

The Risks And Rewards Of Stocking Reps

by GERALD M. NEWMAN and ADAM J. GLAZER



From time to time sales representatives deem it desirable to maintain an inventory of a manufacturer's products for resale. These representatives are often referred to as "stocking reps" or "buy-sell reps." Far from repping pantyhose, a "stocking rep" buys inventory from a manufacturer and resells it to a customer, with the spread between the purchase price and the selling price as its gross profit. From a legal point of view, however, they are more like distributors than sales representatives. As such, there is a different set of risks and rewards to being a "stocking rep."

Inventory Risks

A stocking rep has no obligation to sell products at prices determined by the manufacturer, but is instead free to sell products for whatever price a customer is willing to pay, thus giving the stocking rep the potential for greater profit. There are, of course, additional costs for warehousing and insuring inventory, to say nothing of the risk of getting stuck with a warehouse full of goods that no one wants to buy in a down market. Ideally, the agreement with the manufacturer enables the stocking rep to return goods that do not sell, but few manufacturers accept such terms.

- **Inventory Financing** — A stocking rep needs to buy inventory from the manufacturer. Thus, unless the rep can get favorable payment terms from the manufacturer, it will need the ability to finance the purchase of inventory. Banks will typically lend about 50% of the lower of cost or mar-

ket value of inventory. Upon the sale of inventory, banks will generally lend about 80% of the face amount of the account receivable. But whether inventory is financed or purchased on open account terms, the result is a potentially substantial level of debt that sales reps are not accustomed to carrying. Accordingly, sound financial planning is necessary before a rep agrees to accept inventory.

Credit Risks

When a traditional sales rep's customer fails to pay for the products shipped to it, the sales rep often loses a commission. When a stocking rep's customer fails to pay for the products shipped to it, the stocking rep loses much more. Thus, the stocking rep must pay much closer attention to the credit-worthiness of its customers. Many sellers claim a lien on the goods sold to secure payment of the purchase price, but unless such a lien is properly perfected, it will likely be of no use to the seller. To have an effective lien, the seller must typically comply with the "purchase money security interest" provisions of the Uniform Commercial Code, something that is best done with the help of legal counsel. Legal counsel can also assist a stocking rep with the necessary transac-

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tional documents, such as purchase orders, acknowledgments, invoices, etc.

Product Warranties

Although the product warranty will likely come from the manufacturer, stocking reps may have responsibility for warranty service. A prudent agreement with the manufacturer should include the product warranties offered by the manufacturer to the end-users of the product, and the remedies it offers for breach of product warranty. As part of any agreement to be responsible for warranty service, the stocking rep's contract with the manufacturer should at least include compensation for providing this service.

Product Liability Risks

A sales rep is not generally considered to be in the "chain of commerce" for product liability

purposes. However, because a stocking rep buys and resells products, it is often viewed by the public as in the chain of commerce. Thus, a stocking rep can find itself as a defendant in a product liability case. The stocking rep can protect itself on a contractual basis from this risk. First, in negotiating the terms and conditions for its purchase of products from the manufacturer, it can and should require that the manufacturer make the stocking rep an additional insured on the manufacturer's product liability insurance. In addition, it can also require that the manufacturer indemnify the stocking rep for product liability claims. If the manufacturer is not willing to agree to either of these, then the stocking rep should maintain its own product liability insurance, assuming the arrangement will still prove profitable. The magnitude of the risk, and the cost of the insurance, will naturally vary depending upon the nature of the product.

Tax Matters

Most sales reps keep their books for both financial and income tax purposes using the cash method of accounting. This means that they do not count sales as income until the commis-

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sion check is actually received. Stocking reps are distinct because they actually carry inventory, and

therefore must report income for tax purposes under the accrual method. A stocking rep will have

taxable income when goods are shipped and an invoice is issued, even though the customer has not yet paid.

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Benefits

While making the decision to maintain an inventory requires advance planning and evaluation, it can prove financially lucrative under the right conditions and provide better service to the customer while developing an important market niche. To avoid the disappearing sock phenomenon, however, stocking reps must pay careful attention to both sides of their relationship with the manufacturer throughout the contract, warehousing and sales cycles. □

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