a retail branch bank. When completed through an Integrated Voice
Response Unit (IVRU) which supports automated servicing, the costs drops to 5% of a
retail branch transaction. By locating telephones with a direct link into a remote service
center in its mini-branches, Consumer Bank has made it very convenient for customers to
use the remote channel. By redesigning the menuing on its IVRU so that no transaction
takes more than three steps, the bank has encouraged most customers to use the
automated phone channel rather than speak to a call center service representative. In
1998, 80% of phone transactions into Consumer Bank’s call centers were completed
through the IVRU.

A Value Band Strategy to Compete on Differentiated Service Delivery. A
value band strategy brings together person-to-person and electronic channels to target the
value-oriented customer by support a strategy of differentiated service delivery. Retail or remote management channels are used to give customers access to skilled sales and service representatives that can provide advice, broker information, and offer a personalized sales experience. Electronic channel are used to allows customers to complete routine sales and service transactions conveniently and to reduce the costs of account maintenance activities. Charles Schwab’s emerging business model provides a good example of a value band strategy. Schwab has put together a combination of retail, remote management, and electronic channels to differentiate itself from cut-rate on-line brokers while also keeping its costs below full-service brokers.

Top Flight Travel,* a leading travel service provider, offers another example of how to use a value band strategy to balance the twin goals service quality and cost effectiveness. Many of Top Flight’s premium customers are loyal, value-oriented purchasers; other customers vacillate between purchasing on value and purchasing on price. To serve each of these groups more cost-effectively, Top Flight has launched a major initiative to harness the power of the Web to reduce the costs of routine sales and service transactions. Company executives think, for example, that eventually nearly all of its low margin, commuter airline tickets (e.g. Boston to New York; San Francisco to LA) could be purchased over the Web. The Web is also becoming a main source of customer information, with consumers able to review and compare product offerings before calling in to make a reservation.

At the same time, Top Flight is continuing to invest in retail distribution system to provide value-added service to premium customers. Travel agents in Top Flight agencies are expected to work proactively to identify particularly good travel offerings for premium customers. To support this proactive targeting, agencies have been outfitted with information systems that allow the travel interests and preferences of premium customers to be easily tracked. Travel agents frequently review premium customers on-line purchases to see it they can find a lower prices and then present the customer with the product alteratives. Top Flight executives also expect the retail channel to be the main source of product information and advice for the purchase of high margin cruise and vacation packages.
The goal of the value band strategy is to substantially improve the profitability of customers in commodity or commodity-like market segments through a combination of value-added service delivery and convenience. Both enhance customer loyalty which in a commodity market segment can substantially improve customer profitability. Work by Frederick Reichheld and Earl Sasser on the service profit chain suggests that a 5% increase in customer tenures can produce profit increases from 25% to 85%. Our research suggests that successfully cross-selling single product customers across an additional product line can increase retention rates 30-60%.

A Relational Band Strategy to Compete on Customized Solutions. A relational band strategy brings together a dedicated account channel, a remote management channel, and an electronic channel strategies to develop unique systems solutions for corporate customers. The dedicated channel allows an account manager to develop the in-depth understanding of each companies unique product requirements and business operations. The electronic channel gives business customers access to customized account information and allows transactions to be completed cheaply and conveniently. The remote management channel gives business customers access to a skilled sales or service representative for more complicated questions. The use of both electronic and remote management channels frees up dedicated account managers to spend more time working with new and existing customers on developing customized business solutions.

USA Courier,* a provider of package and logistics services, offers a compelling example of how to use a relational band strategy to serve the needs of large corporate customers. USA’s target customers are the Fortune 500 and the larger middle market customers that have specialized product needs. The company uses a dedicated sales force to identify opportunities for providing these large corporate customers with unique business solutions. A dedicated sales representative helped develop the idea for laptop shipping box that stacks neatly on a truck for several of USA’s customers in the computer industry. For a medical equipment company, another representative helped develop “lab packs” to safely transport lab testing equipment. For most of their large corporate,

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dedicated representatives negotiated customized reporting, shipping, invoicing, and monitoring of customer orders.

At the same time, USA Courier has made a fairly big push to get customers to do account management activities on-line. USA gives its larger customers a computer and a dedicated link, and sets them up with software to make it easier to tender shipments, send invoices and submit remittances. Currently, 60% of shipments, 70% of invoices, and 80% of remittances are tendered electronically. Using electronic channels for routine account maintenance has lead to significant reductions in operating costs.

Managing Customers within and across Channel Bands

Having created channel bands that bring together sales and service channels with complementary functionality, a third step in using channels strategically is to proactively manage customers within and across channel bands. Rather than proactively managing customers, many of the companies we spoke to took a “smorgasbord” approach to their channels. The smorgasbord approach is summed up well in the comment by a sales executive, “we will build a full range of channel choices and let customers choose the one they prefer.” While ostensibly very customer-friendly, the smorgasbord approach to channels raises a number of potential mismatches between customer channel choice and optimal channel use.

A first mismatch occurs when customers use high-cost channel for low margin, simple transactions. There is a small but growing number of customers that prefer to use electronic or remote channels because they are convenient, but there are a large number of customers that prefer personalized attention and without appropriate incentives will opt for higher cost channels. A second mismatch occurs when customer use a low-cost channels for complex transactions that they do not fully understand, which leads to an unsatisfactory customer experience. The customer may have freely chosen to use a lower cost, more convenient channel, but the costs of damage from the unsatisfactory service experience is borne by the company in higher attrition rates and lower levels of repeat purchasing. A third mismatch occurs when employees discourage customers from making the optimal channel choice. This may occur inadvertently because of employee
ignorance about channel functionality; it may also occur intentionally because employees feel threatened by a new channel.

To avoid all of these potential channel mismatches, a company needs to develop a comprehensive channel management strategy. This comprehensive channel management strategy needs to draw on both marketing capabilities and sales force management to cover the four following areas (Table 2):

- matching product distribution and pricing to channels
- enhancing the capabilities of low-cost channels
- educating employees, then customers about channel capabilities
- using incentives to encourage channel hand-offs.

**Matching products and pricing to channel.** A first step towards effectively managing customers within channel bands is aligning products and pricing with channel costs. Lower margin products should be distributed through low cost channels. Higher margin products should be distributed through higher cost channels, particularly for new customers or first-time purchasers. Distributing higher margin and more complex products through higher cost and more personnel intensive channels allows new customers to receive consultations from a sales representative as they become more familiar with a product. Once they understand the product well, they can begin to make purchases through lower cost channels. Top Flight Travel eventually expects to sell all its shuttle airline tickets through its electronic channel, while continuing to use its retail offices to sell high-end cruises and travel packages. Gateway, Inc. is similarly using its Gateway Country outlets to drive sales of higher-end computer models, while continuing to distributed very standard products over the phone.

For products that can be distributed through multiple channels, product pricing needs to reflect channel costs. Channel-based pricing creates incentives to use lower cost channels by rewarding customers with price discounts. To encourage use of its vast ATM network, Consumer Bank dropped fees on checking accounts for those doing all their checking through an ATM machine. Southwest airlines, similarly, offers super low
<table>
<thead>
<tr>
<th>Customer Management Strategy</th>
<th>Specific Steps</th>
</tr>
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| Match product placement and pricing to channel | • distribute low margins products through discount and Web channels  
• distribute high margin products through face-to-face and person-to-person channels  
• price products distributed through multiple channels to reflect channel costs |
| Align channel functionality with channel role | • make Web rich source of information on products and product offerings  
• make remote account management attractive channel to conduct service transactions |
| Educate employees, then customers about channels | • use sales force as primary mechanism to educate customers about channel functionality  
• build customer education into initial sales and service transactions  
• use traditional marketing techniques (e.g. brochures, mailers) in support of sales force |
| Use incentives to minimize channel conflict | • book revenue credits from on-line transactions to referring channel  
• allow individual sales offices to shape role of Web in supporting customer management |

round trip fares of $49 for destinations that normally cost $100, but only makes these fares available to customer purchasing on-line. The discounted on-line fares are in part a promotion to encourage on-line ticket purchases, but they are also reflect cost differentials for on-line and paper-based ticketing.

**Enhancing the functionality of low cost channels.** A second step in managing customers within channel bands is to the enhance the functionality of lower cost channels. By making a lower cost channel a better source of information or more convenient source to conduct sales and service transactions than a high cost channel, a company creates incentives for low cost channel use. Dell’s Premier Pages give corporate customers much more extensive access to product information and pricing
structures than is available through a conversation with a sales representative or from reviewing a product brochure. The Webpage’s search capability allows a corporate purchasing agent to quickly narrow in and compare product offerings. Once having the opportunity to review the product information on-line, they can then call a dedicated sales representative to finalize sale.

Bank One use dedicated account representatives to serve its most profitable small business customers, but supports the cost effectiveness of these relationships by making its remote management channel very attractive for account maintenance activities. Unlike the dedicate sales force, representatives in the remote channel are available to small business customers twenty-four hours a day, seven days a week. They also have access to more information on customers’ current accounts and recent transactions than the dedicated sales force.

Educating employees, then customers. A third step in managing customers channel choices is through effective customer education. Customer education can help overcome a number of very simple obstacles to customers using an appropriate channel. These obstacles may include customers not being aware the channels exist, not understanding the channel benefits, and not being comfortable with channel functionality. Traditional marketing tools (e.g. brochures in retail outlets or stuffers in mailings) can be used to heighten customer awareness of channel choices, but in themselves will probably not convert customers to a new channel. They are often short on details and do not allow customers to raise issues and concerns.

Traditional marketing tools need to be used in support of direct customer education through the sales and service workforce. The best opportunities to educate a customer come during the completion of a sales or service transaction. As one bank executive stated, “during a [sales or service] transaction customers are focused on a problem and open to learning more effective strategies for solving that problem. Showing them just once how to use a new channel can break a psychological barrier.” Ideally this direct customer education should occur very early in a customer relationship before the customer establishes a set pattern of channel usage. To use direct customer contact to educate customers means educating employees first. Employees need to understand the capabilities of all new channels. In the words of a second bank executive,
“nothing could be worse than having customers inquire about the services available at a call center and to have the sales representative unable to answer intelligently.”

**Using incentives to encourage channel hand-offs.** A final step in managing customers within channel bands is to develop employee incentives that encourage channel hand-offs. If employees in an existing channels see an emerging channels as a threat to their own business, they may well sabotage efforts to transition customers over to the new channel. When Citibank found that its branch managers were resisting efforts to transition customers to call centers because it lowered their own book of business, it began to allow branches to retain revenue credits for transitioned customers.

For a similar reason, Top Flight Travel is making its electronic channel agency-centric. Rather than developing one centralized Web-page, the company is developing a unique Webpage for each agency and allowing agencies to customize features and offerings on the electronic channel. While the agency-centric channel approach requires more up front investment, over the longer term the company expects to reap considerably operational savings by avoiding channel conflict. Agencies will view the electronic channel as complementary to the agency distribution system and as they move to integrate electronic channels seamlessly into their operations will reduce costs and create profits that can be shared between the agency and Top Flight Corporate.

**Summary**

The explosion of channel diversity presents companies with both an opportunity and a threat. Channel diversity can easily degenerate into channel chaos, but it also presents an opportunity to reach customers and manage customer relationships more profitably. The key to using channels strategically is a sophisticated understanding of a company’s customer base. By understanding the full range of its target customers product and service needs, a company can begin to develop a channel band strategy that brings together a set of channels with the right functionality to addresses each category of needs. Having developed a channel band strategy, a company then needs to harness both its marketing and sales force capabilities to ensure that customers are conducting individual sales and service transactions through appropriate channels.