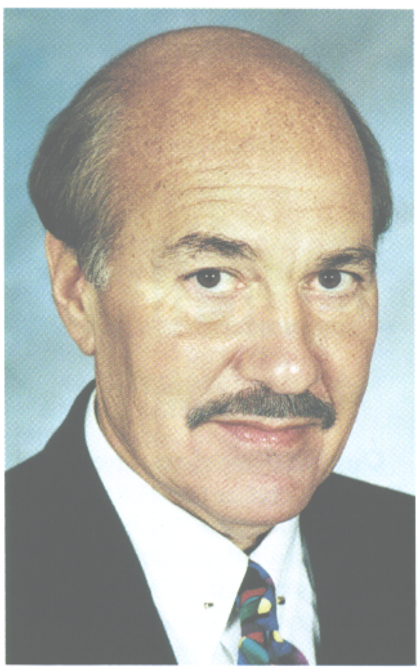
Commission rates and consequences

By Harry J. Abramson
President
Electronic Salesmasters, Inc.
Beachwood, OH 44122

Unabridged presentation made at the 37th annual Management and Marketing Conference of the Electronic Representatives Assn., Maui, HI.

Dr. Chester Karrass stated that "In business, you don't get what you deserve, you get what you negotiate." This quotation is especially appropriate with today's economic pressures on prices, profit margins and, especially, sales commission rates. For manufacturers' representatives, I believe it is the most serious business issue that we face.

Most representatives don't receive what they feel they deserve but, unfortunately, they do not try to negotiate or renegotiate their contracts. They fear that their principals will have a "take it or leave it" attitude. If they are negatively predisposed, the negotiation process will never get started.



Harry Abramson

Q. What do commission rate cuts and poison have in common?
A. Both can kill you in small doses.

Many reps are in the midst of troubled times. Some have taken on low commission rate lines or accepted reduced commissions on existing lines. Unfortunately, this has resulted in numerous rep firm failures. In Ohio alone, six rep companies went out of business within a 60 day period last year. In my opinion, the 1998 economy was not that bad. Some of these rep firms have accepted 2-3% commission rates from their largest principals and that won't cut it for the majority of us. Many of their principals were semiconductor lines, but it included "mega" passive component manufacturers as well.

There is no doubt that during the good economic times, reps can make money on lower commission rates. However, in a soft market, it could be suicidal. For reps and distributors alike, low margins and low commission business are the first step towards financial disaster. It can develop into a bad habit and, in simple terms, we have to **stop the insanity!**

Many manufacturers look at rep firms as "interchangeable parts" and, therefore, think they can get the same quality of service for less. **Wrong!**

Rep firms are not commodities-there is no such thing as "sameness."

- People are different
- Lines are different
- Chemistry is different
- Management is different
- Abilities are different

Rep firms are all unique.

Some reps feel they can afford to take on a 2% or 3% line, but <u>can they afford to have all their principals request or demand the same deal?</u> To this extent, I believe that principals and reps are playing with financial time bombs. How many manufacturers' representatives who attended this conference, or are reading this article, consider themselves "commission rate discounters"? How do you like this title? Conversely, true professionals resist discounting the value of their services.

Points to ponder

• In the history of U.S. business, market discounters are not long-term successful companies.

• Do manufacturers feel that a rep will create more demand at lower commissions than at higher commissions'? If so, why?

• Any rep can accept reduced commissions, but exceptional reps should get more!

Customers push hard for cost reductions, not margin reductions. Customers want healthy vendors, and reps want healthy principals. The logical conclusion is that **principals should want financially healthy reps.** Is there anything wrong with this logic?

If preferred customers get "preferred pricing," shouldn't preferred reps receive preferred commission rates? Unfortunately, top performing reps have not found this to be the case.

Hyprocrisy

"What is the most significant difference between manufacturers' representatives and other professionals?" Unfortunately, I don't like the answer. In today's economy, when doctors and lawyers become more proficient, they raise their rates/fees. When reps become more efficient (more sales), some principals lower our rates. Many a rep feels that this is the ultimate in hypocrisy. When a sales executive seeks out the best medical professional or lawyer, he fully expects to pay more because they are at the top of their field. But when it comes to seeking out the best available rep organization, these same sales execs try to get the best for less! This just doesn't add up.

Achievers

It's my belief that high achievers respond to incentives and that, obviously, low achievers do not respond as well. Therefore, when incentives are taken away from high achievers, it is safe to assume that they will do one of three things: slow down, stop selling, or refocus their sales efforts. In today's marketplace reps are getting lower commissions on lower selling prices. In many cases we have to sell twice as much for the same revenue as we did just a few years ago. The situation is exacerbated for reps when confronted with "sliding scale commission rates" and "commission capped accounts." Achievement of goals and quotas should bear rewards. The greatest form of recognition is a reward of increased income

Dealing with commission cutting practices

When commission cuts happen, how do you handle them? Do you let the "discount rep" set your commission rates'? If reps are going to be treated as a commodity, they should be a precious commodity. We should respond to the low commission rate proposition by suggesting incentives or higher commission rates for a creative, customized program that could include:

- Sales over quota
- Sales of new products
- Sales to new accounts

Reps should resist the temptation of taking on new lines at low commission rates for the sake of added revenue. Figure out the cost of sales. **Do the math!**

Do principals honestly believe that lower rates will produce higher sales? Reps. as well as all commissioned sales people, should point out that low rates don't create greater demand, but that the value of quality performance does.

The challenge

There are two different types of sales executives and ways they react to the mandate of increasing profits. The bright, creative thinker develops new sales programs to help sell more product so that all of the involved parties may prosper. The counterpart who reacts by cutting the commission rate is devaluing their line. Which principal would you rather work for?

Why lower rates?

When a principal advises you they are reducing commissions, ask why! It's a good idea to get their latest financial report, 10K, D&B report, or other financial statements. Is there a good reason for them to reduce rates? Are they reducing the compensation of their employees? Are they losing money? Arc their sales down? How about a price increase instead? It used to suffice. If principals consider their representatives to be their partners, why aren't we financially partnered?

Sales managers who discount commission rates give reps the feeling of Bad Karma.

Are CPA's responsible?

Some reps believe that accountants are at the heart of the problem. They accuse CPA's of being naive and insensitive to what motivates salespeople. One of the late Timothy X. Cronin Sr.'s favorite quotations was, "Bad CPA's are bean counters. Good CPA's are bean planters." I personally believe our industry needs more bean planters.

House accounts

The establishment of house accounts is the same as a commisssion rate cut. House accounts take away the very reason why principals got to where they are today. Furthermore, there is no guarantee that they will stay there. If the number of house accounts increases, it is a sign of a serious underlying problem in the rep-principal relationship. Many reps feel that manufacturers who convert large accounts to house accounts lack business ethics, and they are better off without those principals. House accounts are often a psychological barrier to a good rep-principal relationship.

The establishment of a house account is the same as commission rate cut!

Rep Councils

The inception of the Rep Council has proved to be a valuable asset to manufacturers and representatives alike. It's proven to be an effective tool in establishing creative ways to better sell products and to establish mutual expectations. Unfortunately, it has not proven to be an effective tool in battling commission rate issues. Sometimes, yes-but seldom. Why is this the case'? In some instances principal staffers have rehearsed and are not about to back down among their peers. Often the decision was made before the meeting began. Personally, I have found the better approach is "one on one." It is easier to cite accomplishments, efforts, expenses, commitments, and win your own battle. The Rep Council approach may. in fact. be a rep's last resort.

Would a clear-minded principal let a good rep walk because of a commission rate issue? Rarely! Do principals let good customers walk on a price issue'? Rarely, and not before exhausting all alternatives. **Reps should not cave in. They should negotiate!**

Why should reps discount the value of their service when they don't discount the value of the products we sell?

Do manufacturers realize that reps will probably be forced to take on more lines as a result of lower commission rates? Do reps have the courage to tell them? Would you rather surprise them! Say it firmly, but diplomatically. The better your performance, the louder you speak. If reps say nothing, it may reinforce the myth that all reps are rich.

Reps should aspire for higher commission rates. We should sell our competitive edge, i.e. product. account and market knowledge. We should emphasize the stability of our valuable team members. and even use customer testimonials. We should sell the value-added services of our firms and illustrate the cost of doing business. We should summarize. by pointing out that performance is the bottom line and we deserve higher commission rates. The fact of the matter is, manufacturers' representatives are an "outsource" function that has only improved over the years.

Representatives have never been better equipped to sell principals' products because. we are:

- Better educated
- More sophisticated
- Computer literate
- Technically competent
- Communicative

...and all that costs money while we are trying to reduce our overhead.

Where are reps heading?

Reps have "upsized" because their principals have "downsized." Reps are providing functions that principals have off-loaded onto them.

Situations

What happens when a prospective principal states, "You are asking for a higher commission rate than other reps will accept." Your answer might be, "You are darn right we are and let me tell you why." This is when your sales pitch begins. A typical retort would be. "We are a proven sales team (track record). We add value to your sales and marketing efforts. and we are at the top of our game." Point out that lower commission rates may dictate lesser services.

Be a hard negotiator

In situations that call for negotiation, such as commission rates, street smarts and nerve will get you a better deal than intelligence and being nice, according to *Psychology Today*. To get the best commission, expect that you will get a great deal going in. Then be aggressive in your proposals and counter offers. Sometimes a rep will hear a sales manager say, "I can find a rep who will sell for less." My response to that is, "That rep will probably sell less for less." Then a good comeback would be, "Mr. Principal, do your competitors sell a comparable product for less?"

Some reps feel that they can't argue commission rates with their largest lines. First of all, you shouldn't argue-you should negotiate. My feeling is that you must diplomatically discuss the issues. COWARDS LOSE!

High commission rates demand superior performance.

They are:

- A reflection of worth
- A reflection of performance
- A reflection of stability
- A reflection of superior service.
- High performers get the first look, last look, and the order.

Industry facts

Historically, commission rates have averaged 5%. This is no accident. It's based on what it takes to run an average rep agency. Some lines require higher rates due to the difficulty (time) in selling the product and smaller niche markets.

Principals who cut commission rates take the risk of being cut themselves or treated with apathy.

Most representatives favor principals who are partnered with them through the "walk away point." There are principals who view business opportunities on a "cost-managed (proportional) walk away point." This means that, if a principal cuts their margin 30%, a rep may have his commission reduced accordingly-not more!

Benchmarking

In the past, manufacturers

benchmarked themselves versus competition in several areas: market share, technology, productivity, ROI, EPS, etc. These are all-important factors to the owners or stockholders. Today there is a new and insidious rep related benchmark that principals are looking at-commission rates.

Questions to ponder

• If commissions are motivators, does it not stand to reason, the higher the commission rate, the greater the motivation?

• If the cost of living, and cost of doing business, has increased, what is the justification and logic for lower commission rates?

• If the rep strives to maximize the principals' revenues and profits, shouldn't the reverse be true?

• Have you ever heard of a principal going out of business because their commission rates were too high? Conversely, I am familiar with numerous reps going out of business when hit with commission rate reductions.

The $64 question is: Are principals reducing commission rates out of desperation? Some reps believe that this may be true, but in very few cases. Principals' annual reports and financial statements contradict the premise of "desperation."

If principals find it difficult getting rep mind share and time share, could they honestly expect to get more for less (commission rates)?

How low is low?

Are principals poised to see "how low is low?" Please don't test your reps! When commission rates are too low, direct sales may be your last alternative, but not your best alternative. It may even cost principals more, with inferior results. Losing a good rep loses the principal continuity of relationships, synergy of lines, and ultimately, the business. It's my belief that reps should strive for new contracts that incorporate the following:

- Automatic contract extension at existing commission rates
- Profit partnering
- Negotiated fixed commission rates for the duration of the relationship. Exceptions are high volume and marginal transactions.

Resisting commission rate cuts

All manufacturers' representatives should take a firm, but understanding position. We should be willing to take reductions as long as there are specific caveats, such as:

• Predetermined time period (in writing)

• Until a specific profit level is reached

• Until a specific sales volume is attained

• To penetrate new accounts and new markets

Q. What do Siberian tigers and full commission rate lines have in common?
A. They are both endangered species!

We should protect both of them.

Reps should not feel outmatched during head-to-head negotiating. Because many of us aren't particularly good at bargaining with principals for what we as reps need, it's easy to let a rep-principal negotiation turn into a conflict. In the old days people waged wars to settle disputes. Now we hire lawyers to wage war. The point of negotiating is to wage peace and develop a "win/win" outcome. People mistakenly feel that winning or losing is the only possible outcome and fail to realize that both parties can win.

Information is the fundamental asset of negotiation. The more ways you have to support a higher commission rate, the better the chances of attaining your goals. In other words, reps have to build their case. **Precaution:** Don't get emotional and don't "lose it." It contradicts the very premise of negotiating.

We should keep in mind that commission rate cuts are just as bad for our financial health as poison is to our physical well-being. As representatives, we don't necessarily get the commission rate we deserve, we get what we negotiate.

Warning to principals

"The sweetness of paying lower commission rates is quickly forgotten with the bitterness of poor performance."

-Harry Abramson