2009 Report

# CHANNEL CONFLICT

## A FOCUS ON THE KOREAN LIFE INSURANCE INDUSTRY

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008256-0909 (562-44-G-J34) Printed in U.S.A.

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# RECOMMENDATIONS

- *Korean companies should take potential channel conflict more seriously*.

  Although channel conflict in the industry doesn't seem serious, the current distribution system includes conflict issues such as unclear market segmentation and channel performance-oriented considerations. Channel conflict is not a top priority.

- *Companies may need to adjust market segmentation or roles for distribution channel members to avoid conflict.*

  Current multiple distribution channels have potential conflicts over domain because different distribution channels can reach the same customers.

- *Companies need to strengthen their cooperation system between channel members as customer needs become diversified and more complicated.*

  Only a few multiple distribution channel members in Korean companies show cooperation during sales activities or have centralized intelligence-gathering processes. As customer needs become diversified and complicated, cross-channel cooperation will be a very important strength. Insurers should strengthen their system for cooperation between channels by aligning the distribution process according to each channel's capability and making channels work together. However, cooperation during sales activities can succeed only when companies understand customers through use of a centralized intelligence-gathering system.

- *In order to keep conflict functional and to gain sustainable growth, companies should match their distribution goals with those of the channels.*

  Goal mismatch issue is a serious channel conflict issue for Korean companies. However, when common objectives and solutions generally meet both members' decision-making criteria, the conflict becomes functional.

- *Companies should use formal communication before and after conflict, as a conflict resolution strategy.*

  Companies depend on communication resolutions to help resolve conflicts. Companies and channels need to communicate with each other before and after conflict occurs with formal communication tools. One of these tools — the rules of engagement — is a very important tool for helping channel members understand their role and expectations and for controlling channel conflict. Furthermore, the rules of engagement should be based on broad principles because of their flexibility in the changing market environment.

In addition, a company can build its distribution systems with a structure that enhances communication to help prevent conflicts from emerging.

- *Korean insurance companies need to have a solid fair treatment policy for distribution channels.*

  Only one third of companies treat their channel members fairly in terms of whole sale commission or monetary compensation. If Korean insurance companies implement a fair treatment policy for distribution channel members, communication will improve, and channel members will gain an understanding of company compensation philosophy, which will minimize dysfunctional channel conflicts. As monetary incentives are the best methods to resolve channel conflict, it is important to fairly compensate all channel members so that channel managers can prevent channel members from demanding excessive commission and can thereby minimize dysfunctional channel conflicts.

- *When companies use a product differentiation strategy, they should keep a balance between channel-specific product differentiation and unfair channel member treatment.*

  Companies focus on product differentiation to put their products on the shelves of channel members. However, channel-specific product differentiation can act as conflict resolution, or as a cause of channel conflict, depending on the perception of product discrimination. The insurer needs to keep a balance between channel-specific product differentiation and unfair channel member treatment.

- *Strategic alliances are the best resolution strategy under multiple distribution channels, to avoid manifest conflicts and to accept functional conflicts.*

  Forming strategic alliances is one of the most favorable conflict resolution strategies because the company and channel members match their goals and benefit mutually from their cooperation. It is especially true when a company works with independent channels.

# CHANNEL CONFLICT

Channel conflict is a state of opposition or discord among the organizations comprising a marketing channel.[1] Channel conflict is a natural phenomenon in business because it emerges as the market evolves and business strategies change. A company with no channel conflict usually is a company with a coverage gap in its market strategy. A certain amount of conflict is essential for maintaining high performance and sustainable growth. For example, Norwich Union Life recognizes that channel conflict can help the customer receive more advice and choose the proposition in his/her best interest.

However, as channel conflict has both positive and negative effects managers should recognize the nature of the conflict, how that conflict can benefit their companies, and manage them to function properly in the short- and long-term period.

In the next section, we are going to identify the types of conflict, their causes and effects, and discuss how the conflicts can be controlled to optimize channel management.

## MARKET MATURITY AND CHANNEL CONFLICT

The product life cycle is a concept used to describe the progress of a product through a series of stages: Emergence, Growth, Maturity, and Decline. This cycle explains the introduction of multiple distribution channels and channel conflict.

Generally, at the Emergence stage, a company uses a sole in-house distribution channel, and develops multiple channels during the Growth stage to extend its market coverage.

At the Growth stage, channel coalitions are focused on identifying and serving new customers as they enter the market. In this stage, a channel can reach new customers easily and grow without cannibalizing other channels. In addition, the competition for resources can be more functional because it motivates coalitions to adapt, grow, and seize new opportunities. Thus, conflicts between channel coalitions during the Growth stage act as a mechanism for finding creative ways to increase channel scope and efficiency.[2]

However, at the Maturity and Decline stages, it is hard for a channel to increase its performance without decreasing another channel's performance. Therefore, goals of growth in revenues, profits, and market share across channels are no longer compatible.[3] In addition, at the Maturity stage, due to high competition and high penetration rates, the ability to remain cost-efficient becomes a competitive advantage for survival. Therefore, companies try to optimize their resources under a restricted budget. However, restricting resources leads to a focus on internal issues, which in turn induces harmful, internal competition and affects performance across the board.

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[1] Coughlan, Anne T., Erin Anderson, Louis W. Stern, and Adel I. El-ansay, *Marketing Channels 7th*, Upper Saddle River: Pearson Prentice Hall, 2006.

[2] Webb, Kevin, L., and , John E. Hogan. "Hybrid Channel Conflict: Causes and Effects on Channel Performance." *The Journal of Business & Industrial Marketing* Vol 17, 2002.

[3] Webb *et al* (2002), ibid

This concept can be applied not only to a product but also to an entire market. As a market matures, companies add distribution channels in order to gain sustainable growth. Simultaneously, companies focus on cost efficiency because of increased competition in the market. As a result, distribution channels are found to be in conflict.

## TYPES OF CHANNEL CONFLICT

### Horizontal and Vertical Conflict

Depending on the parties involved, channel conflict can be classified as horizontal or vertical conflict.[4]

*Horizontal conflict* is the friction between two or more channels or between two or more channel members at the same level in a single channel. Horizontal conflict occurs when there is a *dual distribution* — multiple distribution channels to distribute the same product in the same target market. Horizontal conflict stems primarily from competition between channel participants and the fear of channel cannibalism. It can also arise when there are different compensation structures for different channels. Horizontal conflict, if not controlled, turns into vertical conflict.

*Vertical conflict* is the friction between an insurance company and members of its distribution channels. It often arises when actions that may be good for an insurance company also may result in increased competition for its current distribution channel. For example, the increasing use of the Internet by insurers to generate sales and increase access points to customers may result in a conflict with agents who fear a substantial income loss as a result.

### Functional, Latent, Perceived, Affective, and Manifest Conflict

As conflict progresses, it can become functional, latent, perceived, affective, or manifest conflict.[5]

*Functional conflict* occurs when channel members recognize each other's contributions and understand that each party's success depends on the others. As channel members drive each other to improve performance, people feel free to express their opinions and to challenge ideas, beliefs, and assumptions, even people who disagree respect each person's viewpoint if the conflict is functional. In these conflicts, group brainstorming can lead to best resolutions without causing negative effect.

*Latent conflict* exists when there is the potential for contention but the organization is unaware of it. When an organization faces more conflict than it can deal with given the time and capacity available, it may leave potential conflict issues unmanaged while focusing on existing conflicts.

*Perceived conflict* occurs when a channel member senses that some sort of opposition exists: opposite viewpoints, perceptions, or interests. However, in this stage the conflict lacks emotion and members would not describe their dealings as conflicting.

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[4] LIMRA, "Channel Conflict." *Asia Executive Board Meeting,* June, 2006

[5] Coughlan *et al* (2006) , ibid

With *affective conflict*, channel members experience detrimental emotion: tension, anxiety, anger, or frustration. Members begin to personalize their differences. Emotional disputes between related parties make them drop even reasonable economic considerations.

If not managed, affective conflict can escalate quickly into *manifest conflict*. In this stage, related parties take personal offense from the conflicts. They block each other's initiatives and withdraw support, preventing everyone from achieving their goals.

## CAUSES OF CONFLICT

Channel conflict stems from goal incompatibility, clashes over domain, and differing perceptions.[6]

Multiple distribution channels may conflict due to the demand for products, capital, or personnel — because the company tries to optimize those resources. Differing channel goals can lead to conflicts in target marketing and customer ownership, or between the insurer and its channels. This results in deteriorating customer satisfaction and sales performance.

### Goal Incompatibility

*Goal incompatibility* occurs when one channel member's goals are incompatible with the goals of another channel member. While an insurer may want achieve rapid market penetration through a low-priced policy, dealers may prefer to work with high margins and pursue short-term profitability.[7]

When a company uses independent distribution channels, generally its overall distribution cost decreases and the independent channels offer the business greater flexibility compared with its affiliated agent channels. However, coordinating with the independent channel is challenging if there are multiple insurers and product lines. Independence makes it more difficult for a company and its agent to have common goals.

There are inherent differences in the viewpoints of companies and distributors, which lead to natural sources of conflict (Table 1).

[6] Goldkuhl, Lena, *Multiple Marketing Channel Conflict with a Focus on the Internet,* Lulea University of Technology, 2005.

[7] Kotler, P and Keller, K.L., *Marketing Management 12th ed.,* Upper Saddle River: Pearson Education Inc, 2006.

**Table 1 — Natural Sources of Conflict: Inherent Differences in Viewpoints**

| Area of Conflict | Insurer's Viewpoint | Distributor's Viewpoint | Expression of Clash |
|---|---|---|---|
| **Financial Goal** | Maximize own profit with<br>-Higher prices to seller<br>-Higher sales by reseller<br>-Low allowance to reseller | Maximize own profit with<br>-Lower prices from insurers and higher prices to customers<br>-High allowances from insurers | I*: You don't put enough effort behind my brand, Your prices are too high.<br>D**: You don't support me enough. With your wholesale prices, we can't make money. |
| **Desired Target Accounts** | -Multiple markets or segments<br>-Many accounts | -Markets or segments that correspond to reseller's positioning<br>-Select accounts | I: We need more coverage and more effort. Our reseller doesn't do enough for us.<br>D: You don't respect our marketing strategy. We need to make money too. |
| **Desired Product and Accounts Policy** | -Concentrate on our product category and our brand<br>-Carry out full line of products | -Achieve economies of scope over product categories<br>-Serve customers by offering brand assortment<br>-Do not carry inferior or less compatible items | I: You carry too many lines. You don't give us enough attention.<br>D: Our customers come first. If we satisfy our customers, you will benefit. By the way, shouldn't you be pruning your product line? |

Source: Coughlan *et al* 2006.

* I: Insurer, **D: Distributor

## Clashes Over Domains

*Clashes over domains* often occur when one channel member perceives that the other is not taking responsibility for its domain. This conflict questions which channel member has a right to represent certain domains such as product, functions, or customers.

From the viewpoint of the company, domain clash occurs when distributing partners represent its competitors. From the viewpoint of an agent, domain clash occurs when an insurer sells through many of the agent's direct competitors in a market. That is, when insurance companies use several marketing channels simultaneously, those channels may have to compete for the same customers.[8]

There are four critical elements of channel domain:

- Customer (population or territory) to be served
- Products available
- Functions or tasks to be performed
- Technology employed

[8] Coughlan *et al* (2006), ibid.

However, as communication media such as the Internet develops, conflicts increase in domains like territory. Another common reason for conflict is pre- and post-sales support; that is, marketing channel members argue over who should do it, how it should be done, and how they should be compensated.[9]

Clashes over domains happen particularly when customers can free-ride, gaining services from one channel while placing their business in another.

### Differing Perceptions

*Differing perceptions* also cause channel conflict. Even though individual goals within the marketing system may correspond and domains may be well defined, channel conflict still may occur when channel members have conflicting perceptions of the same situation. Channel members are often confident that they know the facts of a situation, however their perceptions may vary. One major reason for such misperception is that different channel members are exposed to varying information and influences, giving them different pieces of the overall picture.

A lack of communication intensifies this type of conflict. Timely, relevant communication assists in aligning perceptions and expectations. [10] The communication should include not only business process but also business culture. From another angle, however, Goldkuhl [11] states that differing perceptions are not really the cause of — but rather derive from — poor communication.

## EFFECTS OF CONFLICT

Channel conflict may negatively affect customer satisfaction as well as channel member satisfaction. Conflict often causes dysfunction, hurting relationships and performance.

Channel members in a domain conflict may confuse customers when multiple channels reach them with the same product at different prices. While this is generally true, there are occasions when opposition actually makes a relationship better when channel members recognize each other's contribution and understand that each party's success depends upon the others. In addition, customer satisfaction will be enhanced when channel members with different capabilities provide one-size-fits-all services to meet their customers' needs.

Rosenbloom[12] categorizes three effects of channel conflict on efficiency: no effect, positive effect, and negative effect. [13] These categories are shown in the Conflict-Efficiency Curve below (Figure 1).

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[9] Ibid.

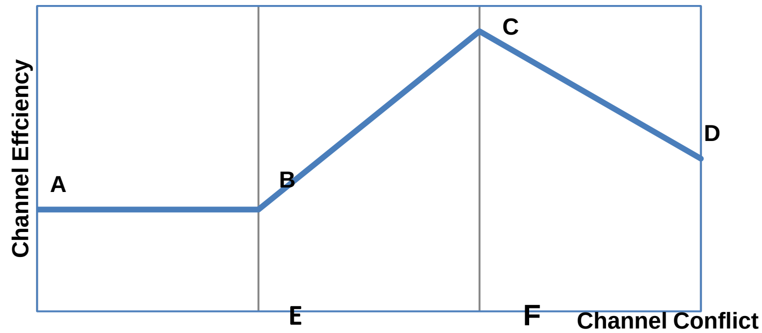
[10] Massey, Graham R. and Dawes, Philip L., *Functional and Dysfunctional Conlfict in the Context of Marketing and Sales,* University of Wolberhampton, 2004.

[11] Goldkuhl (2005), ibid

[12] Singh, Ramendra. *An assessment of the Impact of Distribution Channel Conflict on Channel Efficiency - Few Improvised conceptual Models.* Indian Institute of Management, 2006.

[13] Efficiency is defined as the "degree to which the total investment in the various inputs necessary to effect a given channel decision can be optimized in terms of output."

**Figure 1 — Channel Conflict-Efficiency Curve**




Source: Ramendra Singh 2006

*No effect* (A to B in Figure 1) occurs when channel efficiency remains nearly the same despite an increase in conflict. This may happen when channel members do not recognize conflicts as either motivational or discouraging.

*Positive effect* (B to C in Figure 1) occurs when the efficiency of the channel increases with the increase in conflict due to factors such as increased motivation to attain common goals. That is, functional conflicts work as a goal-centric behavior.

*Negative effect* (C to D in Figure 1) occurs when efficiency and conflict are negatively correlated. In this stage, the advantages of conflict are overwhelmed by the disadvantages.

Insurance company managers should be aware of the timing and methods of three decisions for increasing efficiency as channel conflicts increase.

- First, what conflicts or how much conflict should the company allow in order to increase efficiency? (B&E)
- Second, what kind of conflict resolution strategies should the company use in order to maintain higher efficiency? (C&F)
- Third, is the efficiency after channel conflict higher than before? (Comparison of efficiency level between A&D) As long as "D" is higher than "A," the conflict is beneficial.

When it comes to conflict frequency and intensity, the effect will be different depending upon the market maturity stage. Conflict intensity and frequency can negatively affect channel system performance at any stage.[14] In addition, conflict intensity negatively affects customer satisfaction among channels at any stage. However, while the conflict frequency has very little effect on performance in the growth stage of the product or market life cycle, it reduces channel performance significantly in the maturity stage.

[14] Webb *et al* ( 2002) ibid

## EVALUATION OF CHANNEL CONFLICT

Conflict comes in many forms. A channel manager must differentiate between poor channel design and poor performance due to channel conflict because both result in the same problem but require different solutions. The seriousness of channel conflict can be evaluated qualitatively or quantitatively.

In a qualitative way, Bucklin recommends that management answer four questions in order to gain a better understanding of which channel conflicts are really dangerous: [15]

1) Do the different channels really serve the same customers?

2) Do channel members mistakenly believe the channels are competing when they actually benefit from each other?

3) Is the declining profitability of a channel genuinely the result of another channel's advance?

4) Will a channel's decline necessarily harm a company's profits?

Based on these questions, if a company judges that a channel is dysfunctional and a substantial amount of current or future volume passes through that channel, it must act to remedy the situation. As a rule of thumb, a channel in conflict that is not in decline and carries more than 10 to 15 percent of volume and/or profit, needs attention. [16]

*Do different channels really serve the same customers?* What at first may seem like channel conflict may instead present the opportunity to reach previously underserved customers. [17] In order to find out the truth, managers should find out how much revenue the company has in conflict. Managers can estimate this by monitoring feedback from customers and marketing personnel. As a rule of thumb, destructive behavior will occur when 10 to 30 percent of revenue is in conflict.[18]

*Do channel members mistakenly believe that channels are competing when they actually benefit from each other?* It can seem as if new channels are in conflict when they actually expand product use or build brand support. For instance, Progressive Auto Insurance successfully introduced direct telephone sales in addition to its agency channel. Auto-Pro provides a 24-hour referral service to agents as part of the service. We believe that efforts like these will actually enhance rather than cannibalize sales in other channels.

*Is the declining profitability of a channel genuinely the result of another channel's advance?* When a channel can no longer compete, the real cause may be poor operations rather than conflict. Therefore, when a weak channel member is the only one complaining about conflict, the insurer should assess the likelihood that its business will fail and estimate how much revenue would be lost. Then the insurer must decide whether or not to support the threatened channel player. The company should

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[15] Bucklin, Christine B., Pamela A. Thomas-Graham, and Elizabeth A. Webster, "Channel Conflict: When Is It Dangerous?" *Mckensy Quarterly*, No. 3 (1997): 40.

[16] Ibid

[17] Ibid

[18] Moriarty, R,T. and Moran U., "Managing hybrid marketing systems," *Harvard Business Review*, November-December, 1990.

then decide whether to support the player more actively or develop a migration strategy to replace lost profits by using other, more viable intermediaries. To prevent becoming dependent on unsuitable distributors, insurers should monitor the operations of channel partners, and work to develop their skills and capabilities.

*Will a channel's decline necessarily harm* ***a*** *company's profits***?** Sometimes economic shifts or customers' changed preferences are the real cause of a channel's decline. If a channel's deterioration is caused by changed customer preferences, management must prioritize a new channel without offending the declining channel members — especially if they continue to carry a significant volume.

The seriousness of conflict is quantitatively calculated using three factors: importance, frequency, and intensity. Conflict managers can diagnose the level of manifest conflict using four steps in the evaluating process. [19]

- *Identifying the issues:* What are the major issues that affect the channel relationship? Whether the issues are in dispute at the moment does not matter. What matters is that they are major aspects of the channel relationship. For example, a distribution channel member's relationship with the insurer may be affected by product availability, compensation, customer ownership, non-monetary support (training, technology and office support, etc.), or a producer's change of intermediary.
- *Evaluating the importance of each issue:* For each issue, the channel manager ascertains how important the issue is to the distributor.
- *Determining the frequency of disagreement:* How often do the two parties disagree over each particular issue?
- *Measuring the intensity of the dispute:* The channel manager or dealer evaluates how intensely the related parties differ on each particular issue; that is, how far apart their positions are.

Manifest conflict is calculated by multiplying three factors (importance, frequency, and intensity) by issue.

$$\mathbf{Conflict}_i = \mathbf{Importance}_i \times \mathbf{Frequency}_i \times \mathbf{Intensity}_i \quad (i\text{: Issues})$$

If any of these elements is low, the issue is not a genuine source of manifest conflict. By using this approach, a company can easily grasp the overall picture of channel conflict.

[19] The channel manager can field a survey to channels. Coughlan *et al* (2006) ibid.

## MANAGING CHANNEL CONFLICT

Insurance companies generally use a bundle of solutions to manage conflict. These solutions may include *institutionalized, strategic alliance, pricing, product version, brand name, compensation, communication, or target market approaches*.[20]

### Institutionalized Approaches

Institutionalized approaches refer to mechanisms that mitigate disputes before they turn into hostile attitudes.[21]

First, an insurance company can resolve the conflicts by letting channel members share information with the company or other channel members. The channel members can easily understand the true nature of conflicts and try to resolve them actively if they work in the home office or another channel member's office, or if they join a channel-related decision-making group in the insurance company. Companies can use several methods such as exchange-of-personnel programs, co-optation, exclusive distribution, or joint membership (see Appendix 1).

In addition, the company can use third-party mechanisms such as mediation and arbitration to manage conflict. The mediator typically has a fresh view of the situation and may perceive opportunities that those involved in the conflict cannot.

Another solution is integrating strategies.[22] Channel members work together to reach customers and close contracts, sharing the credit from their joint sales. More and more insurers are managing potential channel conflict by integrating multiple distribution channels. For example, insurers that sell products through banks often use company-affiliated wholesalers or salaried sales representatives to assist bank personnel in the sale of traditional insurance products. John Hancock introduced this new model in 2001 in order address the needs of the marketplace and leverage the strengths of both its bank channel and its tied traditional agency channel. In this model, the bank's reps sell the full portfolio of Hancock's products, and Hancock's Financial Institutions Group manages the relationship. The local agency acts in a wholesale capacity, adding value to the bank on a local level, providing training, sales support, seminars, and representation on joint sales calls. Production credit is shared by the two channels, and all players are fairly compensated.[23] In another integrating solution, an insurer might assign customers who purchase the Internet-only products to its agents for service, enabling the agents to collect service fees and giving them the opportunity for future cross-selling.[24]

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[20] Goldkuhl (2005) ibid

[21] Ibid

[22] LIMRA (2006) ibid

[23] Mawn, Peter F. "How Hancock in Managing the Multichannel Challenge." *National Underwriter /Life & Health financial services edition*, July 23, 2001: 10

[24] LIMRA (2006) ibid

## Strategic Alliance Approaches

A strategic alliance is a formal relationship between insurance companies and channel members to pursue the same goals or to meet an important business need while remaining independent organizations. [25]

From the company's perspective, there are several reasons to maintain strategic alliances.

- The channels will represent the company better.
- The company can coordinate its marketing efforts.
- The alliance creates entry barriers to other competitors.
- The company offsets its weaknesses and maximizes its strengths, sustaining competitive advantage and preventing opportunistic behavior from channel members.

As a result of a strategic alliance with Fedex, for instance, Fujitsu delivers customized laptops within four days from order, resulting in spectacular profit.[26]

How do insurance companies build strategic alliances with channels? First they must establish a policy of honesty and trust with each partner, especially with economic incentives. This trust will be the foundation of the strategic alliance and also a critical factor for creating functional conflict. How do they build trust? It cannot be achieved by the company's decision to build trust. It takes continual communication between the channel manager and channel member and mutual commitment to partners. That commitment, a signal of trust, means that a company invests its resources in its partners and may sacrifice opportunities in order to build a future cooperative relationship with its partners. Continuous communication and commitment to honesty build trust, leading to a closer strategic alliance. To ensure channel members are fairly treated also helps to create trust.

## Pricing Approaches

Offering the same products to all available marketing channels at the same price is another approach to avoiding channel conflict. Omnitel Vodafone, for instance, offers its prepaid telephone credit cards through traditional channels and on its Web site, at the same cost. Taking business away from channel partners, such as retailers, by making a product available through the Internet at a lower price will cause channel conflict.[27] Lincoln Financial Group operates multiple distribution channels including banks, regional broker-dealers, or independent marketing organizations. It distributes the same products through multiple channels at the same price.[28]

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[25] Refer to [Appendix 2]

[26] In the 1990s, Fujitsu's laptop business was less competitive due to inefficient logics because it imported computers from Japan. The company could increase competitive advantage and profit by building an alliance with Fedex. Fujitsu turned over its distribution and warehousing function to Fedex in Memphis, its super-hub area. On the other hand, Fedex suggested building a facility for customized laptop in there. Coughlan (2006) ibid.

[27] Goldkuhl (2005) ibid

[28] Catanzano, Dennis. "Selling through independent distribution." *LIMRA 2009 Sales Compensation Seminar.* Simsbury, 2009

## Product Version Approaches

Multiple products or versions give companies the opportunity to target different market segments through different channels. Customers will accept price differences if the products differ in some way. A company can create the illusion of differentiation just by introducing minor product modifications or by using different names.[29] This approach, however, might not work on the Internet, or within the new financial regulation environment. Many Internet customers use price and feature comparison Web sites. Moreover, insurance regulators are strengthening requirements for disclosure of product information. Thus, products with minor changes can be easily identified by independent intermediaries because they may have to recommend the most appropriate product from the entire market.

Therefore, developing more channel-specific products may be a better way to manage channel conflict. A company might develop products exclusively for new distribution channels such as the Internet. UK Prudential (AVIVA) in Canada sells its funeral product through broker channels and through TV commercial ads. In order to avoid conflict, each channel sells different products. The product sold through TV ads is simple and requires no underwriting but is expensive. The broker product, in contrast, has much higher coverage, a tougher underwriting process, and is less expensive.

Companies also can create channel-customized products to avoid conflict between banks and agency networks. Banks focus only on plain vanilla insurance products which are low-return and a potential threat to bank deposit products. Through banks, insurers can tap into market segments otherwise untapped by traditional channels.[30] However, companies should be careful with product differentiation, as it may cause conflict. If a company provides similar but different products through different channels, one channel member may feel that it is selling a less competitive product than the other channel member. The insurer needs to keep a balance between channel-specific product differentiation and unfair channel member treatment.

Another approach is to offer *product bundles*. Product bundles allow companies to offer complementary products that customers value and that are available only separately elsewhere, if at all. Take, for example, providing meal suggestions and recipes when selling wine online. Although a customer could buy the wine elsewhere, they have the additional benefit of serving the wine with a particular meal.[31]

[29] Goldkuhl (2005) ibid

[30] Jaffe, Douglas. "Bancassurance In Asia/Pacific - Embracing Alternative Distribution Channels." *www.financial-insights.com.* 8 30, 2006 [Accessed 06 June 2009]

[31] Goldkuhl (2005) ibid

## Brand Name Approaches

Using different brand names when offering products online can minimize channel conflict. One of the goals of this approach is to compete with lower-priced competitors, while continuing to serve the high-priced segment with a high-end product. However, such an approach could lose its effectiveness due to the use of comparison sites by online customers. Moreover, a brand is a search attribute that assures customers a certain level of product quality. Therefore, the choice to separate a brand or not in different marketing channels is largely a choice between flexibility and trust.[32]

In Korea, newly-established online auto insurance companies have taken a considerable portion of market share from existing insurers in the 2000s. In order to avoid channel conflict and compete with online companies, Korean non-life companies have introduced online auto insurance brands that are sold only online at a lower price than their off-line product. However, they are still experiencing conflict, because the introduction was led by an external factor — the severe competition in the market — rather than by agreement with current distributors.

## Compensation Approaches

Considerable field evidence indicates that economic incentives are the best way to resolve conflict.

If a company and its channel distributors have conflicts involving compensation levels, how will the company handle it? The company compensates the channel distributor based on the value[33] it contributes. This strategy more closely links the business objectives of the insurer with those of channel members because it reflects the value that the latter bring to this marketing relationship. If channel members are in conflict due to the perception of unequal compensation levels, the insurer can avoid dysfunctional channel conflicts by fairly treating their distribution channels based on each channel distributor's performance.[34] When many U.S. insurance companies introduced new independent distribution channels, one of the main conflict issues was the level of compensation. Companies could solve the conflict by introducing a fairly equal compensation strategy (called whole sales commission[35]) and consistent communication between the parties. With whole sale commission, even if a company pays different commission to different channel members, it treats all channel members fairly by providing additional benefits at differing levels. The whole sales commission includes not only direct monetary payments such as commission, overrides, or bonuses, but also indirect support such as training, office space, office managers and staff, conferences, field operation expenses, marketing, and other benefits. For example, a company pays higher commission to its bank channel but pays a lower benefit for office rental because the bank uses its own branch for selling (Figure 2). On the other hand, the company pays career agents lower commissions, but more for office rental. Therefore the total that the company pays to each channel member is the same.

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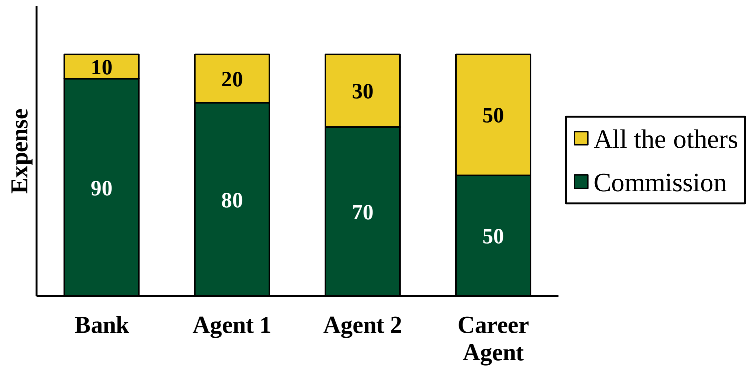
[32] Ibid

[33] Value may be a profit or market share percentage depending on the company's strategies. Value and cost are assigned to each marketing function as part of the marketing process. The channel gets compensated by the value it contributes through the marketing functions it takes on.

[34] Coughlan *et al* (2006) ibid

[35] The phrase "whole sale commission" was coined by John Wellborn, consultant for LIMRA International.

**Figure 2 — Expense Structure by Channels a Company Pays Under Whole Sale Commission***




* This is not a real number.

Lincoln Financial pays fairly equitable commission in terms of whole expenses. Even if commissions differ by channel type, the company pays nearly same amount of support to every channel type when including monetary and non-monetary support.[36]

However, it goes without saying that there are exceptions. A company may pay a certain channel member additional incentives when the channel is new, when it wants to push a certain channel distributor to sell new products, or to launch a new distribution strategy to expand to the new market. Incentives can be used to manage cooperation between cross-channels or conflict between channels of different cost structures and capabilities. A company pays a channel distributor a specific, additional commission if it performs a measurable task or function for the insurer.

On the other hand, economic incentives have a drawback. Channel networks develop many points of contact and frequently include many organizations. Therefore, keeping track of each channel's performance is very difficult.[37] Companies should apportion expenses, revenue, and profit to each channel. This allows the company to adapt the profit center concept to its business management.[38] Companies that want to introduce the concept in their distribution system face several problems such as the difficulty of allocating cost and/or profit, the system not being easily accepted by channels, or the inability of their current systems to get the information across all products and channels.

[36] Catanzano (2009) ibid

[37] Coughlan (2006) ibid

[38] A profit center concept means that company can evaluate each channel's performance based on its own actual cost and revenue contribution regardless of whether in-house distribution channels are separate, independent legal entities.

## Communication Approaches

Working with channel members to develop joint solutions is an effective way to solve conflict. Through communication both externally with their distribution partners, and internally among the subunits responsible for managing the various channels, insurers can prevent conflict from emerging or getting destructive.[39] A compensation resolution for solving conflict works extremely well when combined with a strong program of communication and good interpersonal working relationships.[40]

A channel manager communicates with the distributor in two basic ways: through formal management, such as contracts and policies or institutional management, or through informal management of the relationship.

*Contract and policies (Rules of Engagement)*
An effective way to eliminate unwanted conflict before or after it occurs, is to clearly communicate the role of each channel member.[41] The lack of trust between channel members or between channel member and home office — a frequent cause of channel conflict — is often caused by miscommunication and the absence of business rules. Webb recommends that companies use a specified protocol for communications when problems do arise — Rules of Engagement. [42] This rule, a kind of contract, is a written procedure that governs conflict resolution. Published rules of engagement covering potential conflicts reduce not only time and negative emotions, but also ambiguity, uncertainty, and disagreements. The Rules of Engagement is an effective tool for minimizing conflict and opportunism.[43]

The rule generally includes target market segment assignments, use of channel sales resources, access to resources and subject matter experts, conflict resolution processes, the contracting process for the sale, and compensation.[44]

The Rules of Engagement must be clearly communicated and strictly enforced. The more clearly a channel member understands the conflict-solving procedure, the less manifest conflict will happen.[45]

On the other hand, the Rule should be based on broad principles. Insurance companies should decide how specific to make the rule, as distribution channels must constantly adapt to the dynamic business environment. There are two kinds of rules — explicit and normative. Explicit rules spell out what parties should do or expect from each other. Normative rules clarify channel members' roles and

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[39] Bengtsson, Daniel. "Channel Conflict When Adding an Internet Based Marketing Channel in An Existing Marketing Channel System." *http://epubl.luth.se/1402-1617/2007/237/LTU-EX-07237-SE.pdf.* 2007. [Accessed 2 May 2009).

[40] Coughlan *et al* (2006) ibid

[41] Webb *et al* (1997) ibid

[42] Ibid

[43] In addition, conflict occurs when channel members act in their own self interest rather than for the good of the channel as a whole. Foreman, Susan, "Power conflict and control in distribution channels", Henley Manager Update, Vol. 17 No3, Spring 2006

[44] Gartner. "Rule of Engagement Critical in Avioding Channel Conflict." *Gartner Research*, 12 17, 2003.

[45] Brown, James R., Anthony T. Cobb, and Robert F. Lusch. "The roles played by interorganizational contracts and justice in marketing channel relationships." *Journal of Business Research* 59,2006: 166-175.

expectations through commonly held beliefs, values, and norms among related parties. Explicit rules can reduce role ambiguity but limit flexibility and autonomy. Therefore explicit rules governing a channel relationship may create more conflict. On the other hand, normative rules are negatively related to conflict because they can clarify roles without harming flexibility.[46]

Take the insurance industry for example. The Rules of Engagement for a life insurance company in the United States includes: assuming the same gross margin across all distributors; a gross margin cap at the distributor level (except conscious subsidy); free market concepts (a client decides whom to buy from, broker decides who to sell through unless contractually bound); and underwriting criterion — one person, one rating.

*Institutional management*

A company can build distribution organizations more successfully with communication enhancing structure. John Hancock's case shows the importance of communication and how company organizational structure can be restructured to increase the effectiveness of communication. John Hancock set a goal that the company would be wherever consumers were buying financial products. It had increased its agents from 5,000 in 1991 to 66,000 in 2000. The most important success factor is that its retail sales operation — including channel management, product development, and process development — reports to one individual who oversees all channels and communicates a common vision. Channel managers meet regularly to work toward the shared goal of allowing issues and cross-channel opportunities to be explored and capitalized on. Also, the company clearly communicates the benefits that the agency system can expect from the additional brand exposure and increased referrals, as channel members try to fit the client to the appropriate level of service.[47]

On the other hand, U.S.-based Colonial Life and Accident expanded into the brokerage marketplace and set up an entirely separate entity from the existing agents, resulting in conflict between agencies and brokers. As a result, one channel was directly linked to the failure of the other.[48]

*Informal relationship management*

Another important resolution to forestall conflict is informal management — a norm that governs how channel members manage their relationships. A channel's norms are its *expectations about behavior*, expectations that are shared or at least understood by the channel's members. For example, norms might include: channel members expect each other to adapt readily to changing circumstances, to share any and all pertinent information freely, frequently, and quickly, and to work for mutual benefit. A channel with a strong relationship norm is particularly effective at preventing conflict. These norms discourage players from pursuing their own interests at the expense of other players and encourage them to work through their differences, thus keeping conflict in the functional zone. Management cannot simply decide to create norms. They are created over time, through the interactions of people who constitute a marketing channel.[49]

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[46] Iibid.

[47] Mawn, Peter F. "How Hancock in Managing the Multichannel Challenge." *National Underwriter /Life & Health financial services edition*, July 23, 2001: 10.

[48] Pollock, Geraldine. "Is it wise to stay a singleton?" *Financial Services Distribution*, May 2001 p 12

[49] Coughlan *et al* (2006) ibid

### Target Market Approaches

The most effective means for insurers to manage channel conflict usually is to avoid it. For example, an insurer might use different distribution channels to market to different market segments. A company with an agency system might use its direct mail efforts to target customers who are not being actively targeted by its existing distributors — for example, by offering older customers low-premium or guaranteed-issue products. Some insurers have chosen to carry out customer segmentation according to distribution channel in order to avoid channel conflict. Sumitomo Life sells a whole life product through sales representatives, and a saving-type product through banks. Customers who aren't fond of face-to-face sales representatives can access retail stores and direct sales channels.[50] When segmenting customers by channels, distinct customer segments should be based on consumers' channel preferences.

## CONFLICT RESOLUTION STRATEGIES

Until now, we have looked at ways for companies to reduce or forestall conflict. Insurance company managers should be aware of the timing and methods of three decisions for conflict resolution.

- What conflict or how much conflict should the company add in order to increase efficiency or performance and attain its goal?
- What kind of conflict resolution strategies should the company use?
- Is the performance after channel conflict higher than before?

Generally, companies use multiple approaches, rather than one solution. Economic arguments work extremely well when combined with a strong program of communication in a good interpersonal working relationship. In this section, we will look at how a company makes a decision when conflict occurs.

### Estimation of the Conflict and the Level of Company Tolerance

When a conflict is destructive, and a substantial amount of current or future volume passes through the offended channel member, insurance companies must act to alleviate the situation. In the conflict-efficiency curve, channel efficiency increases as functional conflict increases, but decreases after the benefit of the conflict is outweighed by its negative effects. However, it is hard for channel managers to find the point at which functional conflict turns into manifest conflicts.

When making this judgment, insurers should compare the cost of preserving the volume and profits of the existing channel with the economic benefit of entering a new channel, taking into account the likelihood of retaliation and the costs it might incur.[51] Conflict is considered destructive when 10 to 30 percent of revenue is affected. As an alternative, insurers can figure the level of conflict based on how channel managers evaluate the importance, frequency, and intensity of the issues.

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[50] Asia Insurance Review, "Seeking Success In Personal Lines", December, 2008

[51] Bucklin *et al* (1997) ibid

Also, depending on the maturity of each product or market, a company may decide *not* to bring conflict resolution to the channel players. A company encourages functional conflict at the growth stage of the market or product because the benefits outweigh the issues. However, it controls the conflicts at the maturity and declining stage inversely.[52]

## Decision to Conflict Resolution Strategies

*Conflict resolution options of dominant companies*

According to the conflict management process, conflict resolution by a dominant company involves three main areas:[53]

- *Problem solving* — With this approach there is a common objective and a solution that generally meets both members' decision-making criteria. This is functional conflict.
- *Bargaining* — Here, all members acknowledge the disagreement; the common goal may or may not exist; and behaviors may include threats, promises, positional commitments, and non-concessionary behavior. This may be functional or manifest conflict.
- *Political* — This signals the failure of all the above internal processes of conflict resolution, when members choose to resolve their conflict through mediation or third-party arbitration. This is manifest conflict.

Companies may prefer a political approach when stakes,[54] non-dominant member dependence, and complexity are high.[55] However, political is more likely to lead to low satisfaction and efficiency than will problem solving and bargaining, because the conflict is solved only after damaging the mutual trust between the parties.

A problem-solving approach is preferred when risk, stakes, complexity, and non-dominant member dependence is low.[56] The superiority of problem-solving becomes obvious when we analyze the three conflict resolutions according to the Channel Conflict-Efficiency Curve (Figure 3). If an insurance company uses problem solving, the conflict will be resolved favorably and the level of trust remains unchanged. Therefore, the efficiency level after the conflict (D) will be higher than before the conflict (A). In addition, the highest point of channel efficiency (C) is achieved by problem solving. In the case of the political approach, conflict will be resolved only at the expense of communication and mutual trust. Therefore, the efficiency level after the conflict (D) will be lower than before the conflict (A). With the bargaining approach, the conflict will be resolved before parties have to resort to third-party mediation. The efficiency level after the conflict (D) will be higher than the level before the conflict (A), but lower than the efficiency level of problem solving.

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[52] Webb, , Kevin L., and , Jay C. Lambe. "Internal multi-channel conflict: An exploratory investigation and conceptual framework." *Industrial Marketing Management* 36, 2007: 29-43.

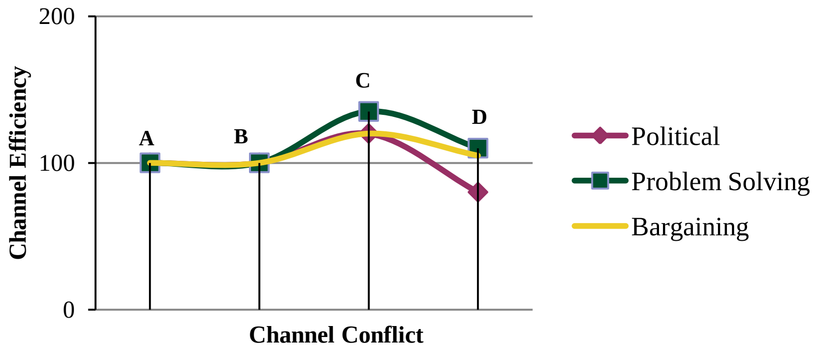
[53] Singh (2006), ibid.

[54] The term "stakes" denotes the potential financial implications (i.e., gains or losses) of the issues under dispute. Dant, Rajiv P. and Schul, Patrick L., "Conflict Resolution Processes in Contractual Channels of Distribution" *Journal of Marketing*; Jan 1992; 56, 1

[55] Singh (2006) ibid.

[56] Ibid.

**Figure 3 — Channel Conflict-Efficiency Curve by Resolution Strategies**




Source: Singh (2006)

*Channel conflict resolution strategy by market power and channel value*

The Channel Conflict Strategy Matrix[57] analyzes the forces and opportunities for change in a given industry and identifies the optimal strategies for a company to minimize channel conflict (Figure 4). This matrix shows interplay between market power and channel value. Market power is a function of where power resides — with the supplier or with the distributor. Channel value is a measure of how much worth the channel adds for the customer, beyond what the insurance company provides.

**Figure 4 — The Channel Conflict Strategy Matrix 1**

| Market Power | Insignificant | Significant |
|---|---|---|
| **Channel controls customers** | **Forward integrate**<br>• Identify new value proposition<br>• Act fast/independently<br>• Fill gaps in channel coverage | **Cooperate**<br>• Look for win-win, grow the pie<br>• Seek compromise<br>• Look to sell new products through new channels |
| **Supplier controls customers** | **Compete**<br>• Create Internet-enabled direct link to customers<br>• Shift volume to new channel through promotions | **Lead**<br>• Define appropriate approaches for the channel<br>• Make initial investment |

**Channel value added**

Source: Bruce *et al* (2001), Accenture

[57] Bruce W. Bendix, John B. Goodman and Paul F. Nunes. "New channel opportunities: The channel conflict strategy matrix." *Outlook*, Accenture, 2001.

The matrix shows four different strategies based on market power and channel value.

- *Compete* —When market power lies with the insurance companies and the channel adds little or no distinct value to the sales proposition, the optimal strategy is to compete directly with the channel.
- *Forward integrate* — When market power rests with the distribution channel even though it adds little value to the transaction, insurers should offer new value propositions to the channel, enabling it to increase its capacity for added value.
- *Lead* — When the value of a channel is high but the insurer has more market power, the insurer should attempt to lead the distribution channel. This often happens when channels are small or fragmented. Strong leadership can help the channel players to achieve goals. For example, a company can lend additional support to high performing individual agents who prefer to be independent but may have resource gaps in areas such as marketing, systems support, and new market identification.
- *Cooperate* — When a channel's market power and value are both high, there is a greater potential for conflict. In this case, a cooperation strategy is best. The insurer takes full advantage of every opportunity to cooperate with the channel to maximize the total value created.

*Channel conflict resolution strategy by conflict type and channel's profit performance*
This second matrix shows the interplay between the prospect of destructive conflict and the importance of a threatened channel, based on current or potential volume or profitability (Figure 5).[58]

- When the prospect of destructive conflict and the importance of the threatened channel are both high, the company should act to avert conflict.
- When the prospect of destructive conflict is low but the importance of the threatened channel is high, the channel player may perceive the conflict as destructive even though it is actually functional. The company should identify opportunities and communicate closely with the channel player to reassure its benefits. The insurer may need to offer additional resources to the channel player.
- When the prospect of destructive conflict is high but the importance of a threatened channel player is low, the company may just let the threatened player decline, or replace it with a more capable player.
- When the prospect of destructive conflict and the importance of a threatened channel player are low, the best strategy for the company is to do nothing.

[58] Bucklin *et al* (1997) ibid

**Figure 5 — The Channel Conflict Strategy Mix 2**

| Prospect of destructive conflict | | High | Low |
|---|---|---|---|
| | High | Act to avert or address conflict | Allow threatened channel to decline |
| | Low | Look for opportunities to reassure threatened channel and leverage your power | Do nothing |

Source: Bucklin (1997)

# CHANNEL CONFLICT IN THE KOREAN LIFE INSURANCE INDUSTRY

## INTRODUCTION

Channel conflict hasn't yet been a hot issue in Korea, because the tied agent channel still dominates the market. However, as the Korean life insurance market matures and independent channels gain more power, channel conflict will become a more serious issue. The multiple channel distribution strategy and conflict management strategy will play core roles as insurers try to sustain growth in future.

Twenty-two life insurance companies currently do business in Korea, 15 of which participated in the survey.

## DISTRIBUTION CHANNEL OVERVIEW

### Company Distribution Channels

In order to look at how many channels companies operate, we categorized the channels into seven groups. This report classifies tied agents into two groups: Tied Agent (face-to-face [F2F]) and Tied Agent (TM/CM/DM).[59] Independent agents are divided into four groups: Bancassurance, Independent Agent (individuals), Independent Agent (home shopping), and Independent Agent (legal entity).[60] Home office staff are classified as a separate group.

*Distribution channels used by companies*

Korean insurance companies usually run multiple distribution channels (Table 2). The industry average is six channels (median).

**Table 2 — Number of Channels**

| Number of Channels | 1 | 2 | 3 | 4 | 5 | 6 | 7 | Industry* |
|---|---|---|---|---|---|---|---|---|
| Number of Companies | 1 | 0 | 0 | 4 | 2 | 5 | 3 | 6 |

*Median

[59] The Tied Agent (face-to-face) or TA [F2F], is an agent who sells products by meeting customers face-to-face. The Tied Agent (TM/CM/DM) or TA (Hybrid), is an agent who sells products by reaching customers through such media as telephone (telemarketing), Internet(Cyber marketing), or mail (direct mailing).

[60] First, we divide the independent agent into two groups: the individual and the corporate agent. Second, we subdivide the corporate agents into three groups: Bancassurance, Home shopping (TV),and other corporate agents. They are described as follows; Banc for Bancassurance, IA (Individual) for individual independent Agent, IA (corporate) for the other Legal-Entity Independent Agent, IA(TV) for Home Shopping channel.

Traditional TA (F2F), bancassurance, corporate independent agents, and home office staff are the prevalent channels for Korean insurers (Table 3), however the core channel is still face-to-face tied agents.[61]

**Table 3 — Channels Companies Operate and Their Importance**

| Distribution Channel | Number of companies running each | Core channels (Top-two choices) |
|---|---|---|
| Tied Agent (face-to-face) | 15 | 12 |
| Tied Agent (TM/CM/DM) | 9 | 4 |
| Bancassurance | 14 | 6 |
| Independent Agent (legal entity) | 12 | 4 |
| Independent Agent (individuals) | 7 | 1 |
| Independent Agent (home shopping) | 9 | 1 |
| Home Office Staff | 12 | 0 |

*Line of business served by distribution channels*

The traditional face-to-face Tied Agent channel sells mostly individual products, and less group products (Table 4). The Hybrid TA channel and IA (TV) channel focus on more traditional insurance-oriented products. They sell simple, commoditized products. Bancassurance sells mainly saving and investment products, such as a pure endowment product or a variable product. The corporate IA channel sells mostly individual products. This channel tries to approach consumers through as many media as possible such as face-to-face, TM, or CM. The Home Office channel focuses on group products such as retirement products.

**Table 4 — Lines of Business Served by Distribution Channels**

| Distribution Channel | Pure Endowment | Term | Mixed[62] | Group | Variable Life | Variable Annuity | Retirement |
|---|---|---|---|---|---|---|---|
| TA(F2F) | 11 | 15 | 13 | 8 | 15 | 13 | 5 |
| TA(Hybrid) | 7 | 8 | 9 | 1 | 4 | 3 | 0 |
| Banc | 9 | 0 | 9 | 1 | 9 | 10 | 0 |
| IA (corporate) | 9 | 12 | 11 | 4 | 12 | 11 | 2 |
| IA (individuals) | 5 | 7 | 7 | 3 | 6 | 5 | 1 |
| IA (TV) | 6 | 9 | 8 | 0 | 1 | 1 | 0 |
| Home office | 4 | 6 | 5 | 4 | 6 | 6 | 10 |

[61] The market share (by first year premium in individual insurance in 2008) is around 70% for the tied agent channel and 30% for the independent agent channel . While large companies have more tied agents, medium and small companies have more independent agents.

[62] The Mixed product is a combined product in which saving and protection coverages are included together.

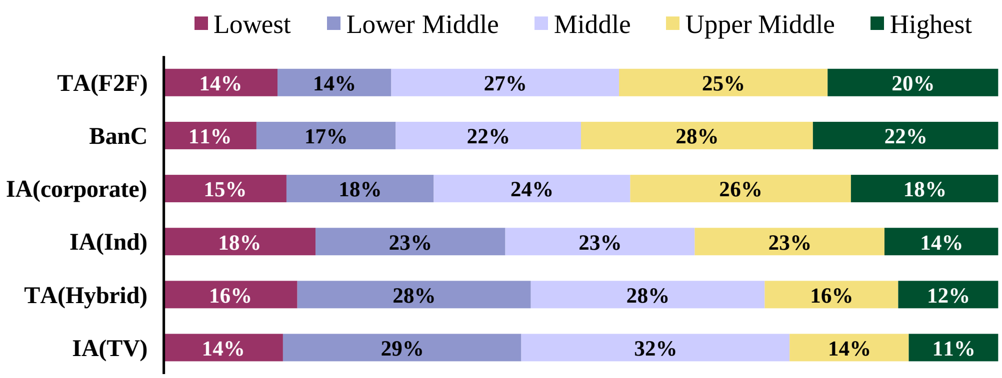
*A market served by channels*

Generally, any distribution channel player can access any customer and market with a few exceptions. However, the industry as a whole may perceive the market as differentiated by channels (Figure 6).

Most channels except the Home Office channel target the individual customer market. When analyzing segmentations based on the individual market, many companies have their face-to-face tied agents targeting middle and affluent markets, and their hybrid tied agents or IA (TV) targeting middle or lower-income markets. [63] Certain channels such as face-to-face tied agents, bancassurance, and corporate IAs generally serve the affluent market not only because the market is highly profitable, but also because these channel players have the knowledge and consulting capability to reach these customers.

However, the potential still exists for domain conflict, as any distribution channel player can generally access any customer and market. Therefore, channel managers should keep an eye on potential channel conflict or adjust target market segments to their channels. In addition, integrating channels by aligning distribution process and making channel players work together, can turn potential destructive conflicts into functional conflicts.

**Figure 6 — Target Market (Based on Income) by Channels**

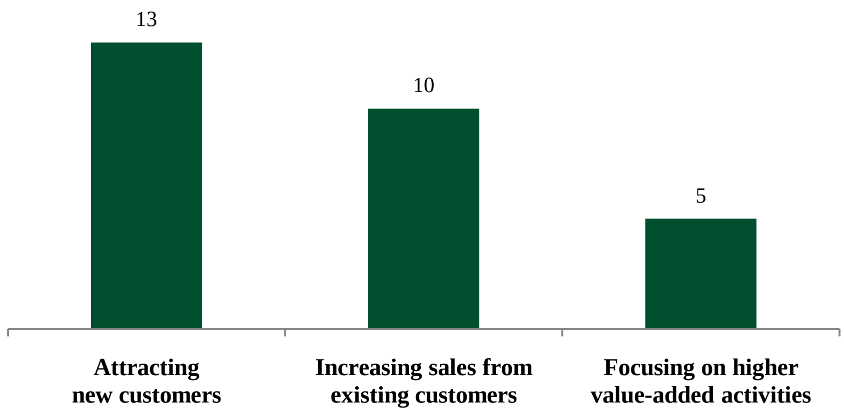



[63] Companies have tied agents, female-oriented traditional producers, and male-oriented professional financial planners. Companies have established their professional male-oriented financial planners to cover the affluent market since the male-oriented tied life planner channel in Korea Prudential life was successful in the late 1990's.

*Channel strategy*

While Korean insurance companies' top goal is attracting new customers, they are also trying to realize additional profit by providing current customers with additional service (Figure 7).

**Figure 7 — Top Two Distribution Goals**




*Multiple distribution system characteristics*

While most companies run multiple distribution channels, their characteristics differ depending on the company. This report analyzes companies' distribution system characteristics as follows: (A) whether a company has different customer contact points; (B) whether a company shares distribution-related operational functions[64] across all channels; (C) whether a company centralizes the intelligence-gathering processes to provide a single view of customers, products, and channels; and (D) whether a company enables channels to cooperate with each other in selling activities.[65]

Having shared distribution-related operation functions (B) means that companies have economical distribution strategies because shared distribution-related operation functions (B) relate to cost efficiency. On the other hand, as customer needs become diversified and complicated, a single channel may not be able to meet all of those needs. Therefore cross-channel cooperation (D) is very important not only to reach new customers but also to increase current customer wallet share.
To build cross-channel cooperation, companies should strengthen their cross-channel cooperation system between channels. Companies should align channels with sales processes according to each channel's capabilities.[66]

In fact, cooperation during sales activities (D) can be effective only when the centralized intelligence-gathering processes (C) are developed, so a company understands its customers and can change its organization to fit customer needs.

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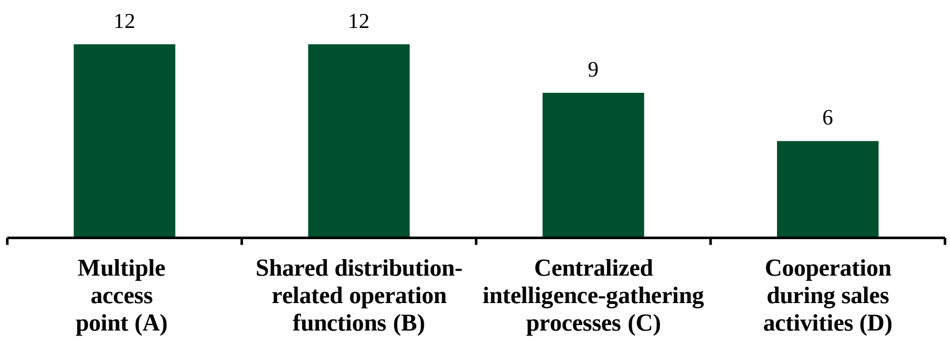
[64] IT, HR, operational finance, marketing and commercial management

[65] Based on the Capgemini report. Capgemini, and EFMA. *World Insurance Report 2009.* Capgemini and EFMA, 2009

[66] Processes include Lead Generation, Qualification, Pre-Sales, Close of Sales, and Fulfillment/Support after sale.

Global insurers in mature markets have developed the first two characteristics (A&B) in their systems but haven't yet fully developed the others (C&D).[67] More companies in Korea also have characteristics A and B. However, few companies have characteristics of cooperation during sales activities (D) and centralized intelligence-gathering processes (C) (Figure 8).

**Figure 8 — Distribution Channel Characteristics**




*Channel launching*

Only five companies plan to add new channels. The objectives of adding a channel are to make up for the lack of productivity in an existing channel, to increase market share, or to gain additional profit from the new channel. Most companies that do not plan to add new channels state that their current channels are enough to cover their current market. They plan to strengthen current channel productivity.

Profit, revenue growth, and productivity are the factors that companies consider most when launching a new distribution channel (Table 5). From a multiple distribution channel perspective, it is essential for companies to consider "mutual benefit building" because it is a core factor in maintaining strategic alliance relationships with independent agents.

However, if companies are not careful of the "potential for channel conflict", the introduction of a new channel can cause conflict, and may result in lower productivity. In addition, inadequate branding, promotion, and support functions (sales support systems or training) will hurt relationships with channels.

[67] Capgemini *et al* (2009) ibid

**Table 5 — Three Most Important Factors Considered When Launching New Distribution Channels**

| Factors | No. of Companies |
|---|---|
| Additional profit from the new channels | 11 |
| Market share or revenue growth | 10 |
| Making up for inadequacies in an existing channel | 9 |
| Giving each other mutual benefits such as profit, customer satisfaction, etc. | 8 |
| Increasing company's wallet share of current customers | 2 |
| Potential for channel conflict | 1 |
| Branding and promotion | 1 |
| Customer ownership | 0 |
| Non-monetary support (sales support systems, training, etc.) | 0 |

*Strategies for putting products on agents' shelves*

Product differentiation, good sales and marketing support, high commission, and price differentiation are companies' top strategies for putting their products on agents' shelves (Table 6).

Product differentiation and good sales and marketing support are very important strategies. However, competitors can easily copy products or price differentiation, and agents fly to competitors who provide higher commission. Price strategies such as high commission and price differentiation are effective in the short-term, but not in the long-term. In addition, high compensation and low product price can result in financial insolvency. Contrary to expectation that companies can be competitive at the mature market by reducing expense, their channel strategy results in bringing additional cost against the trend. Rather, companies should place more focus on communication and mutually beneficial growth strategies. Efficient communication builds mutual trust, which is a cornerstone for long-term relationships. And, mutually beneficial growth strategies are also critical for maintaining relationships with independent channels and keeping sustainable growth.

**Table 6 — Strategies for Putting the Company's Products on Agents' Shelves**

| Service and Support from Company | No. of Companies |
|---|---|
| Product differentiation | 11 |
| Good sales and marketing support | 8 |
| High commission to agent | 6 |
| Price differentiation | 3 |
| Financial strength of company | 3 |
| Advertising/brand management | 2 |
| Communication strategy | 2 |
| Mutual beneficial growth strategy | 2 |
| Supporting of agent's operation | 2 |
| Fast and competitive underwriting | 1 |
| Integrated support systems for channel and customer | 0 |

*Best strategies for building mutual benefits between companies*

Companies cite effective product development, product training, recognition, and communication as top strategies for achieving mutual benefits (Table 7). The strategies used for the tied agent channel are similar to those for independent agent channels except recognition which is, of course, more important to a tied agent than to an independent agent. In addition, the effectiveness of these strategies correlates to how many types of strategies the insurer uses.

**Table 7 — Best Strategies Companies Use to Achieving Mutual Benefits, and Their Effectiveness**

| | No. of Companies | | Effectiveness |
|---|---|---|---|
| Service and Support from Company | TA (F2F) | IA (Corporate) | (max=5.0) |
| Effectively develops new products to meet the needs of the market | 8 | 6 | 4.4 |
| Provides effective new product training | 6 | 3 | 4.3 |
| Recognizes producers who write quality business | 6 | 1 | 4.2 |
| Provides sufficient level of communication between the company and agent | 4 | 3 | 4.1 |
| Provides effective and useful point-of-sale materials | 6 | 3 | 4.1 |
| Offers quality policy owner service | 5 | 4 | 4.0 |
| Provides responsive and effective sales/marketing support | 5 | 3 | 4.0 |
| Provides useful marketing ideas and techniques | 5 | 3 | 4.0 |
| Clearly understands the challenges of managing agent's practice | 4 | 3 | 3.9 |
| Issues policies promptly | 5 | 3 | 3.8 |
| Carrier visits are timely and useful | 4 | 3 | 3.8 |
| Provides user-friendly, effective illustration software | 3 | 2 | 3.7 |
| Provides quality advanced sales support | 3 | 2 | 3.6 |
| Provides updates on legislative changes | 5 | 3 | 3.6 |
| Makes the investment to learn issues of importance to agent | 4 | 2 | 3.4 |
| Offers good practice management support | 6 | 3 | 3.4 |

## CHANNEL CONFLICT

Eleven of the 15 companies have experienced or are experiencing channel conflict.

### Seriousness of Types of Channel Conflict

According to channel managers, many companies have been experiencing conflicts, but they do not pose a serious threat (Table 8).

We identified ten conflict issues.[68] Findings indicate that conflict occurs over various issues. The top-three types of conflict are: same market access (Type 5), perception of product (Type 8), and perception of compensation (Type 7).

However, seriousness[69] of conflicts issues are different from occurrence of conflict issues. The more serious types of conflict are: producer recruiting (Type 6), goal conflict (Type 2), perception of product (Type 8), and perception of compensation (Type 7).

**Table 8 — Seriousness of the Types of Channel Conflict**

| Causes of Conflict | No. of companies | Seriousness (max=125) |
|---|---|---|
| 1. The goal of channels is/was not compatible with the goals of your company. | 2 | 18 |
| 2. Your company tries to provide customer with better valued product at lower cost. However, some channels prefer highly-compensated products over highly–valued products to customers | 4 | 59 |
| 3. The goal of one channel is/was not compatible with the goals of other channels. | 1 | 16 |
| 4. One channel perceives that another channel is working outside of its designated target market; so multiple channels are serving the same customers. | 4 | 39 |
| 5. Different channels serve same customer because there is no customer segmentation by channels. | 8 | 30 |
| 6. Different channels recruit or contract the same producer. | 2 | 60 |
| 7. One channel perceives that it is not fairly compensated by the company compared with other channels. | 7 | 42 |
| 8. One channel perceives it to be unfair that it sells a less competitive product than another channel does. | 8 | 43 |
| 9. One channel perceives that it is not sufficiently supported by the company compared with other channels. | 5 | 32 |
| 10. Channel members mistakenly believe the channels are competing when they actually are benefiting from each other. | 5 | 35 |

[68] Types 1–4 are based on goal incompatibility, types 5 and 6 are clashes over domain, and the remaining four are differences in perception.

[69] Seriousness of conflicts is calculated by the Coughlan's method: $\text{Conflict}_i = \text{Importance}_i \times \text{Frequency}_i \times \text{Intensity}_i$ ($i$: Issues). Each factor is calculated zero to five scales.

On the other hand, the conflicts seem not to be serious because even the most serious issue measures only 60 points, less than a half of the maximum possible. For example, same-market-access conflict does not lead to destructive results even though it occurs in many companies. This may be due to the face-to-face tied agent-centric channel structure in Korean companies. To measure the seriousness of conflicts, we also asked for profitability damage from channel conflict. All companies except one report no effect on the profitability of the channel. Only one company says that the deteriorating profitability of one channel is caused directly by another channel's success. That company expanded a new channel by transferring some salesmen from the current channels into the new channel. This caused channel conflict in areas such as customer ownership, top producers, and resources, resulting in serious deterioration of the company's performance.

However, those companies that try to add new channels by following the current market trend of growing independent channels need to be aware of the potential conflicts.

## Conflict Resolution Strategies

What kinds of resolutions do companies use to manage conflicts? According to the survey results, companies depend most on communication and product differentiation resolutions (Table 9).

Companies and channel players are communicating before and after conflict. For example, one company runs a special committee in which all parties related to product and distribution participate in order to review issues as conflict occurs, or as it is expected to occur. Decisions from the committee are enacted with the CEO's permission, allowing conflict to be minimized. Lack of communication before and during conflict will lead to even greater conflict.

Operating all channels under the same head is an effective conflict resolution (4.2), yet many companies do not use this organizational structure.[70] In fact, this strategy results in increased communication traffic to the head, and it may be not easy for large companies to adapt this strategy.

Only a few companies are currently operating using a written procedure for governing conflicts although the procedure is one of most effective conflict resolutions. As a company grows and business becomes more complicated, the company should introduce a formal procedure for dealing with channel conflict.

In addition, it is necessary that more companies encourage channel players to share their sales credit because sharing sales credit is a critical factor for them to reach customers without destructive conflicts.

Companies should be careful in using product resolution. Product differentiation can function not only as a resolution, but also as a conflict and may decrease customer satisfaction. For example, a company can create different products for channels by introducing minor product modifications. However, this resolution will harm customer satisfaction and brand awareness because many customers are using price-and-feature-comparison Web sites. In addition, if a company provides similar but different products via different channels, a channel player selling an "inferior" product may argue that it is a less competitive product. Therefore, the insurer must keep a balance between channel-specific product differentiation and unfair treatment.

[70] Only five companies use that.

**Table 9 — Effectiveness of Conflict Management Resolutions**

| Conflict Managing Resolutions | No. of companies | Effectiveness (max=5.0) |
|---|---|---|
| 1. Exchange of their members between conflict-related parties | 1 | 4.0 |
| 2. The heads of channels attend advisory councils, board of directors and the like of other channels or company | 4 | 3.3 |
| 3. Company offers the same products in all available marketing channels at same price | 6 | 3.7 |
| 4. Company provides different channels with different products | 9 | 4.0 |
| 5. Some channels use different brand names than others do | 1 | 4.0 |
| 6. Company pays all channel players nearly the same amount of compensation, including both monetary and non-monetary compensation | 6 | 3.7 |
| 7. Company uses communication systems such as regular or ad hoc meetings before conflict. | 8 | 4.0 |
| 8. Company uses communication systems such as mediation or arbitrage, regular or ad hoc meetings after conflict. | 12 | 3.8 |
| 9. Company organizes all the distribution channels under one head and makes all activities of distribution systems prescreened and controlled by the head. | 5 | 4.2 |
| 10. Company uses different channels to market to different market segments. Or, company allows only certain distributors to carry its products and services | 4 | 4.0 |
| 11. Company has a written procedure that governs conflict and its resolution practices. | 3 | 4.0 |
| 12. Channel players work together to sell, and share sales credits | 5 | 4.0 |

## The Effectiveness of a Conflict Management Rule

A specified protocol for communications — Rules of Engagement that companies use when problems do arise — is very important for conflict resolution. However, only three Korean life insurance companies have a protocol (Table 10). While two companies say the rule works well, one company says it doesn't work well.

**Table 10 — Rules of Engagement (ROE) by Company**

| No. of Companies Running ROE | Contents of ROE (No. of Companies) | Effectiveness (No. of Companies) |
|---|---|---|
| Three Companies | Target market segment assignments (1)<br>Use of channel sales resources (2)<br>Access to resources and subject matter experts (1)<br>Conflict resolution processes(3)<br>Compensation(1) | It works well (2)<br>It doesn't work well (1) |

All companies with Rules of Engagement have a conflict resolution process in their protocol. While two companies include the use of channel sales resources, only one company has target market assignment, access to resources, and compensation in its protocol.

Companies that do not have a rule but control channel conflicts well report several reasons for their success. Some companies deal with the conflict through a management-level discussion and decision. Another company reviews conflict issues such as product availability at a meeting in which all product and distribution heads, including channel heads, attend. One bigger company gave an interesting response — that the company resolves conflict through irregular *ad hoc* meetings, when necessary. However, as the company grows and its business becomes more complicated, it may need to introduce a formal procedure. Some companies say that conflicts exist, but have not yet surfaced because the company makes decisions favorable to only the core channel. Those companies will need to consider channel conflict if they want to add to or grow their minor channels.

## Fair Treatment

Economic incentives are the best method to resolve channel conflict, so it is important to fairly compensate all channel players so that managers can prevent players from demanding excessive commission and to minimize dysfunctional conflict.

Assuming that all channels sell the same amount of similar product, we asked companies to consider two different treatment criteria; including only monetary compensation or including monetary and non-monetary compensation together (whole sale commission). In other words, does a company pay approximately the same amount of benefits to all channels based on performance?

Of the 14 companies who run multiple channels, only six[71] treat their channel players fairly based on whole sale commission or monetary compensation (Table 11).

**Table 11 — Fair Treatment to Channels**

| Fairly Equal Treatment to Channels | No. of Companies |
|---|---|
| Yes, we treat all channels equally. | 6 |
| No, we treat differently channel by channel. | 8 |

When a company has multiple distribution channels, the biggest issue of conflict is fair compensation. The channels that have more market power have players who always push the company to compensate them more. If a small, less powerful channel player does this, the insurer can manage its demands; however, the company cannot treat a dominant channel player the same way. Accepting the demand may result in weaker control of the channel player, conflict from disregarded channel players, and bad financial performance. If Korean insurance companies create a fair treatment policy for distribution channel members, companies can easily communicate with channel members, gain understanding of company compensation philosophy, and minimize dysfunctional channel conflicts.

[71] Responses are the same for monetary compensation and whole sale commission.

## Conclusion

Although conflicts do occur in Korea, channel conflict does not seem excessive. However, newer multiple distribution channel systems have greater potential for conflict, with clashes of domains because any distribution channel can generally access any customer and markets. Channel managers may need to adjust target market segments to its channels.

As the Korean insurance market matures and more independent channels grow, those companies that have multiple distribution channels or try to add new channels should be aware of the potential conflicts. In addition, when launching new distribution channels, companies often focus on the productivity despite wanting to consider "mutual benefit building." However, companies need to focus on potential channel conflicts as well.

To resolve conflict, companies depend on communication and product differentiation. Companies and channel members communicate before and after conflict through *ad hoc* meetings. However, companies need to implement more formal communication resolutions, such as Rules of Engagement or institutional communication structures. The Rules of Engagement is a very important tool for controlling channel conflict.

Moreover, even though companies provide different channels with different products, companies should be careful because product differentiation acts not only as a conflict resolution but also as a conflict enhancer. The insurer should keep a balance between channel-specific product differentiation and unfair channel treatment.

Korean insurance companies need to have a fair treatment policy for distribution channel members. Through the policy, companies can easily communicate with channel members, gain an understanding of company compensation philosophy, and minimize dysfunctional channel conflicts.

# PARTICIPATING COMPANIES

American International Assurance Korea

Dongbu Life Insurance Co., Ltd

Hana HSBC Life Insurance Co., Ltd

Heungkuk Life Insurance Co., Ltd

ING Life Insurance Company Korea, Ltd

KB Life Insurance Company

Kumho Life Insurance Co., Ltd

Kyobo Life Insurance Co., Ltd

Lina Life Insurance Company

MetLife Insurance Company of Korea, Ltd

Miraeasset Life Insurance Co., Ltd

New York Life Insurance Ltd

Samsung Life Insurance Co., Ltd

Shinhan Life Insurance Co., Ltd

Tongyang Life Insurance Co.

# APPENDIX 1

## INSTITUTIONAL CONFLICT RESOLUTIONS

### Exchange-of-Personnel Programs

Programs that exchange personnel for a specified time period; thereby, channel members are encouraged to develop solutions rather than engage in conflict.

### Co-Optation

An effort by an organization to win the support of the leaders of another organization by including them in advisory councils, boards of directors, etc. The danger with this approach, though, is that each side risks unintentionally revealing sensitive information.

### Exclusive Distribution

The manufacturer allows only one distributor to carry its products and services. The manufacturer can assign distribution channels by territory, or accounts. The manufacturer obtains a more loyal and dependable distributor and the dealer obtains a steady supply of special products, and stronger manufacturer support. However, the manufacturer may find it difficult to keep assigned markets from being reached by other distributors because of technology development and customer needs.

### Joint Membership

It is a strategy that creates mutually beneficial cooperation by joint membership between trade associations.

### Mediation

Parties get outside help to resolve their disputes. A third party, the mediator, attempts to settle a dispute by, among other things, getting participants to talk to each other, helping them understand their problems, and suggesting possible solutions.

### Arbitration

In arbitration, a third party decides how to solve the conflict situation. This solution is final and binding for both parties.

# APPENDIX 2

## TYPES OF STRATEGIC ALLIANCES

There are three types of strategic alliances: joint venture, equity strategic alliance, and non-equity strategic alliance.

### Joint Venture

It is a strategic alliance in which two or more firms create a legally independent company to share some of their resources and capabilities, and to develop a competitive advantage.

### Equity Strategic Alliance

It is an alliance in which two or more firms own different percentages of the company they have formed by combining some of their resources and capabilities to create a competitive advantage.

### Non-Equity Strategic Alliance

It is an alliance in which two or more firms develop a contractual relationship to share some of their unique resources and capabilities, to create a competitive advantage.

# APPENDIX 3

## RESEARCH METHODOLOGY

For this report, we reviewed literature regarding channel conflict and fielded a survey to Korean life insurance companies to examine their current channels and channel conflict and to evaluate managerial implications.

First, the report identifies the types of conflict, discerns the true nature and level of conflicts, and evaluates the anticipated effects. The objectives are to attain a solid understanding of channel conflict features and relevant conflict drivers and explore the viable management resolution for the conflicts from a manager's viewpoint.

Second, based on the survey of Korean life insurance companies, the report identifies current operating channels and the companies' channel management strategies in the areas of multiple distribution channels and conflict management. We place heavy emphasis on how channel conflict affects a company and how it is resolved. In addition, we analyze the gaps between current conflict causes, effectiveness, and resolution, and future possible conflict issues, effectiveness, and resolution.

This report provides valuable insight for Korean insurance companies. It recommends how companies can manage their future distribution effectively when the market matures and other distribution channels become more popular than the traditional face-to-face tied agent channel.