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Free riding and conflict in hybrid shopping environments: Implications for retailers, manufacturers, and regulators

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Shoppers increasingly utilize multiple distribution channels. One variation of this behavior is hybrid shopping—jumping across channels in the path to a single purchase.

Hybrid shopping can create coordination challenges for the distribution system. These include two types of free riding: using the presentation and services offered by a brick-and-mortar channel but making the purchase in an online channel (recently termed "showrooming") or, conversely, first obtaining information online before ultimately purchasing in a physical store.

This article explores the implications of hybrid shopping for retailers and manufacturers, and their evolving responses to the prospective free riding. These include price matching, restrictions on product offerings that provide channels with some degree of exclusivity, service enhancements that leverage multichannel capabilities, and schemes that compensate channel members for

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contributing to the sale. For each of the developments considered, findings and responses provide implications for competition policy and antitrust.

KEY WORDS: *multichannel retailing and marketing, hybrid shopping, cross-channel shopping, showrooming, value added compensation*

I. INTRODUCTION

Consider the shopper to whom a manufacturer mails a brochure that describes product features and includes a link to the manufacturer's website and online store. After flipping through the brochure the shopper might browse the manufacturer's website for additional product information, visit the neighborhood brick-and-mortar store of a retailer carrying the product, and use a smartphone-based price-comparison app while inside the store to check prices and availability at a selection of retailers, before finally making the purchase from one of the online options. For this transaction the shopper interacted with channels belonging to the manufacturer (direct mail, web), several retailers (brick-and-mortar, web), and a third party (the operator of the price-comparison service, which might itself be one of the competing retailers). This commonplace example illustrates that, not only do modern consumers have multiple channels from which to shop, they may traverse channels on the way to a single transaction. This behavior is known as hybrid shopping.[1]

On the selling side, the related term is hybrid marketing, in which a seller spreads the channel and marketing activities for a single transaction across channels that are both indirect (the transaction between seller and end customer goes through an independent intermediary) and direct (no intermediary is involved).[2] Hybrid shopping

[1] In some industry circles the term omnichannel conveys the same basic meaning as hybrid in this term and related ones. *See* Ivano Ortis, *Unified Retailing—Breaking Multichannel Barriers*, IDC RETAIL INSIGHTS ANALYST REPORT (2010); Darrell Rigby, *The Future of Shopping*, HARV. BUS. REV., Dec. 2011.

[2] For some context on the term hybrid marketing, see V. Kasturi Rangan et al., *Transaction Cost Theory: Inferences from Clinical Field Research on*

can engage the different channels within one seller's hybrid marketing system or touch the marketing systems of distinct sellers. Although not strictly required by the definitions of these terms, this article focuses on hybrid shopping and hybrid marketing systems that include an Internet channel in order to reflect contemporary developments and to be of greatest use to current decision makers.

This article synthesizes the existing evidence from a diverse set of sources regarding hybrid shopping and hybrid marketing and explores the implications for retailers, manufacturers, and competition policy stakeholders. Several insights emerge from the analysis. First, hybrid marketing is not a new concept, with these systems appearing whenever firms have added multiple channels. However, much of the salient thinking originated from contexts in which the firm initiated and controlled the system, as is often the case in business-to-business (B2B) or industrial settings, and before the Internet became pervasive. Relatively new is the extent to which hybrid shopping is transpiring in contemporary business-to-consumer (B2C) markets. Because this behavior is mainly shopper-initiated, it is harder to control. Second, the popularity of hybrid shopping suggests that shoppers find that different channels add distinct forms of value and gravitate to a particular channel for what it does best. This makes a case for channel specialization. Third, although this mixing and matching of channels might benefit consumers, hybrid shopping can create coordination and free riding challenges for members of the distribution system. One example is the phenomenon recently termed showrooming, in which shoppers treat the brick-and-mortar store as a place to experience the product (as in a product showroom), but make the purchase online.[3] In the course of this discussion we will broaden the concept of retail service in a way that perhaps has not been appreciated in the extant antitrust analysis.

Downstream Vertical Integration, 4 ORG. SCI. 454 (1993). In the original definition the seller is a manufacturer. However, much of the discussion continues to apply to a retailer that uses multiple channel types to reach customers. We differentiate channels according not only to their control structure (the presence or absence of an intermediary) but also their physical structure (brick-and-mortar versus Internet).

[3] This term is new enough that its precise definition has not yet stabilized. The casting of showrooming as a severe threat to brick-and-mortar retailers relies on their losing significant sales to online competitors. However,

Financial data that juxtaposes the two largest American discount retailers, Target and Walmart, will sharpen this point by showing that these retailers pursue strategies distinct enough to differ in susceptibility to free riding. For example, Target, which is not considered a high-service merchant in the sense of, say, a Nordstrom, does in fact make nontrivial investments in the quality of the shopping environment, such as store ambiance, in a way that makes free riding a concern.

Fourth, this article notes that in a world in which brick-and-mortar and Internet channels coexist, free riding can occur in both directions. In showrooming, the online channel free rides off the brick-and-mortar channel. In the phenomenon termed "research online buy offline" (ROBO), a brick-and-mortar channel can free ride off the information provided by the online channel. This article discusses these two types of free riding and their technological enablers.

Finally, this article describes the evolving managerial responses of both manufacturers and retailers to free riding in the hybrid shopping context. Certainly, antitrust has often focused on the manufacturer's perspective, specifically in examining the distribution restraints that manufacturers impose on their retailer partners. A frequent justification for such restraints is that they mitigate problems like free riding that could otherwise eventually denigrate manufacturer distribution systems and thereby undermine the individual manufacturer's ability to compete against other brands. However, an assessment of manufacturer restraints is incomplete without an understanding of all the alternatives, including retailer-centric ones, that might be able to keep free riding in check. These may entail some manufacturer participation, but not necessarily in the form of vertical restraints on retail pricing.

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some invocations of the term also encompass the case in which the shopper makes the purchase from the retailer's own website, which many brick-and-mortar retailers are encouraging. Although potentially positive for the retail firm as a whole, the latter form of showrooming can still create conflict among the retailer's internal divisions because "most retailers do make [the] distinction [between buying a product in the store or from the retailer's website]. They have separate teams and business units for each with different approaches, offers and information and even prices." This acknowledgement of the persistence of organizational silos comes from Vibes, Mobile Consumer Report: Understanding the Showrooming Shopper (2012), *available at* http://www.vibes.com/resources.

This article uses the terms manufacturer and retailer for clarity, as this allows visualization of a simple and familiar channel setting: a manufacturer places product in the retailer's stores, which are visited by individual shoppers. However, real distribution settings can involve one or more layers of intermediaries, which may be more aptly called resellers than retailers. And the channels may sell services to the end customers, rather than physical products. Much of the analysis in this article will be just as relevant for this broader set of scenarios, and we introduce additional terminology as needed.

II. THE EVOLUTION OF HYBRID MARKETING-CHANNEL SYSTEMS

Today companies go to market using multiple channels. In the B2C context, Apple sells through company-owned retail stores, Apple.com, mass discounters such as Walmart (which operates both brick-and-mortar and online stores), category-focused retailers such as Best Buy (also both offline and online), specialized retailers such as the Army & Air Force Exchange Service, online-only retailers like Amazon.com, and websites of wireless carriers like AT&T and Verizon as well as their ubiquitous physical outlets. In B2B selling, networking equipment maker Cisco Systems reaches end customers by means of a direct sales force, value added resellers, and service providers such as AT&T.

Adding channels can increase distribution intensity, which can extend market coverage and increase market share.[4] Diversity in channel types can address heterogeneous customer needs. Full-serv-

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[4] If the channel intermediaries in turn make stocking decisions based on market share, then higher market share brands will get even more distribution. Consequently these brands will tend to capture a disproportionate share of any demand growth generated by the added distribution. Evidence for this comes from studies of cross-sectional data that describe various brands and numerous packaged goods categories; plots of market share versus distribution intensity consistently exhibit a convex relationship. *See* Paul Farris et al., *The Relationship between Distribution and Market Share*, 8 MARKETING SCI. 107 (1989); David J. Reibstein & Paul W. Farris, *Market Share and Distribution: A Generalization, a Speculation, and Some Implications*, 14 MARKETING SCI. G190 (1995).

ice selling formats are best suited to shoppers that require extensive service, while do-it-yourself shoppers might be satisfied with the minimal level of live attention provided by a discounter.

A single shopper might utilize different channels for different purchase occasions or products. However, when customers use multiple channels on the path to a single transaction, say one channel to gather information, another to touch and feel the product or get a demo, and a third to complete the purchase, they are engaged in hybrid shopping. A company that adds channels might be unintentionally creating a hybrid marketing system. Some examples of hybrid marketing have appeared in case studies of Siebel Systems,[5] Cisco Systems,[6] Becton-Dickinson, U.S. Steel, and Terumo.[7]

Hybrid marketing systems are not new. In an early and influential article that predicted their dominance, Moriarty and Moran noted that hybrid marketing systems are a natural outgrowth of multichannel strategies, have benefits, and are difficult to manage.[8]

What is relatively new is the dynamic introduced by the Internet channel, with its ubiquity[9] and fundamentally distinct cost structure. In a relatively short period of time, Internet sellers have enhanced their service capabilities. Supporting functions like express logistics and online payment have advanced and earned the trust of more and more consumers. The penetration rate of Internet connectivity contin-

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5 Michael J. Roberts et al., *Siebel Systems (A)*, (Harv. Bus. Sch. Case 898210-PDF-ENG, 1998).

6 Kirthi Kalyanam & Surinder Brar, *From Volume to Value: Managing the Value-Add Reseller Channel at Cisco Systems*, 52 CAL. MGMT. REV. 94 (2009).

7 V. Kasturi Rangan et al., *Transaction Cost Theory: Inferences from Clinical Field Research on Downstream Vertical Integration*, 4 ORG. SCI. 454 (1993).

8 *See* Rowland T. Moriarty & Ursula Moran, *Managing Hybrid Marketing Systems*, 68 HARV. BUS. REV., Nov.–Dec. 1990, at 146. This analysis focused on industrial markets, in which firms have more control over channel demarcations.

9 Because of their ubiquity and ability to influence multiple sectors, information technologies are considered general purpose technologies. For a discussion of the Internet as a general purpose technology, see WARD A. HANSON & KIRTHI KALYANAM, INTERNET MARKETING & E-COMMERCE ch.1 (2006).

ues to grow, with a recent acceleration in mobile access due to the popularity of smartphones. These kinds of developments have catalyzed a surge in hybrid shopping with an Internet component. A 2005 study by van Baal and Dach[10] reported that over twenty percent of consumers have shopped this way. The research firm IDC Retail Insights estimates that some 48 million shoppers, or about twenty percent of the U.S. adult population, will use their smartphones to access online resources in some manner while they shop in stores during the 2012 holiday season.[11] Historically closer to the periphery, hybrid shopping may have moved into the core of buying behavior.[12]

An insight from the growth in hybrid shopping is that consumers see different channels as filling different needs.[13] The Internet provides broad selection that can be examined from anywhere and at any time and excels at conveying nontactile information about many product categories, which can include detailed product specifications and user reviews. Brick-and-mortar stores provide touch and feel, immediate product availability, personal assistance, and avoidance of explicit shipping costs both for the purchase and any needed return of merchandise. Catalogs present appropriately curated assortments of products. So a shopper who values tasteful presentation might start with the catalog, further research the product interactively by directing subsequent questions to a call center, and then physically inspect

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10 Sebastian van Baal & Christian Dach, *Free Riding and Customer Retention across Retailers' Channels*, 19 J. INTERACTIVE MARKETING 75 (2005).

11 GREG GIRARD & HOLLY BROWN, AT HAND VERSUS IN HAND—WILL CONSUMERS HAVE THE UPPER HAND IN THE 2012 HOLIDAY SHOWROOM SHOWDOWN? (2012), *available at* http://www.idc-ri.com/getdoc.jsp ?containerId=GRI237839.

12 NIKKI BAIRD & BRIAN KILCOURSE, OMNI-CHANNEL 2012: CROSS-CHANNEL COMES OF AGE (2012), *available at* http://www.rsrresearch.com/2012/06/12/omni-channel-2012-cross-channel-comes-of-age ("Retailers are learning that their cross-channel shoppers are increasingly just shoppers, and that their biggest challenge is in how to merge the digital and physical selling worlds into one compelling, seamless customer experience.").

13 For industry perspectives on the strengths of various channels with respect to a range of services and activities, see DALE D. ACHABAL ET AL., CROSS-CHANNEL OPTIMIZATION: A STRATEGIC ROADMAP FOR MULTICHANNEL RETAILERS (2005), *available at* http://www-03.ibm.com/industries/ca/en/retail/cross_opt.html.

the merchandise in a brick-and-mortar store. The actual purchase might occur in any of the available channels depending on the shopper's needs.

This discussion suggests that hybrid shopping can improve the consumer's shopping experience. The selling firm can benefit as well, through reductions in marketing and distribution costs. A prospective customer who has already read about the product in a catalog or on the Internet might require less sales effort in the call center or in the store.

Coordination or integration across channels can encourage hybrid shopping. Consider a consumer researching printers on the website of Hewlett-Packard. This consumer would likely appreciate seeing not only a list of nearby authorized resellers, but also the real-time inventory status at each. However, this simple idea is not as easy to implement as an outside observer might expect. Different information technology platforms often do not communicate well due to the way the data is formatted and transmitted. Trade partners might describe the products using conflicting nomenclature or item numbering schemes. Some members of the distribution system might not possess the technical and organizational sophistication to generate real-time inventory status even for internal use, let alone for their partners. Even if these technical and process obstacles are removed, competitive concerns could render some of the stakeholders reluctant to share what might be regarded as sensitive information or to be reduced to one line in a list of seemingly identical options. In short, Hewlett-Packard and its resellers would need some alignment in organizational processes, technical platforms, and business goals in order to be able to display this information.

III. MANAGEMENT CHALLENGES: FREE RIDING IN THE CONTEXT OF HYBRID SHOPPING

> Last week, in an urgent letter to vendors, [Target,] the Minneapolis based chain[,] suggested that suppliers create special products that would set it apart from competitors and shield it from the price comparisons that have become so easy for shoppers to perform on their computers and smart phones. Where special products aren't possible, Target asked the suppliers to help it match rivals' prices. It also said it might create a subscription service that would give shoppers a discount on regularly pur-

> chased merchandise. "What we aren't willing to do is let online-only retailers use our brick-and-mortar stores as a showroom for their products and undercut our prices without making investments, as we do, to proudly display your brands," according to the letter, which was signed by Target Chief Executive Gregg Steinhafel and Kathee Tesija, Target's executive vice president of merchandising.[14]

Competition is natural any time customers have options and by itself is not necessarily a bad thing. Complications arise when the options are channels belonging to different entities,[15] some costly channel services may be used by shoppers independently of purchase (such as distribution of product information), and the channels have fundamentally disparate cost structures that can translate into nontrivial differentials in end pricing. Consequently, hybrid shopping environments that comprise both online and brick-and-mortar channels are a rich substrate for free riding.[16] Absent some remedy, free riding may lead some of the aggrieved channels to underinvest in promoting the products involved or simply drop those products altogether.

Conventional wisdom sees Internet channels free riding off bricks-and-mortar retail, such as in the showrooming phenomenon

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[14] Ann Zimmerman, *Showdown over "Showrooming,"* WALL ST. J., Jan. 23, 2012, http://online.wsj.com/article/SB10001424052970204624204577177242516227440.html.

[15] As noted in section I, this scenario arises naturally among distinct firms but can also be present within a single firm due to internal incentive conflicts.

[16] A concise illustration of the meaning of free riding in the context of antitrust comes from Herbert Hovenkamp, *Exclusive Joint Ventures and Antitrust Policy*, 1995 COLUM. BUS. L. REV. 1 (1995) ("For example, the full service computer dealer may have, among other things, an expensive showroom, trained personnel demonstrating computers and assembling optimal packages, seminars for prospective purchasers. The free riding dealer down the street has a cheap warehouse, untrained minimum wage personnel, and stacks of computers in boxes. Customers will go to the full service dealer and obtain the information they need to make a wise choice; then they will go to the free rider to make their purchase at a lower price."). Thinking of online retail as a low-service channel takes too narrow a view of the notion of service. However, the cost structures of online stores and their supporting supply chains often enable the charging of prices lower than those of brick-and-mortar stores.

that Target's letter highlights. Before analyzing that scenario, we note that Internet channels can participate in bidirectional free riding.

Although Internet shopping is well on its way to becoming a mainstream practice, some segment of shoppers will always prefer to complete some types of transactions at a physical retail store. Many of these shoppers will nevertheless perform Internet research prior to purchase, leading to the now-routine tactic of "research online buy offline" (ROBO). According to Forrester Research, online sales will grow to roughly eight percent of all retail spending in the United States by 2015, but an additional segment of more than five times size that will be "web influenced."[17] Capgemini's 2012 survey of 16,000 digital shoppers across sixteen developing and mature markets found that fifty-six percent of respondents are likely to spend more money at a physical store if they used digital channels to research the product prior to purchase.[18]

A key contributor to the popularity of ROBO is the availability of user-generated online content in the form of reviews and ratings. These provide a wealth of information for potential customers regarding the strengths and weaknesses of products, brands, services, and retail establishments. Industry surveys show that these reviews are used heavily by shoppers in a wide range of categories.

Generating, maintaining, and presenting an adequate repository of reviews in a user-friendly format are costly enterprises. Free riding occurs when the entity that funds these activities does not capture the sale. This can create conflict whether the online and offline entities are part of the same firm or are independent firms.[19]

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[17] Sucharita Mulpuru et al., US Online Retail Forecast, 2010 to 2015: Ecommerce Growth Accelerates Following "The Great Recession" (2011), *available at* http://www.forrester.com/US+Online+Retail+Forecast+2010+To+2015/fulltext/-/E-RES58596.

[18] Capgemini, Digital Shopper Relevancy (2012), *available at* http://www.capgemini.com/services-and-solutions/by-industry/consumer-products/digital_shopper_relevancy. This survey defines digital shoppers as those who use one or more digital technologies or channels in one or more phases of their shopping journey.

[19] In retail firms these costs are typically borne by the online division of a brick-and-mortar retailer. Yet shoppers might use the reviews and ratings on the website but complete the transaction in the same retailer's brick-and-

Showrooming is free riding in the direction opposite to ROBO, such as when shoppers visit a brick-and-mortar store to experience the merchandise, then use web-enabled mobile devices to compare prices and availability, and ultimately complete the transaction online while still in the store or later. This emerged as an option for shoppers as soon as the Internet became a viable sales channel for items also carried in physical stores, but attention to this behavior dramatically intensified with the rapid adoption of smartphones and the development of price comparison applications for these devices.[20] In showrooming the online seller free rides off the demonstration, presentation, and merchandising occurring in the brick-and-mortar operation.

Mainstream attention to showrooming seems to have taken off from 2011 to 2012. Numerous studies have attempted to quantify the phenomenon and illuminate its drivers. Market research firm comScore conducted a survey in April 2012 that found showrooming to have been performed by thirty-five percent of all respondents, fifty percent of respondents aged 25–34 (the highest of any age group surveyed), forty-eight percent of tablet owners, and forty-three percent of smartphone owners. Six in ten of these showroomers reported they

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mortar store, which then gets credit for the sale. Hence the brick-and-mortar channel is free riding off the online channel, giving rise to what might be termed internal channel conflict. Webb and Lambe also discuss internal multichannel conflict. However, their focus is on the conflict among internal organizational entities that manage different external channels as opposed to hybrid shopping systems. *See* Kevin L. Webb & C. Jay Lambe, *Internal Multi-Channel Conflict: An Exploratory Investigation and Conceptual Framework*, 36 INDUS. MARKETING MGMT. 29 (2007).

[20] Amazon's Price Check application for smartphones allows a user to identify a product by typing or speaking the name, photographing the bar code, or photographing the product itself. The app responds with the current prices at Amazon.com and its network of partners. The user can also report the in-store price, providing Amazon with precious market intelligence. Price Check has been available on Apple's iOS since November 2010 and achieved notoriety with Amazon's one-day offer in December 2011 of a five percent discount on individual purchases made through the app (up to $5 each for single purchases in up to three of a select group of product categories). The RedLaser app (launched by Occipital in May 2009 and acquired by eBay in June 2010) focuses on product barcodes and QR (quick response) codes, but provides similar real-time price discovery capability that encompasses both online and local retail stores.

originally planned to purchase at the store, but changed their minds while there and instead bought online. Thirty-two percent went to the store already intending to buy online. Regarding the motivation for showrooming, seventy-two percent of showroomers emphasized the lower online price, while forty-five percent planned to buy online all along but wanted to see the item in person first. By far the top two affected categories were consumer electronics (sixty-three percent) and apparel, clothing, and accessories (forty-three percent).[21]

Harris Interactive surveyed 2361 adults between September 18 and 20, 2012, and found that forty-three percent of smartphone and tablet owners reported that they have showroomed. Of these, twenty-eight percent said they did this often, while sixty-eight percent said they do it sometimes. The incidence rate by product category was fifty percent for home electronics, forty-four percent for tech devices, forty percent for entertainment items, thirty-one percent for clothing, twenty-nine percent for shoes, and twenty-four percent for computers.[22]

Independent surveys of this nature may produce divergent results due to differences in methodology, survey pool, phrasing of questions, and the shortcomings of self-reporting. Prior intention of shoppers is particularly hard to define and therefore measure. Estimating the economic impact of showrooming faces the additional challenge of tracking whether showroomers eventually buy from the website of the showroomed store or from a competitor's. These issues aside, the current evidence seems to suggest that the behavior is significant and growing, especially for electronics. Indeed, electronic items are readily searchable by model number and have higher price points that can justify the effort of price comparison and create meaningful sales tax savings when purchased online (for as long as this tax loophole persists).[23]

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[21] Tiffany Walker, State of US Internet in Q1 2012 (2012), *available at* http://www.comscore.com/Press_Events/Presentations_Whitepapers/2012/State_of_US_Internet_in_Q1_2012.

[22] Alaric Dearment, *Study: More Than 40% of Smartphone, Tablet Owners "Showroom,"* Drug Store News, Oct. 17, 2012, *available at* http://www.drugstorenews.com/article/study-more-40-smartphone-tablet-owners-showroom.

[23] Joan E. Solsman, *Best Buy Limits First Foray into Online Price Matching*, Wall St. J., Oct. 12, 2012, http://online.wsj.com/article/BT-CO-20121012-710127.html.

Meanwhile, a number of retailers are publicly downplaying concerns over their own susceptibility to showrooming. Best Buy, frequently named as a major showrooming victim (perhaps due to the aforementioned attributes of electronic goods), in 2012 estimated an incidence rate in the mid-teens, with an increase of about three percentage points over the preceding two years. Moreover, Best Buy believes that one in five of its showrooming shoppers ultimately does make the purchase in the store.[24]

Before considering strategies for mitigating this problem, let us further contemplate the nature of susceptibility to showrooming. We will do this in the next section with a case study that provides some insightful back history of Target and Walmart. These two firms are front and center in the current drama, and their actions affect massive numbers of consumers, manufacturers, and other retailers.

IV. FREE RIDING AND DIFFERENCES IN RETAIL BUSINESS MODELS: A CONTINGENT PERSPECTIVE

The previous section opened with a recent letter from Target's senior management expressing alarm about showrooming and calling on its product vendors for help in the form of Target-exclusive products and preferential pricing. A natural question might be: Why Target? Why not its major competitor, Walmart? Of course, that Target is the first one willing to express its concerns publicly does not mean it is the only one concerned. Showrooming can impact all brick-and-mortar retailers to varying degrees. Certainly, numerous major players are on alert, and section V showcases measures being taken by Walmart, Best Buy, Toys "R" Us, and others.

This section will make the case that vulnerability to showrooming depends on the retailer's business model, especially as it drives merchandising, in-store display, brand presentation, and setting of prices. Indeed, Target's letter reminds its vendors that, more so than the online-only retailers, Target is "making investments . . . to proudly display your brands."

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[24] Ann Zimmerman, *Best Buy to Match Online Prices*, WALL ST. J., Oct. 12, 2012, http://online.wsj.com/article/SB10000872396390444657804578050864206903402.html.

Below we analyze some key financial metrics that reflect Target and Walmart's business models over a forty-year span. These data illuminate the evolution of each retailer's business model and its relative positioning.

A. Walmart's low-cost emphasis

Walmart is a mass discounter and historically has sold a variety of merchandise at attractive prices while providing the convenience of one-stop shopping. The world's largest retailer stands as a powerful exemplar of low-cost operation.

Walmart is especially well known for its every day low pricing (EDLP) approach. Despite the L in the acronym, EDLP is less about having the absolutely lowest prices and more about consistent pricing over time. Hi-Lo pricing is an alternative to EDLP under which temporary promotional prices are offered at regular intervals, typically valid for one week. Figure 1 illustrates the two approaches at both the item and stock-keeping unit (SKU) level, such as Surf Laundry Detergent or Surf Laundry Detergent in a particular size, respectively.

Figure 1
EDLP versus Hi-Lo Pricing

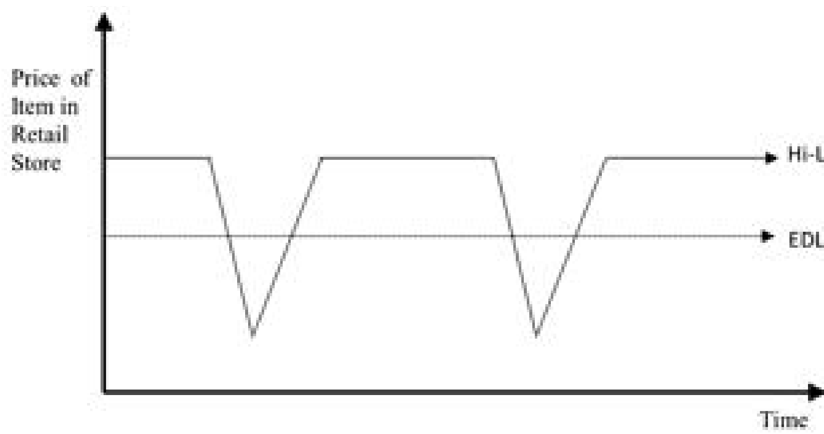
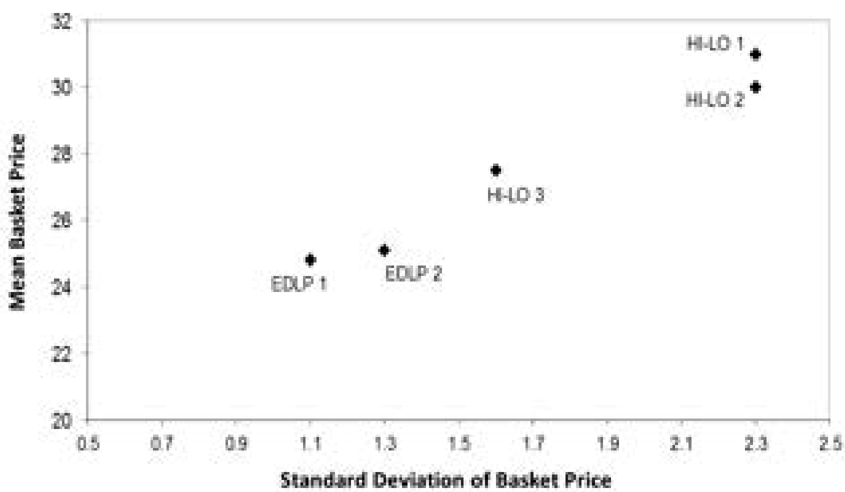


Figure 2 compares basket prices under EDLP and Hi-Lo formats. Besides having average basket prices that are higher than those of the EDLP retailers, the three Hi-Lo retailers have higher variances due to their frequent price promotions. This suggests that EDLP retailers compete based on the price of the entire shopping basket rather than on individual item prices.[25]

Figure 2
Basket Price Comparison of EDLP versus Hi-Lo Formats



SOURCE: Christopher S. Tang et al., *Store Choice and Shopping Behavior: How Price Format Works*, 43 CAL. MGMT. REV. 56 (2001).

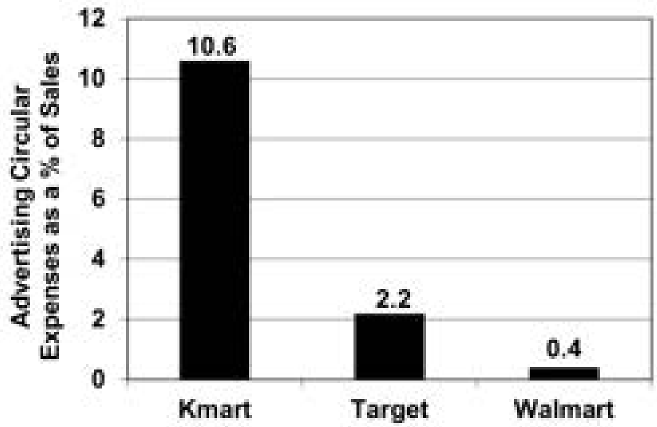
Hi-Lo promotions incur many costs, including those associated with in-store signage and circulars, labor to physically change marked prices, and inventory buildups at multiple points in the supply chain.[26] The fall of Kmart has been attributed in part to this pricing

[25] David R. Bell & James M. Lattin, *Shopping Behavior and Consumer Preference for Store Price Format: Why "Large Basket" Shoppers Prefer EDLP*, 17 MARKETING SCI. 66 (1998).

[26] Hau L. Lee et al., *The Bullwhip Effect in Supply Chains*, 38 SLOAN MGMT. REV. 93 (1997).

strategy. Figure 3 compares advertising circular costs as a percent of sales for Kmart, Target, and Walmart. For 2001, Kmart's 10.6% dwarfed Target's 2.2%, which in turn was an order of magnitude larger than Walmart's 0.4%.[27]

Figure 3
Advertising Circular Costs, 2001



SOURCE: Amy Merrick, *Costly Ad Circulars Precipitate Departure of Kmart's President*, WALL ST. J., Jan. 18, 2002.

A well-executed EDLP strategy can reduce a retailer's operating costs while, as Walmart has shown, serving as the centerpiece of a marketing message that showcases the benefit to shoppers of not having to drive all over town in search of the lowest prices.[28] This theme is reinforced throughout Walmart's in-store displays, as figure 4 illustrates.

[27] Amy Merrick, *Costly Ad Circulars Precipitate Departure of Kmart's President*, WALL ST. J., Jan. 18, 2002 ("At a September [2001] analysts' meeting in New York, Mr. Conaway [the Kmart CEO] called the circulars a 'heroin needle' and 'the apex of what's wrong with Kmart.'").

[28] In conjunction with an advertising campaign launched in April 2011, Walmart announced more steps to reaffirm its EDLP strategy. According to Duncan MacNaughton, chief merchandising officer of Walmart U.S., "Walmart's reputation was founded on the principle of providing low prices day-in and day-out on the broadest assortment of merchandise. Our company is determined to create

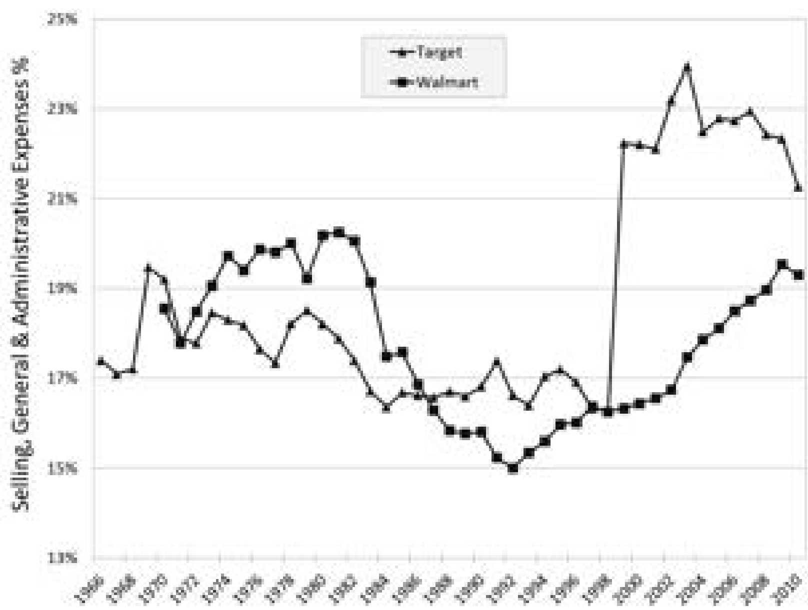
Figure 4
Every Day Low Pricing (EDLP) at Walmart

SOURCE: Photos courtesy of Walmart.

the best one-stop shopping experience and low prices on the right products backed by a clear, consistent ad match policy." WAL-MART, WALMART REINFORCES ITS COMMITMENT TO DELIVER LOW PRICES. EVERY DAY. ON EVERYTHING (2011), *available at* http://news.walmart.com/news-archive/2011/04/11/walmart-reinforces-its-commitment-to-deliver-low-prices-every-day-on-everything.

Selling, general and administrative (SG&A) expense is an important indicator of a retailer's cost structure. Figure 5 graphs SG&A as a percent of sales of Walmart and Target. Target's SG&A was initially lower, but Walmart hit a "productivity loop"[29] in 1981 and was able to reduce SG&A significantly.

Figure 5
Percent of SG&A of Walmart and Target

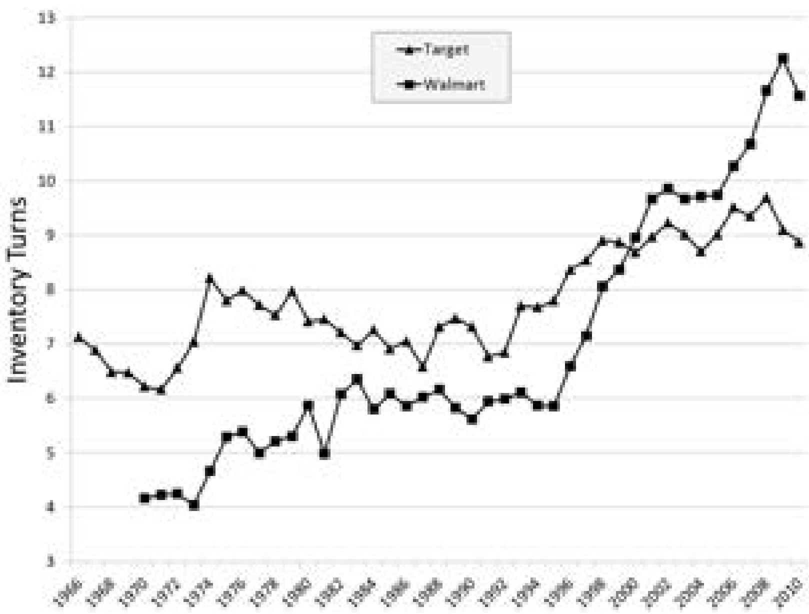


SOURCE: Wharton Research Data Services.

[29] The "productivity loop" is a foundational principle for Walmart, as described by CEO Mike Duke in a 2011 interview. *See* Maria Bartiromo, *Bartiromo: Wal-Mart CEO Sees Stressed U.S. Consumers*, USA TODAY, September 19, 2011, *available at* http://usatoday30.usatoday.com/money/companies/management/bartiromo/story/2011-09-16/walmart-ceo-mike-duke /50457744/1. ("At Wal-Mart it goes back to Sam Walton and the foundation and business model that we simply operate for less, or everyday low cost. We're known for operating in a very efficient way and then giving those savings to customers. That's why everyday low price is the second part of the productivity loop. Having low prices ends up driving traffic to our stores and increasing sales, which allows us then to lower expenses again and lower prices.").

Another perspective on retailer efficiency is the speed of turning over fixed and current assets. Inventory turns, the amount of revenue flow sustained per dollar of inventory investment, is a standard measure of current asset productivity. For a given level of sales, a larger value of inventory turns is better. Figure 6 shows that for many decades Target outperformed Walmart. However, 1986 was an inflection point, marking a dramatic acceleration for Walmart. Walmart overtook Target shortly after the turn of the century and has sustained a sizable lead since then.

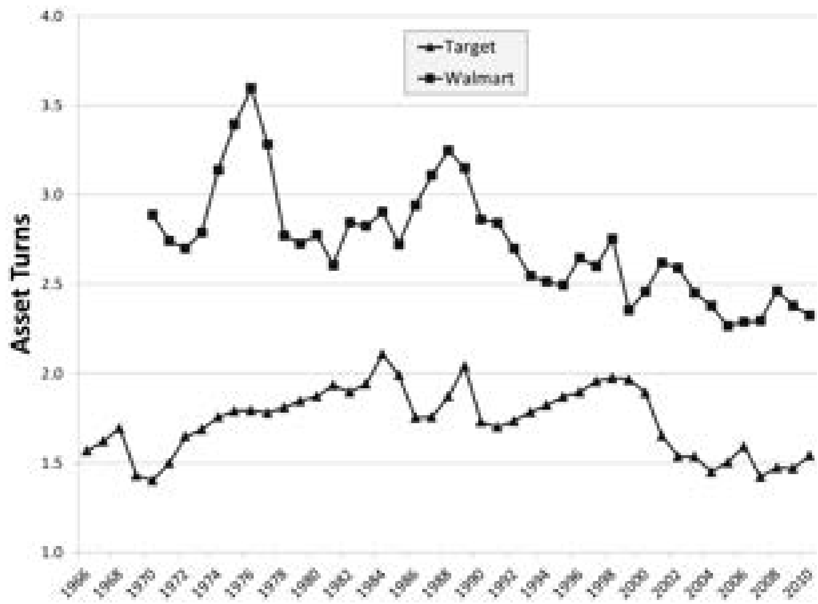
Figure 6
Inventory Turns of Walmart and Target



SOURCE: Wharton Research Data Services.

Figure 7 graphs total asset turnover, which addresses both fixed assets such as distribution centers and current assets such as inventory. Here Walmart has consistently dominated Target.

Figure 7
Asset Turns of Walmart and Target



SOURCE: Wharton Research Data Services.

These data demonstrate the ways Walmart holds cost leadership over Target. Next we will link this to a deliberate repositioning decision by Target.

B. *Target's Cheap Chic model*

Target is a mass discounter like Walmart. In contrast to Walmart's EDLP, Target promotes select products in weekly advertising circulars, bearing the aforementioned costs of Hi-Lo pricing.

As figures 5, 6, and 7 show, in the early 1970s the two retailers performed comparably with respect to key financial metrics such as SG&A percentage, inventory turns, and asset turns. Target even outperformed Walmart for a period of time. However, as Walmart acquired scale, Target appears to have adjusted its model. This strategy shift is most evident in the sharp increase in Target's SG&A percentage in 1998, coinciding with Target's scaling up of its Cheap Chic strategy.

Cheap Chic originated from the observation by Target executives, who had extensive experience in the department store business, that department stores were losing foot traffic while more conveniently located mass discounters were gaining. Target's leadership set out to offer the kinds of fashionable home furnishings traditionally associated with department stores in the convenient setting of a discount store. Lacking the credibility to sell fashion products that imbued a "high design element," Target turned to designers like Michael Graves and Isaac Mizrahi to create striking products that would be sold exclusively at Target, as figure 8 illustrates. The celebrated Michael Graves collaboration ended in 2012, but industry observers note that "the impact on Target will be long lasting" and that through this relationship Target gained a reputation for urbancentric design.[30]

The Cheap Chic strategy relies not just on the design of products, but also on a shopping environment and brand image consistent with such product designs, such as wider and cleaner aisles, and well laid out shelves). This emphasis on nonprice dimensions to differentiate from cost leaders is not unique to Target. Using U.S. price index microdata on inventory shortfalls, Matsa has shown that food retailers have also pursued the strategy of improving on nonprice dimensions such as product availability to differentiate from Walmart.[31]

Figures 5 and 9 show that Target's SG&A percentage and gross margin percentage both increased after the launch of the Cheap Chic strategy.

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30 Thomas Lee, *Graves Gave Target an Edge*, MINNEAPOLIS STAR TRIB., Feb. 10, 2012, http://www.startribune.com/business/139065819.html.

31 David A. Matsa, *Competition and Product Quality in the Supermarket Industry*, 126 Q. J. ECON. 1539 (2011).

Figure 8
Presentation of "Cheap Chic" Products at Target

SOURCE: Target Brands, Inc., www.target.com.

Figure 10 plots Target's gross margin percentage against its SG&A percentage. The lower cluster is pre–Cheap Chic, and the higher cluster corresponds to the Cheap Chic era. A simple linear regression generates a very high R-Squared (0.9), suggesting a strong correlation. This is consistent with a popular adage in retailing that higher prices are necessary to support higher costs. The gross margin data suggest that for a considerable time Target has been able to sustain premium prices for its exclusive designs and perhaps more broadly throughout its assortment.[32]

[32] Target's deployment of Cheap Chic together with Hi-Lo pricing in direct competition with Walmart is highly consistent with a study conducted

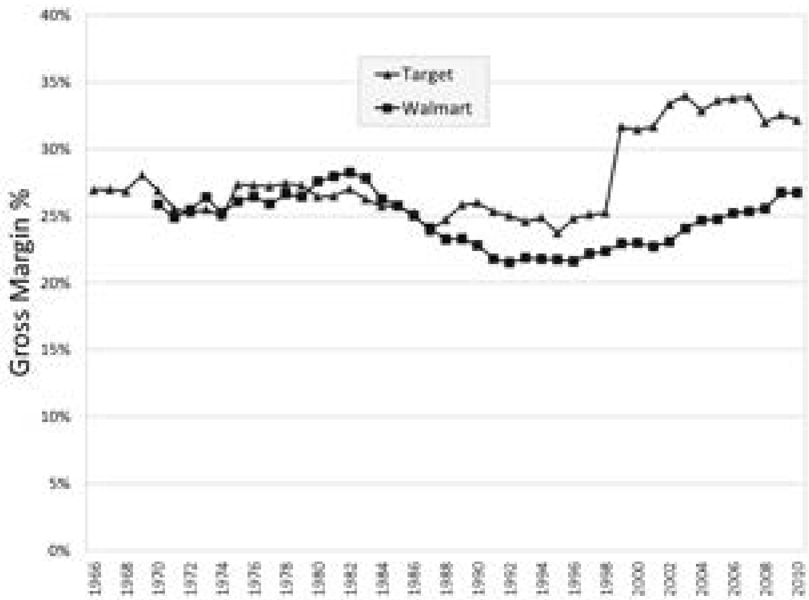
Figure 8 (continued)

SOURCE: Wharton Research Data Services.

Leinwand and Mainardi summarize the two retailers' corporate strategies as follows. Walmart focuses on low prices, which includes no-frills store design and avoiding big-ticket items, such as furniture and large appliances, where it has no cost advantage or where new service capabilities might be required. Target emphasizes design-forward apparel and home decor for image-conscious consumers, with everything from store layout to advertising to inventory conveying an eye for style, and the entire strategy supported with image advertising.

by Lal and Rao. Their model predicted that a cleaner segmentation of the market would result if a Hi-Lo retailer used a higher level of service to respond to an EDLP retailer. *See* Rajiv Lal & Ram Rao, *Supermarket Competition: The Case of Every Day Low Pricing*, 16 MARKETING SCI. 60 (1997).

Figure 9
Gross Margin Percents of Target and Walmart



SOURCE: Wharton Research Data Services.

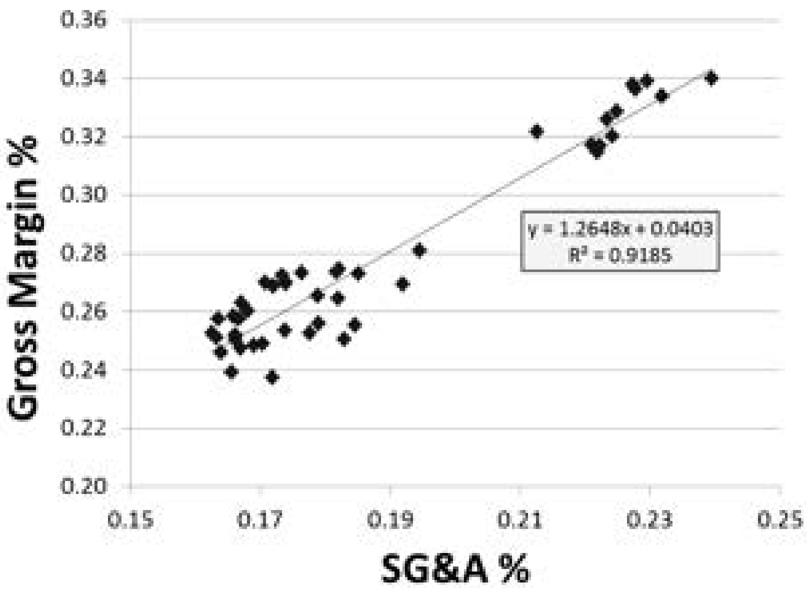
The firms, which have both been fantastically successful to date, have each developed a "system of a few truly unique capabilities that help them create differentiated value for their chosen customers."[33] But these different approaches leave one of the retailers more susceptible to showrooming, as we explain next.

C. *Implications for hybrid shopping and showrooming*

The preceding analysis suggests a relatively straightforward conclusion. Target is vulnerable to showrooming, evidently more so than Walmart, because Target has invested in making its stores into effective showrooms. And the Hi-Lo pattern of pricing can exacerbate the risk.

[33] Paul Leinwand & Cesare Mainardi, *Why Can't Kmart Be Successful While Target and Walmart Thrive?*, http://blogs.hbr.org/cs/2010/12/why_cant_kmart_be_successful_w.html (HBR Blog Network, Dec. 15, 2010).

Figure 10
Percents of Gross Margin vs. SG&A for Target



SOURCE: Wharton Research Data Services.

To effectively merchandise Cheap Chic products requires creating a certain ambiance throughout the store, as well as branding efforts to craft the Chic part of the overall corporate image. The entire operation must be aligned around the identity, and the resulting costs likely need to be shared across the broader product assortment. This includes manufacturer brands that competitors might offer at a meaningfully lower price.

The nature of what is being free ridden on here merits additional elaboration. In terms of services, certainly Target provides physical samples that allow shoppers to "kick the tires and feel the leather," and some of the sales staff might be able to field certain questions about some products. But nobody would ever confuse Target's floor staff with those at Nordstrom or an Apple Store in terms of knowledge, solicitousness, or individual empowerment to go the extra mile for the customer. The preceding analysis demonstrates that, beyond providing the baseline portfolio of tangible services that is expected of retailers of its class, Target's investment is focused elsewhere, toward establishing a particular store ambiance. This we consider an "intangible service."[34]

Store ambiance can be interpreted through the lens of what the marketing literature denotes as "atmospherics": the design of buying environments to produce specific emotional effects in buyers that enhance purchase probability by manipulating the visual, aural, olfactory, and tactile dimensions of atmosphere. Noting that "in some cases, the place, more specifically the atmosphere of the place is more influential than the product itself in the purchase decision," Kotler has posited that as competition intensifies, atmospherics will matter more.[35] Numerous research studies have investigated various aspects of atmospherics.[36]

Walmart learned a lesson about the power of store ambiance in 2011. At that time it terminated a two-year effort that included remodeling its stores with cleaner and less cluttered layouts to try to retain Target shoppers that had migrated to Walmart during the recession that began in 2008. The more orderly store environments caused shoppers to question Walmart's low-price leadership. "Whether they know it to be more of a discounter or not, if shoppers walk into a less organized environment . . . their first impression is going to be, 'O.K., you're going to find lower prices here,'" said Ben DiSanti, senior vice president of planning and perspectives for TPN, a retail marketing consultant.[37] Decades earlier Kotler documented the power of an "organized chaos" atmosphere in signaling value to price-sensitive customers.[38]

Unlike promotional efforts that call explicit attention to a particular product or brand, atmospherics operate at a more subliminal level

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[34] *See* Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346 (1984) (discussing quality certification and calling it an intangible service).

[35] Philip Kotler, *Atmospherics as a Marketing Tool*, 49 J. RETAILING 48 (1973).

[36] L. W. Turley & Ronald E. Milliman, *Atmospheric Effects on Shopping Behavior: A Review of the Experimental Evidence*, 49 J. BUS. RES. 193 (2000).

[37] Stephanie Clifford, *Stuff Piled in the Aisle? It's There to Get You to Spend More*, N.Y. TIMES, Apr. 8, 2011, at A1, *available at* http://www.nytimes.com/2011/04/08/business/08clutter.html.

[38] Kotler, *supra* note 34.

and with less precision. But the expense to the retailer is real, and if a smartphone app hijacks the purchase-primed shopper on the way to the store's checkout stand, free riding has occurred. When atmospherics and other less tangible forms of services are involved, perhaps a more apt descriptor would be "soft free riding."

Conversely, retailers like Walmart that invest less in ambiance and merchandising ought to be less likely to be victimized by showrooming. Shoppers would tend not to visit these kinds of stores except with intention to buy, reinforced by the ability of these stores to get closer to price parity with online sellers.[39]

To make matters worse for Target, by definition the prices of Hi-Lo retailers are for stretches of time even less competitive against the likes of Amazon, whose pricing is much closer to EDLP. This is in addition to any supply chain and marketing cost burdens that arise in executing Hi-Lo pricing in brick-and-mortar retail, as described earlier.

What prevents Target from becoming more Walmart-like to deter showrooming? Target started down its current path long before smartphones were invented, let alone achieved the critical mass to become a critical catalyst of hybrid shopping. Even if Target decided to abandon its established business model now, and thinking in such drastic terms may be premature since the model has been successful in so many ways, this kind of strategic repositioning would entail significant changes in organizational structure and the nature of the activities per-

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[39] A low cost structure does not automatically translate to low prices, of course. But industry surveys over time have tended to confirm that Walmart has lower prices than Target. On occasion they show the two on a par, or even Target being cheaper, but these results are highly dependent on the timing. Target may be running heavy seasonal promotions during the time frame of the survey, meaning that shoppers might have to switch from their preferred brands to access the lower prices. These nuances aside, the firm with the lower cost structure ultimately is better equipped to cut prices if the competitive landscape requires it. *See* Sarah Mahoney, *Walmart Beats Target, Retains Slight Price Edge*, MARKETINGDAILY, Feb. 28, 2012, http://www.mediapost.com/publications/article/168823/walmart-beats-target-retains-slight-price-edge.html.; Matt Townsend & David Welch, *Target Cheaper Than Wal-Mart as Gap Widest in Two Years*, BLOOMBERG, Aug. 23, 2012, http://www.bloomberg.com/news/2012-08-23/target-cheaper-than-wal-mart-as-gap-widest-in-two-years.html.

formed.[40] Using data on supermarkets' response to Walmart's entry into that line of business, Ellickson, Misra and Nair estimated that switching retail formats, such as from EDLP to Hi-Lo, entails substantial costs.[41] These types of business models require a sustained level of commitment that retailers might not be able to unwind easily. The aforementioned recent attempt by Walmart to be more Target-like in selective ways serves as a cautionary tale. Piecemeal adoption of individual practices, even ones that seem brilliant at face value, cannot succeed without coherent integration into the entire business model.

This is not to say that the Walmart of today is immune to the flavor of showrooming in which the sale goes to a competitor, which the company calls "scan and scram."[42] However, note the stark contrast between the previously cited letter from Target's CEO and this recent declaration by Walmart CEO Mike Duke: "Let us be the best showroom."[43] This presumably means increasing the proportion of showrooming behavior that ultimately leads to a purchase at Walmart.com. Section V will elaborate on how this might be accomplished.

V. RETAILER-CENTRIC RESPONSES TO FREE RIDING IN HYBRID SHOPPING ENVIRONMENTS

Resale price maintenance (RPM) is one way that manufacturers might attempt to combat free riding within its distribution system. This is intended to assure that the manufacturer's chosen channels have the incentive to exert the appropriate level of effort to sell and deliver its products. RPM is relatively straightforward to implement, although the status of its legality has varied over time. As RPM has received considerable attention in the marketing, economics, and law literatures,[44] this article will devote attention to other approaches.

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40 Michael E. Porter, *What Is Strategy?*, Harv. Bus. Rev., Nov.–Dec. 1996, at 61.

41 Paul B. Ellickson et al., *Repositioning Dynamics and Pricing Strategy*, 49 J. Marketing Res. 750 (2012).

42 David Welch, *Wal-Mart Gears up Online as Customers Defect to Amazon*, Bloomberg, Mar. 20, 2012, http://www.bloomberg.com/news/2012-03-20/wal-mart-gears-up-online-as-customers-defect-to-amazon.html.

43 Zimmerman, *supra* note 24.

44 Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J. L. & Econ. 263 (1991); Raymond Deneckere et al., *Demand*

To intelligently prescribe how a manufacturer should address the free riding problem requires an intimate understanding of retail competition in this era of Internet-influenced hybrid shopping. Part of this entails consideration of what the retailers themselves can do to shape the flow of shoppers across channels. If effective, these efforts may diminish the need for manufacturer intervention. On the other hand, the success of certain retailers in this endeavor may motivate a manufacturer to suggest or even impose these practices across the remainder of its retail partners. This could eventually resemble another form of vertical restraint and thereby merit examination for antitrust implications.

This section presents actions retailers can take to hang on to the shopper. These follow what might be called the conventional profit model for retailers, in which sales revenue remains the main mechanism for funding the channel services provided. The manufacturer might be involved, but not in a way that takes away the retailer's control over the retail price. Section VI describes vertical arrangements whereby manufacturers can more directly underwrite the services it wants its channel partners to provide, such as by tying commissions or discounts to the desired activities. Such subsidies either make the partner less concerned about losing the sale to a different channel or give the partner additional latitude to prevent being undercut.

As noted previously, hybrid shopping can engender two primary types of free riding: ROBO and showrooming. However, ROBO has not caused the uproar associated with showrooming. A possible explanation is that the marginal cost to an Internet channel when its visitor engages in ROBO behavior is relatively low. In fact, by selling advertising some websites are able to monetize site traffic even if visitors make no purchase.[45] Amazon.com can do exactly this because its

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Uncertainty, Inventories, and Resale Price Maintenance, 111 Q.J. ECON. 885 (1996).; Gregory T. Gundlach et al., *Free Riding and Resale Price Maintenance: Insights from Marketing Research and Practice*, 55 ANTITRUST BULL. 381 (2010); Gregory T. Gundlach et al., *Resale Price Maintenance and Free Riding: Insights from Multi-Channel Research*, 1 ACAD. MARKETING SCI. REV. 18 (2011).

[45] The original business model of Buy.com, an early competitor of Amazon that reached a market capitalization of over $3 billion during the dotcom bubble of the late 1990s, was to offer retail products at a loss so as to draw

product information and user-generated reviews have become so popular a resource. Site traffic can perpetuate a virtuous cycle, as some of the visitors will improve the resource by adding reviews of their own. Thus most of our attention will focus on responses to showrooming instead of to ROBO.

In an August-September 2012 survey of 100 chief financial officers at leading U.S. retailers, one-quarter of the responding CFOs said that their primary strategy to counter showrooming is improving customer service. Another twenty-five percent are expanding options for in-store pickups and returns, seventeen percent are using exclusive goods, and seventeen percent are working on matching the prices of online retailers.[46] This survey did not elaborate on the meaning of the top response, "improving customer service," but its prominence must be examined with some skepticism in light of our understanding of free riding. Investments in ambiance, in-store product demonstrations, or salesperson training may all be good ideas and necessary to improve a retailer's general level of competitiveness. But any type of service that can be utilized without making a purchase remains unreliable in dissuading showroomers from buying from a competitor. A more focused approach would be for a retailer to stay within striking distance of the prevailing online prices and install improvements that better enable closing the sale, either in its brick-and-mortar stores or on its website.

The CFO survey listed options with this potential. Below we discuss these and other approaches, which are not mutually exclusive. Some are contemporary incarnations of classical tactics; others are novel because they rely on technologies and channel combinations that have only recently entered the mainstream. We present them not in order of frequency of use or likelihood of success, but in accessibility to the typical retailer. The first two are available to any retailer, and the next requires the retailer to have a viable online channel alongside its brick-and-mortar stores and creates coordination challenges. This

enough site traffic to profit from selling advertising. This kind of retailer might be better off if visitors do not buy at all. *See* Justin Hibbard, *Buy.com: How Soon We Forget*, Bus. Wk., Jan. 25, 2005, http://www.businessweek.com/the_thread/dealflow/archives/2005/01/buycom_how_soon.html.

[46] Bdo, Retail Compass Survey of CFOs (2012), *available at* http://www.bdo.com/download/2302.

article has already provided evidence that susceptibility to showrooming can vary across types of retailers and categories of products, so the proper course of action will not be one-size-fits-all.

A. Lowering prices and price matching

The most primal response to a low-price competitor is to reduce one's own prices. Earning a reasonable return on investment while doing so is another matter, and free riding cuts to the heart of this issue.

Rather than cutting prices across the board, the retailer may opt to price match for shoppers who have done a certain amount of research legwork. Price matching can be considered a price discrimination mechanism that selectively targets price-sensitive shoppers or those with lower search costs. Best Buy, Target, Walmart, and Sears match brick-and-mortar competitors' prices throughout the year, but in the 2012 holiday season Best Buy and Target extended this to cover online retailers with certain restrictions (i.e., the policy is valid only for a specific set of online sellers and certain time periods).[47] The full language of Target's policy for matching online prices appears in figure 11.

Figure 11
Target Price-Matching Policy for 2012 Holiday Season

Holiday Price Matching: select online competitors

We'll match the price if you buy a qualifying item at a Target store between Nov. 1 and Dec. 16 and find the identical item for less at Amazon.com, Walmart.com, BestBuy.com, ToysRUs.com or BabiesRUs.com. Simply show us the current online price using your mobile device, or bring in a printed page showing the current online price by Dec. 16. The online price and availability will be validated by a Target team member at the Guest Service desk.

- Excludes "Marketplace" prices. Price matched items must be sold by Walmart.com, Amazon.com, BestBuy.com, ToysRUs.com, or BabiesRUs.com; prices from 3rd party sellers on these websites will not be honored.
- Excludes Target stores in Alaska and Hawaii.
- Limit quantity of 1 online price match per identical item, per guest.
- Must bring in original Target receipt when requesting the price match by Dec. 16.
- The retail price must be shown on the competitor's website and must be valid at the time the price match is requested.
- The item must be the identical item, brand name, size, weight, color, quantity and model number.
- Online prices from Nov. 22–26 are excluded.
- Excludes online prices from competitors not listed above.

SOURCE: Target.com, http://corporate.target.com/about/shopping-experience/our-low-price-promise (last visited Dec. 31, 2012).

[47] Joseph Pisani, *Retailers' Price War Can Save Shoppers Big Bucks*, ASSOCIATED PRESS, Nov. 23, 2012, http://www.nbcnews.com/business/retailers-price-war-can-save-shoppers-big-bucks-1C7308451.

Price matching that is not implemented in a coherent way can confuse and annoy customers. In the policies announced by these two chains, shoppers are responsible for requesting the match and proving the existence of the lower online price, which may be tough to execute given how frequently prices fluctuate on the Internet. Store staff may find themselves frequently explaining and defending the many exclusions, even if the terms are broadcast clearly in advance. This strategy may have the unintended consequence of encouraging even more shoppers to comparison shop on the Internet, at which point they may simply forgo the store visit altogether.[48]

Some retail analysts believe that this tactic plays right into Amazon's hands. Susan Lee, head of the consumer goods and retail practice in North America for Simon-Kucher & Partners, has mused, "Can you imagine if Amazon runs deep, limited promotions on consumer electronics solely during Best Buy's store hours? Time, resources, and flexibility all work in Amazon's favor if Best Buy starts a retail price war in consumer electronics. This is a strategic mistake for Best Buy, from which it might never recover."[49]

Our earlier analysis suggests that, of all the brick-and-mortar retailers, Walmart might be best equipped to keep pace with online prices. So it is worth noting that, as of October 2012, Walmart had not jumped on this bandwagon.[50]

Another way to appeal to showroomers' love of a deal is to broadcast coupons to in-store smartphone users. Retail consultant Andrea Woroch anticipates that consumers will begin to see more such offers tied to behaviors such as checking in using Foursquare or scanning an in-store code.[51]

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[48] Ann Zimmerman, *Holiday Price-Matching Could Backfire for Retailers*, Wall St. J., Oct. 17, 2012, http://online.wsj.com/article/SB10000872396390444592704578062962791253452 .html.

[49] Brad Tuttle, *By Matching Online Prices, Are Best Buy and Target Doing Exactly What Amazon Wants?*, Time, Oct. 23, 2012, http://business.time.com/2012/10/23/by-matching-online-prices-are-best-buy-and-target-doing-exactly-what-amazon-wants/.

[50] Zimmerman, *supra* note 47.

[51] Martha C. White, *Amazon, Retailers Do Combat; Shoppers Caught in the Middle*, NBCNews.com, Oct. 19, 2012, http://bottomline.nbcnews.com/_news/2012/10/19/14538755-amazon-retailers-do-combat-shoppers-caught-in-the-middle.

Compared to price matching policies, this approach gives the retailer more control over the timing and target audience of the discount.

By itself a price-matching strategy may not solve the showrooming problem because online sellers may have a different business model and a different cost structure.[52] Furthermore, it will increase the attention paid to price. A race to the bottom could wipe out some sellers, reducing choice and raising prices for consumers in the long term.

B. Product exclusivity

A seller can protect a product from head-to-head competition by ensuring that an identical product is simply not available anywhere else. Exclusivity can be achieved in various ways, and the product may or may not retain a manufacturer brand.

A manufacturer can directly restrict which of its products are sold in which channels or retail formats.[53] When implemented at the level of a SKU this approach is also called SKU authorization. If the manufacturer feels that a certain SKU requires, for instance, extensive investment in store presentation and merchandising or service, the manufacturer might authorize the SKU only for brick-and-mortar retailers who meet certain standards. Figure 12 shows such a restriction from STIHL, the manufacturer of the world's top-selling brand of chain saws. This example is notable in that STIHL is publicizing these limits as a point of differentiation and identifying by name the retailers considered unqualified to sell the product. Figure 13 gives a sense of how STIHL highlights the value added by its authorized dealers.

Target's January 2012 letter to its vendors asked them to "create special products that would set it apart from competitors and shield it from the price comparisons that have become so easy for shoppers to

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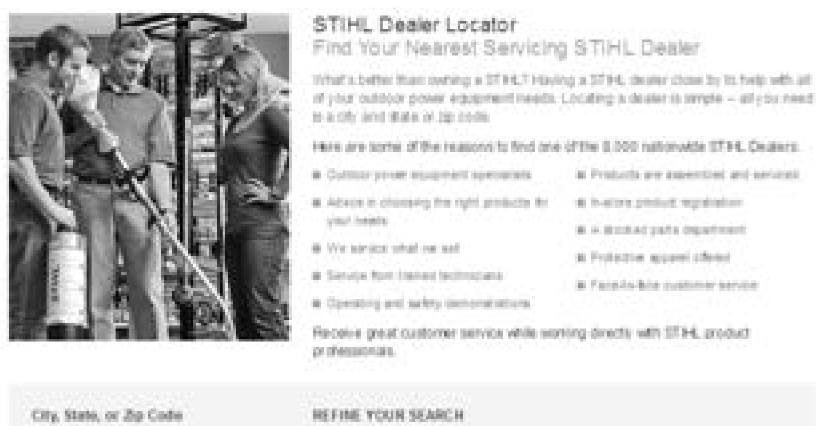
[52] A survey by brokerage house William Blair & Co. found that on average Target's prices were about fourteen percent higher than Amazon's, Best Buy's were sixteen percent higher and Walmart's prices were nine percent higher. The comparison included shipping costs for Amazon, but not sales taxes. *See* Zimmerman, *supra* note 47.

[53] Multichannel retailers do something similar when they designate certain products as "web only." Preempting free riding is a possible motive, but the items might simply lack the popularity to justify holding inventory in the stores.

Figure 12
STIHL Print Ad

SOURCE: Stihl Inc., http://www.stihlusa.com/locator/learn-why/.

Figure 13
STIHL Presents its Distribution Structure as a Competitive Strength



SOURCE: Stihl Inc., http://www.stihlusa.com/locator/ (last visited Dec. 31, 2012).

Figure 13 (continued)

Why STIHL Chooses Independent Dealers

Selling only through servicing Dealers builds loyalty, sales and satisfied customers.

We have nothing against the big box retailers. Really.

But when it comes to distributing, marketing and selling our power equipment, we prefer to keep it in the family. Always have. That's why STIHL is proud to be one of a few power equipment manufacturers to sell its products exclusively through independent servicing Dealers rather than mass merchants.

And the truth is, we owe much of our success to this arrangement, as well as to the quality and dedication of the men and women who proudly display the STIHL sign.

Thanks to 12 hard-working distribution operations across the country, our thousands of dealers stay well stocked and wonderfully supported. So, what advantages do our independent servicing dealers bring to the customer? For starters, they can help you select the right STIHL product.

Most carry a wide variety of tools and accessories for whatever your job, and they can offer fast, professional service if a problem arises. Plus, they can assemble your equipment and give you complete operating and safety instructions before you walk out the door.

To further show our support of our independent Dealers, we decided to sponsor Independent We Stand – a national movement of independent businesses dedicated to educating their communities about the benefits and importance of "buying local." You can support the cause and help revive the local economy by shopping at these independent businesses. Buy their products. Eat their food. Use their services. In turn, these locally owned and operated businesses will continually pump your hard-earned dollars back into the local economy by way of taxes, payrolls and purchases.

So, whether you are a professional who depends on your tools each day, or a consumer who only has the weekend to get the job done, you can depend on STIHL and STIHL Dealers.

SOURCE: Stihl Inc., http://www.stihlusa.com/locator/benefits-of-independent-servicing-dealers/ (last visited Dec. 31, 2012).

perform on their computers and smart phones."[54] Target followed through with this idea during the 2012 holiday season, with plans to carry more than 300 exclusive products from well-known toy brands such as Barbie and Fisher Price.[55] Unknown at this time is whether these will be truly unique designs or part of a "branded variants" approach. In the latter, a manufacturer creates versions of a product as distinct SKUs to be selectively allocated among its multiple channels. These variants might be functionally identical but take on different names and model numbers in different channels, giving some of the benefits of exclusivity while still leveraging the manufacturer's brand equity and numerous forms of product support.[56]

Bergen, Dutta, and Shugan showed through theoretical and empirical analysis that branded variants elevate search costs for consumers and decrease competition among retailers, so that more retailers will carry the product and offer a higher level of service.[57] Branded variants can also enable retailers to more safely offer price comparison guarantees ("If you can find a lower price on an *identical* product, we'll beat it"), which are intended to nudge price-sensitive and regret-averse shoppers to buy. As in many other situations discussed in this article, the Internet can undermine this marketing strategy by empowering shoppers to compare product specifications and features to identify functional equivalencies and disseminating this information on a wide scale.

A retailer can unilaterally achieve absolute exclusivity, and thereby completely prevent showrooming losses to competitors, by carrying private label products. These items bear a retailer-owned brand name. Private labeling was a legitimate retail strategy long

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[54] Zimmerman, *supra* note 14.

[55] Tiffany Hsu, *Target's Holiday Plan: Win Moms with QR Codes, Exclusive Toys*, L.A. Times, Oct. 3, 2012, http://www.latimes.com/business/money/la-fi-mo-target-holiday-plan-20121003,0,776165.story.

[56] Retailers may attempt to achieve this effect unilaterally. On pricier merchandise Best Buy has moved away from universal barcodes and created its own to prevent scanning with smartphone apps. *See* Emma Sapong, *Brick-and-Mortar Stores Serve Customers Who End Up Buying Online*, Buff. News, Sept. 9, 2012, http://www.buffalonews.com/article/20120909/BUSINESS /120909591/1003.

[57] Mark Bergen et al., *Branded Variants: A Retail Perspective*, 33 J. Marketing Res. 9 (1996).

before the Internet era. Benefits for the retailer include control of the pricing, retaining more of the profit margin, control over the product attributes and roadmap, and developing loyalty to the retailer's brand instead of the manufacturer's.[58]

Toys "R" Us has bought into this approach heavily, increasing its number of private label products by thirty percent since 2006 in part to discourage comparison shopping.[59] This includes the Tabeo tablet computer for children, launched in October 2012.[60]

However, obtaining exclusivity by shifting the assortment more toward private labels represents a significant change in business strategy. A manufacturer brand is supported by the manufacturer's investment in customer research, product development, advertising, quality control, and warranty support, to name just a few of the product-management functions that a private label retailer would need to replicate. Although one can easily find contract manufacturers that specialize in supplying private label goods, the management burden for the retailer remains substantial and might be sustainable only by larger chains. Further, although exclusive products that retain the manufacturer's brand are a point of cooperation between a manufacturer and its retail partner, private labels inject an adversarial element into the relationship.

The long-standing view in the academic literature has been that private labels benefit both retailers and consumers: retailers gain a bargaining tool against manufacturers, and consumers enjoy greater choice and lower prices. However, recent empirical and theoretical work has identified circumstances under which branded manufacturers respond to the introduction of private labels by increasing prices

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[58] Amazon has carried private label product lines of its own for several years, including Pinzon for home furnishings, Denali for tools, and the smash-hit Kindle line of e-book readers and tablet computers. However, nothing indicates that this is a response to ROBO behavior. *See* Clay Dillow, *Amazon Plunges into Private Label Business*, FAST COMPANY, June 16, 2009, http://www.fastcompany.com/1295910/amazon-plunges-private-label-business.

[59] Zimmerman, *supra* note 24.

[60] Ann Zimmerman, *New Entry in Tablet Wars: Toys "R" Us*, WALL ST. J., Sept. 10, 2012, http://online.wsj.com/article/SB10000872396390443779404577641582484693296 .html.

and discovered that the impact on consumer and social welfare can be either positive or negative.[61]

C. Hybrid marketing to create services unavailable in single-channel systems

Even without the lowest prices, brick-and-mortar retailers that also have online channels can use an integrated hybrid approach ("bricks-and-clicks" or "clicks-and-mortar") against the pure-play online retailers. Many shoppers still value certain aspects of finalizing purchases in physical stores, such as instant gratification and convenient returns, and a retailer can use its online channel to complement these. The key is to make buying from the store or the store's own website the shopper's path of least resistance.

One familiar example of this kind of hybrid marketing is the option to buy online with a credit card and pick up the merchandise at the store. Walmart has offered this service for years through its Site to Store policy, which charges no shipping fee and allows free returns at the store. Many leading bricks-and-clicks retailers have a similar program.

Walmart's recent enhancement of its Site to Store option revealed an unexpected advantage for retailers with physical store assets. Starting in April 2012, Walmart shoppers could order merchandise online and pay in cash at the store at the time of pickup. The cash option was meant to appeal to customers without bank accounts or credit cards, a nontrivial segment given the economic profile of typical Walmart shoppers. However, after the program was launched, Walmart quickly noticed that roughly forty percent of the customers who chose cash payment at the time of ordering online paid through noncash means on making the store pickup. They had simply not wanted to transmit their financial information over the Internet.

The persistence of certain shopper preferences may lead the currently online-only retailers to emulate their bricks-and-clicks competitors. Alison Jatlow Levy, a retail consultant at Kurt Salmon, predicts, "You will definitely start to see online-only players open stores."[62]

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[61] Bjørn Olav Johansen, *Private Labels, Rent Shifting and Consumer Welfare*, (Univ. Bergen, Dep't of Econ. Working Paper, 2011).

[62] Stephanie Clifford, *Luring Online Shoppers Offline*, N.Y. Times, July 5, 2012, at B1.

Indeed, Amazon is recognizing that it must respond to what shoppers still value about brick-and-mortar shopping. This includes continuing to expand its network of distribution centers, experimenting with self-service pick-up lockers in 7-Eleven stores, and even offering same-day delivery in certain markets for an extra fee, all in hopes of approximating instant gratification for its customers. Amazon is even rumored to be considering opening physical stores to sell e-readers and tablet computers. Amazon would probably have expanded its physical presence much earlier if not for concerns about triggering state requirements to charge sales taxes. That inhibitor is fading away as sales tax becomes mandatory for more and more online purchases.[63]

The shift of pure-play online sellers toward hybrid marketing should be a step closer to parity in overhead cost structure. Even Amazon does not have a magic formula for cost effectively approximating immediate access to product. CFO Thomas Szkutak said in July 2012 that "we don't really see a way to do same day delivery on a broad scale economically."[64] Meanwhile, in October 2012, Walmart began testing its own same-day delivery option, known as Walmart To Go, in certain markets, which fulfills orders from Walmart stores. This leverages Walmart's expansive physical retail network with its locally positioned inventory, although store-based fulfillment is much more expensive than shipping from distribution centers.[65] Walmart executives remain confident of their ability to dominate in a bricks-and-clicks showdown. Walmart.com CEO Joel Anderson has remarked about Amazon: "It's fun to see them trying to be us. We have more than 4,000 forward-deployed fulfillment centers and we're already doing shipments from some of them. Some people call them stores."[66]

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[63] Amy Martinez, *As Tax-Free Sales Go, Amazon Looks to Speed, Convenience*, SEATTLE TIMES, Sept. 1, 2012, http://seattletimes.com/html/businesstechnology/2019048905_amazontax02.html.

[64] Amazon.com, *Amazon.com, Inc. Q2 2012 Earnings Call Transcript* (July 26, 2012), http://seekingalpha.com/article/754571-amazon-com-s-management-discusses-q2-2012-results-earnings-call-transcript.

[65] Shelly Banjo, *Wal-Mart Delivery Service Says to Amazon: "Bring It,"* WALL ST. J., Oct. 10, 2012, at B1.

[66] Farhad Manjoo, *Walmart's Evolution from Big Box Giant to E-Commerce Innovator*, FAST COMPANY, Nov. 26, 2012, http://www.fastcompany.com/3002948/walmarts-evolution-big-box-giant-e-commerce-innovator.

To bricks-and-clicks retailers, showrooming can be positive because the smartphone can be a powerful means of informing and influencing the hybrid shopper, provided that in the end the retailer still captures the sale in one of its own channels. In this sense, technology is not just the cause of the problem, but might be the key to the solution. Retailers like Target, Walmart, Macy's, and Saks Fifth Avenue are improving their smartphone apps and better integrating these into their marketing strategies,[67] with Saks even launching free Wi-Fi networks in all forty-four of its U.S. stores.[68]

Crucial to this approach is making the app convenient and useful to the shopper. Walmart's physical stores are "geo-fenced" to enable the setting of the retailer's location-aware smartphone app to "store mode" when the shopper enters. Numerous conveniences encourage shoppers to use the Walmart app, such as the ability to check prices and keep a running total of the cost of the shopping basket. Out of stock items can easily be ordered from Walmart.com. The Walmart app may even be able to capture additional sales if shoppers use it to showroom at competing retail stores. Walmart executives are happy with results so far, with more than twelve percent of online sales made through Walmart's smartphone app being made while customers are in the store, or at least while in the app is set to in-store mode.[69]

Bricks-and-clicks hybrids must overcome more than an increase in operational complexity, as internal incentive conflicts can just as easily undermine the strategy. If the different channels are managed and rewarded as quasi-independent entities, they can easily come to behave like competitors. Some channels might regard others as free riders. Target's price-matching policy for the 2012 holiday season explicitly includes a clause under which Target stores also agree to match Target.com prices, but only for a limited time, underscoring the reality

[67] Stephanie Clifford & Claire Cain Miller, *The Shrewd Shopper Carries a Smartphone*, N.Y. Times, Nov. 23, 2012, at B1.

[68] Bill Siwicki, *Saks Fifth Avenue Rolls Out Wi-Fi Nationwide*, Internet Retailer, Sept. 19, 2012, http://www.internetretailer.com/2012/09/19/saks-fifth-avenue-rolls-out-wi-fi-nationwide.

[69] Marcus Wohlsen, *Walmart.com CEO: We Embrace Showrooming*, Wired, Nov. 23, 2012, http://www.wired.com/business/2012/11/walmart-embraces-showrooming.

of internal conflict.[70] Confusion can occur if the online and stores divisions independently negotiate with the same manufacturer for product allocations and co-op advertising dollars (funds that manufacturers pay for placement in retailer advertisements, or in the case of online retailers, positioning within the retailer's web page layouts and in search results). In numerous ways the internal conflict among a retailer's channel divisions also affect manufacturer-retailer dealings, which may then bleed over into the structure of the manufacturer's vertical restraints.

Recognizing the danger of internal conflict due to the perception of free riding, bricks-and-clicks retailers seem willing to give double credit for an online sale. Best Buy credits its stores when customers purchase from Bestbuy.com.[71] A 2004 study of online retailing conducted by Shop.org and Forrester Research found that forty-three percent of multichannel retailers were crediting their offline channels for Internet sales, compared to eighteen percent of survey respondents in the previous year.[72] According to Joel Anderson, CEO of Walmart.com, "[in 2013,] store teams . . . will get credit for both store sales and .com sales,"[73] recorded to the store closest to the customer's address.[74]

Transfer pricing can play a role in managing the internal conflict caused by hybrid shopping. Williams-Sonoma Inc., the parent of retail concepts that include Pottery Barn, West Elm and Williams-Sonoma, takes this approach.[75] The company's multichannel

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70 Tiffany Hsu, *Amazon, Watch Your Back: Target, Best Buy to Match Online Prices*, L.A. TIMES, Oct. 17, 2012, http://articles.latimes.com/2012/oct/17/business/la-fi-mo-amazon-target-price- match-20121017.

71 Desiree J. Hanford, *Best Buy Credits Web Sales to Stores*, WALL ST. J., June 22, 2005, at B9A.

72 SHOP.ORG, THE STATE OF RETAILING ONLINE (2004), *available at* http://www.shop.org/soro.

73 Leon Nicholas, Continuous Selling at Walmart (presentation at Kantar Retail trade conference, Apr. 3–5 2012).

74 *Retailers Responding to "Showrooming" by Slashing Prices*, MARKETING, Apr. 12, 2012, http://www.marketingmag.com.au/news/retailers-responding-to-showrooming-by-slashing-prices-12586.

75 DALE D. ACHABAL ET AL., CROSS-CHANNEL OPTIMIZATION: A STRATEGIC ROADMAP FOR MULTICHANNEL RETAILERS (2005), *available at* http://www-03.ibm.com/industries/ca/en/retail/cross_opt.html.

approach includes catalogs, websites, and brick-and-mortar stores. Customers can purchase through any of these channels, but the retailer has long recognized that each channel has its own natural strengths.

Williams-Sonoma has been particularly successful at leveraging the capabilities of the catalog, which serves not only as a self-contained channel but also performs a marketing function by driving traffic to the stores and websites. In the vernacular of catalogers, this means mailing "deeper into the list" to generate interest in the other channels. The company's catalog mailing strategy takes into account the dual objective by using measurements of sales to hold-out groups that did not receive catalog mailings to validate that the catalog mailings are indeed generating traffic for the other channels. The stores division funds the catalog group for the mailings according to a pre-set formula, which is a form of transfer pricing.

This example suggests that recognizing channel specialization allows retailers to actively shape hybrid shopping. They can manage internal channel conflict by setting up measurement and payment systems that compensate the various channels appropriately.

The distinction this article makes between manufacturers and retailers is artificial at times, since a retailer with an autonomous online division resembles in many ways an upstream manufacturer that sells through an independent retailer. Thus some of the techniques directed at incentive conflicts among the retailer's online and offline channel divisions may help remedy conflicts among a manufacturer's different channel partners.

VI. ADDRESSING FREE RIDING IN HYBRID MARKETING SYSTEMS BY CHANGING RETAILER COMPENSATION MODEL

There is no straightforward way to compel Amazon to compensate Target when a shopper treats the Target store as a showroom before purchasing from Amazon. However, part of the proceeds of Amazon's sale end up with the manufacturer, which is thereby in a position to redirect some of the value to parties like Target who participated along the hybrid shopping path. If the manufacturer's intent is to assure the survival of important channel services in spite of free riding, the manufacturer can attempt to measure the provision of those services and tie it to rewards. This section describes some methods, observed in practice, that expand or change the compensation model of the retailer. As some of these settings are B2B instead of B2C, the terms reseller or channel partner may appear in the industry vernacular more than retailer, but the ideas apply just as well to both.

A. Temporary double pay

An enabler of free riding is the difficulty of tying a sale back to the specific services provided by each channel along the customer's path to purchase. Moriarty and Moran[76] recognized that in hybrid marketing systems some channel boundaries are fuzzy and that these "jump ball" situations might lead to channel conflict. Compensation policies can help establish new boundaries. These authors cited an example of a large computer manufacturer adding low-cost direct methods and indirect channels to supplement its traditional high-cost direct sales force. To motivate the direct sales reps to relinquish certain responsibilities, the company initially offered those reps a "strong incentive," paying them the normal commission even though they no longer participated in certain aspects of orchestrating the sale. Once the new channel practices were established, the company phased out what was in effect a system of double pay.

Vinhas and Anderson empirically evaluated double pay using data from eleven B2B firms. They found support for the hypothesis that "the greater the extent to which the manufacturer double compensates when using concurrent channels, the lower is the extent of destructive competition between integrated and independent channels when contacting the same customers."[77]

[76] Moriarty & Moran, *supra* note 8.

[77] Alberto Sa Vinhas & Erin Anderson, *How Potential Conflict Drives Channel Structure: Concurrent (Direct and Indirect) Channels*, 42 JOURNAL OF MARKETING RESEARCH 507 (2005).

In retail sales, many manufacturers directly pay a "spiff" to the retailer's sales personnel for making a sale of specific products.[78] Double pay could be considered in this situation as well.[79]

B. Activity-based compensation

An obvious solution is to tie compensation directly to the channel activity being performed. Suppose a customer browses a manufacturer's website and orders a product that requires assembly, delivery, and training to be performed by an independent dealer in the customer's local area. An activity-based compensation scheme would handle this transaction by crediting the manufacturer's website for lead generation and order taking (comparable to a finder's fee) and the local dealer for holding local inventory, assembly, delivery, and training.

Ethan Allen, the furniture manufacturer, uses such an approach to control conflicts between its company-owned website and its network of franchised stores.[80] Customers can order online, but storeowners deliver the merchandise, accept returns, and perform minor repairs as needed. The company also steers leads from the website to local stores. At the launch of this program, commissions paid to store owners for online purchases were twenty-five percent of the sales price if the store provided service and delivery and ten percent of the sales price for items shipped directly from the factory.

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[78] According to internal Microsoft documents, the company's efforts to market its Windows Phone will make use of a spiff. *See* Paul Thurrott, *Exclusive: Microsoft and Nokia's Plans for Marketing Windows Phone in 2012*, Windows IT Pro, Jan. 04, 2012, http://www.windowsitpro.com/article/paul-thurrotts-wininfo/exclusive-microsoft-nokias-plans-marketing-windows-phone-2012-141784 ("Included in the plan are sales incentives for retail workers, aimed at getting them to finally start recommending Windows Phone as an alternative to Android and iPhone. The amount of payments are $10 to $15 per handset sold, depending on the number sold, for some handset models.").

[79] Section V also described double-credit as a way some retailers are dealing with internal conflict across channels in their hybrid marketing systems. Credit in an internal performance measurement scheme is not necessarily the same as compensation, although it could be.

[80] James R. Hagerty, *Online: Ethan Allen's Revolutionary Path to Web*, Wall St. J., July 29, 1999, at B1.

Commissions or discounts for value added activities resemble what has historically been called a "functional discount," a discount offered by a seller to a reseller for assuming and performing a function.[81] Functional discounts have been attached to carrying a targeted level of inventory, financing (such as a discount for paying in cash), transportation, providing demos, and personal selling.

C. Compensation tied to prior investments in value added activities

In a spirit consistent with the activity-based compensation schemes discussed earlier, some firms address channel conflict by rewarding channel partners for previously made investments in value added activities. Under this regime the reseller who makes the investment receives a larger discount than the reseller who does not.

Cisco Systems has a channel management model for its independent value added resellers (VARs) that implements this activity-based compensation framework.[82] Cisco's networking gear can be used in a basic way as a data transport system or as a platform to deliver advanced solutions such as voice and video communications. Therefore the VARs can either resell the basic product or design and deliver advanced solutions.

All VARs begin with a baseline discount. VARs that specialize in a particular type of solution, such as voice, receive an additional discount through the Value Incentive Program. To qualify for the additional discount a partner must be trained and certified by Cisco. These certifications are renewed annually.

The rationale is that partners who go through this training and certification process can provide a better customer experience. The Value Incentive Program discount compensates these efforts. A noncertified partner receives only the baseline discount, so cannot easily undercut the price of the certified partner. This inhibits the free riding scenario in which a customer exploits the premium service capabilities of one channel but purchases from another channel at a lower price.

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[81] Mark T. Spriggs & John R. Nevin, *The Legal Status of Trade and Functional Price Discounts*, 13 J PUB. POL'Y & MARKETING 61 (1994).

[82] Kalyanam & Brar, *supra* note 6.

The contrast to RPM is worth noting. The basic premise of free riding is that the lower-service channel can charge lower prices and therefore lure customers away from the higher-service channel. In RPM the manufacturer prohibits this price discrepancy in order to remove the disincentive to invest in channel services. Value added discounts leave the resellers with control over their own prices, while adding positive incentives to invest in the capability to provide channel services.

Cisco has deployed this concept through a number of additional programs that use discounts to encourage a variety of value adding activities. For instance, a partner who generates new leads will be rewarded through an opportunity incentive program.

D. Incentives based on customer satisfaction

Another way to encourage value added activities is to award incentives based on customer satisfaction. Customer satisfaction measures can be fairly general or focused upon specific activities such as installation, presales consulting, or after-sales service. This rewards channel partners for desired outcomes rather than desired behaviors. Customer satisfaction addresses the ultimate goal (with the presumption that satisfying the customers will maximize the long-term value of the firm), but is more difficult to measure objectively and impossible to measure in advance.

Cisco compensates its VARs based on both behaviors and outcomes.[83] Discounts provided by the Value Incentive Program reward behaviors. Cisco also rewards outcomes with additional percentage discounts tied to customer satisfaction. These are paid out on a lagged basis to allow time for surveying the end customers.

The research literature acknowledges the challenges in quantifying customer satisfaction and suggests that the weight a firm places on this measure should increase with the precision of the measurement scheme.[84] Perhaps to gain channel partner buy-in for the frame-

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[83] *Id.*

[84] John R. Hauser et al., *Customer Satisfaction Incentives*, 13 MARKETING SCI. 327 (1994).

work, companies like Cisco allow the partners to nominate a subset of the customers to include in the measurement pool.

This discussion illustrates the breadth of ways to tie channel compensation to value adding activities, which can encourage desirable behaviors by channel partners in the face of potential free riding. This goes beyond the scope of traditional methods like functional discounts by attaching compensation to both tangible and intangible activities.

E. Converting retailers to showroom business model

The methods described in this section introduce ways for a retailer to get paid for its service efforts even without capturing the sale. As these fall into place, the retailer may find it makes more sense to completely convert its business model to that of a true showroom, shifting its focus to different types of in-store services and ambiance.

The leadership of Best Buy floated such a vision in 2012. Instead of specializing in selling electronics from store inventory, Best Buy could focus on everything but the sale: instruction, service, support, connections, returns, and pickup. All these are difficult to accomplish remotely. The store would invite shoppers in to play with the latest electronic gear, then help them buy online, even from another seller. Best Buy could perhaps charge the seller a cut of the transaction, but as in the status quo this might be hard to enforce. The primary funding would presumably come from the product manufacturers. According to Best Buy's Chief Marketing Officer, Barry Judge, "We collect . . . more profit from manufacturers than we do from consumers. People talk about Best Buy as being a showroom. We've always been a showroom. We have a place where Sony and Samsung, etc., pay to put their products on the floor."[85]

Some aspects of this may be reminiscent of the slotting fees and related charges that have long appeared in groceries, books, and other segments, whereby retailers require manufacturers to pay for shelf space and other promotional efforts. The implications of these kinds

[85] Tom Webb, *Should Best Buy Embrace "Showrooming"?*, PIONEER PRESS, Apr. 25, 2012, *available at* http://business-news.thestreet.com/twin-cities/story/should-best-buy-embrace-showrooming/1.

of practices for consumer and social welfare have been the basis of numerous legal actions.[86]

This vision has potential for even broader ramifications, as it could usher in the displacement of a long-standing retail format. In Capgemini's 2012 shopper survey, fifty-one percent of respondents expect that by 2020 physical stores in some categories will simply become showrooms to select and order products.[87]

VII. CONCLUSIONS AND OPPORTUNITIES FOR FUTURE RESEARCH

Hybrid shoppers jump across multiple channels on the path to a single purchase. The channels that participate along the way but do not capture the actual sale are potential victims of free riding. This article has analyzed two ways this can occur: ROBO and showrooming. It has presented survey and financial report data that show how these behaviors vary across retail business models (using Target and Walmart as examples) and product categories. And it has documented and analyzed the impact on business practices.

Target, Walmart, and many other brick-and-mortar retailers have been vigorously experimenting with product and service strategies to capture the sale when shoppers can easily showroom. These include, in various combinations, price reductions, exclusive manufacturer-branded products, restricting product distribution, branded variants, private labeling, and bricks-and-clicks coordination such as store pickups and returns for purchases made from the retailer's website.

To mitigate the detrimental effects of free riding some manufacturers are changing the way they compensate channel partners, including double pay, activity-based compensation, compensation based on prior investments in value added services, and incentives

[86] *Slotting Fees: Hearing Before the Fed. Trade Comm'n* (1995) (statement of Robert N. Pyle, President, Independent Bakers Ass'n), *available at* http://www.ftc.gov/opp/global/slott.shtm.; Mary B.W. Tabor, *In Bookstore Chains, Display Space Is for Sale*, N.Y. Times, Jan. 15, 1996, http://www.nytimes.com/1996/01/15/us/in-bookstore-chains-display-space-is-for-sale.html.

[87] Capgemini, *supra* note 18.

tied to end customer satisfaction. Some of these schemes link to prior actions that are readily observable (Cisco's Value Incentive Program) while others require ongoing effort to measure the value added (rewards for customer satisfaction). These may lead to changes in the business models of the venues in which shopping occurs and therefore the quality of the shopping experience.

Many issues in this domain merit further theoretical and empirical investigation. First and foremost we need a better understanding of the phenomenon of hybrid shopping. When do customers engage in hybrid shopping, as opposed to single channel or multichannel shopping? How do these behavioral patterns vary with customer attributes? How do past customer relationships with the firm, product category characteristics, and the extent of channel specialization influence the extent of hybrid shopping? How does hybrid shopping affect customer loyalty and lifetime value? Investigating these questions will help sellers decide how to make investments to support hybrid shopping.

The strategies explored in this article have the potential to affect consumer and social welfare. Price reductions might be welcomed by shoppers in the short run, but what will those shoppers lose if, as a result, some retail formats become extinct over time? As some of the tactics are available only to better-resourced players, will the retail sector consolidate in some anticompetitive ways? If brick-and-mortar retailers increase the use of private labels, will branded manufacturers in turn shift more of their wares to their own online channels or pure-play online retailers? Will some retailers embrace the showroom model, thereby requiring more customers to purchase online more of the time? These outcomes could affect consumer access to product. The Internet is accessible but not perfectly so, and many consumers still prefer to buy offline. Anything that reduces or changes the product assortment available immediately from brick-and-mortar formats has the potential to hurt the welfare of at least some consumer segments. Should manufacturers cooperate with retailers to address the free riding problems or take a laissez-faire posture? How will these trends and decisions affect the balance of power between manufacturers and retailers?

Hybrid marketing systems are adopting compensation systems that tie rewards to value added activities. These should undergo the type of analysis that has been applied to classical channel policies, such as investigating how the incentive discounts affect the behaviors and outcomes of the various parties and whether channel coordination will result. Will new metrics be necessary to properly measure performance? Will technology enable new ways of documenting the contribution of each channel to a sale made in the course of hybrid shopping? As channels and channel types proliferate, and shoppers and merchants alike acquire new technologies, more such issues will continue to emerge and merit research attention.

The repositioning of firms in a world of hybrid shopping will generate new benefits as well as costs. Both sides of the equation are not yet well understood. We hope that this article provides useful guidance to the stakeholders who will drive the ongoing analysis of these developments.