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HOW MOTIVATING IS A COMMISSION CUT?

EDITORIAL | JOSEPH W. MILLER

JOE MILLER

Former MANA President and CEO, **Joe Miller** has more than 40 years of manufacturing and sales agency management experience, including general management responsibility with divisions of Fortune 500 companies. Joe also owned a successful representative firm that sold process equipment and piping systems to energy-related markets, and was president of MANA from 1998-2006. Currently he is president of Miller Management Services, LLC, which provides consulting services to manufacturers in the U.S. and in foreign countries. Joe can be reached at 949·878·0215 or **jmiller204@cox.net**.

I confess. In a past life as general manager of a division of a Fortune 500 company with an outsourced sales force, I was tempted to cut rep commissions in response to global competition and the falling sales of a mature product line. The other bright idea I had was to "save" over $100,000 per year by making two major accounts house accounts. Fortunately, one of our best reps, who would not have been affected by the house account change, talked me out of both decisions. He used the same arguments I use here. If you are a manufacturing executive who uses reps to go to market, I hope these arguments will help you avoid making the same kind of bad decisions.

When I talk to manufacturers, I typically get four "justifications" for reducing commissions or declaring house accounts, which is the same thing as cutting commissions:

1. "Once the customer is sold, we can take it from there."
2. "5% of something is better than 10% of nothing."
3. "We want reps to sell new business, not milk existing accounts."
4. "The sales cost of developing those existing accounts should be easily recovered by the rep in two to three years."

If you are a manufacturer, please read on as I deal with each of these arguments individually. Then give me a call or write to me if you don't agree.

"We'll Take It From Here"

No, you won't! Most customers want to have a local contact who will be their advocate at the factory. Those that say they don't are either on a temporary "I want to deal direct" kick, have a chemistry problem with a particular salesperson, or think that they can save some money by taking the rep's commission and applying it to their bottom line.

The purchasing agent may want to talk to the factory directly, but many others in the organization have learned to rely on the local rep for design assistance, training on your product, cost estimates for their products that are in the design stage, or a variety of other services. It's okay to let the purchasing people talk directly to the factory — just be sure to keep your rep in the loop. The issue of a personality conflict is a little harder to solve, but you may be able to get your rep firm owner to put someone else on the account or just weather the storm until tempers cool. Most importantly, you can easily convince the customer that it will cost you more to service the account without the rep than it currently does. Why do they think you chose the outsourced sales approach in the first place… because it costs more? We had one MANA manufacturer member tell the customer that he would be happy to pull his rep off the account, as long as the customer would agree to a price increase to cover the manufacturer's extra cost.

Remember, you can't afford *not* to have your field sales force hovering around existing accounts! Some manufacturers may actually succeed in maintaining an existing customer for a year or so after declaring it a "house account," but eventually the competitor's sales agent makes an inroad. After all, how did you get into that customer in the first place? Certainly not by telephoning the purchasing department once a month and making two trips per year from the factory to buy lunch. Think about this for a minute! Providing the customer with good quality, on-time delivery, and a competitive price is just not enough today. Your competitor's salespeople are calling at every level of that account — from the janitor to the president —looking for an opportunity, and they will eventually find one. If you don't do it too, sooner or later you'll be displaced. I've seen it happen time and again when I managed corporate sales forces.

This shortsighted philosophy also fails to see the rep in his modern role. He is no longer an order taker — he's a problem solver and a consultant to both you and the customer. Customers today want salespeople to bring them solutions — not catalogs or free golf. Deprive your customer of regular contact with a consultative sales professional, and your competitor's sales rep will solve their problems instead.

Removing your agent from the loop can cause incredible problems. One manufacturer, who made one of his agent's

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Much like ballplayers, **reps can take advantage of free agency!**

best accounts a house account, tells this embarrassing story. His rep continued to work the account for his other principals because he had an incredible relationship there. One day the customer asked the rep a question about the principal's credit policy with other customers in the territory. The rep said he no longer could speak for the principal because of the customer's "house account" status. "Well, just tell me what the payment terms are for all of your other accounts" asked the customer.

The agent told the truth, only to cause the principal a great deal of pain. It seems the "house account" was getting worse terms than all of the other customers in the territory.

Here's another true story about the backfire of a house account decision. A manufacturer of extremely technical products took his rep off of the account of a huge Fortune 100 firm. The division that the principal was dealing directly with did continue to give most of its business to the manufacturer for a while. However, there was another division of that customer at the same location who had a need for the principal's products but was unaware of their capabilities. As a result, a multi-million dollar opportunity was missed. The displaced rep was actually aware of this project at the sister division, but did not sniff out the specific opportunity because he had been banned from calling on that customer.

"5% of Something is Better Than 10% of Nothing"

The theory in reducing commission rates on a mature, competitive product line suggests that the rep is really benefiting from the commission cut because the principal would otherwise lose the business at the higher price level required to sustain the regular rate of commission. Is commission cost (which may be 5-10% of the selling price) the problem, or is it something else? Material cost is often 40-50% of a manufacturer's selling price. Have you done everything you can to reduce cost there? Direct labor and office salaries make up another huge chunk of manufacturing cost. Are all of the employees taking a 50% cut in their compensation like the rep is being asked to do? Some of you may respond by saying, "Yes, we've already cut all of those other areas and now it's time for our reps to share the pain!"

This may not be true if you are a well-managed company that has been investing some of your profits in new product development. Peter Drucker, management guru of the 1970's and 80's, preached that technological innovation, new product development and marketing strategies were the keys to success for a manufacturing business. If you are not bringing new products to market at a rate that is at least equal to the decay rate of your, now, commodity products, you'll be out of business soon. The selling costs of your field sales partners are going up, not down. Milking old commodity lines and destroying the trust of your partners by cutting commissions is not the way to ensure your future. If the old commodity line can't contribute, let it die and replace it with something that provides a unique solution for your customers. Can't do that overnight, you say? Then start innovating now before the Sri Lankans begin copying your existing line. You must have a sustainable competitive advantage in order to earn superior returns on investment, and a low price is only a temporary advantage. Take a look at what price wars have done to the airline and auto industries.

"We Don't Want Reps to Milk Existing Business"

Any salesperson worth his salt knows that 10-20% of his customers turn over every year. Customers go out of business, get better deals from a competitor, storm off due to poor customer service, or refuse to be repeat buyers for a dozen other reasons.

The verb to "milk" is very offensive to reps. The operative phrase here is "account maintenance", and it is often just as expensive to maintain an account as it is to secure it. Past history dictates that a very high percentage of B2B business cannot be maintained without local contact. While there are a few reps who may eventually slow down and rest on their laurels (shame on them), the majority of MANA members are growth-oriented, just like their principals. Lowering commissions on repeat business or taking accounts away is neither conducive to a partnership relationship with your rep, nor the best way to get your share of his time. Nor is it the best way to maintain existing business as mentioned above. It's okay to give incentives for your sales force to bring in new accounts, but don't fund these "rewards" with reduced commissions on repeat customers. It's a major source of de-motivation. Repeat commissions on repeat business help your rep to fund internal growth, which in turn inures to your benefit.

"Sales Cost Should Be Recovered in Two to Three Years"

Maybe so, maybe not. If you buy the account maintenance argument, it should be obvious that field sales costs are ongoing; not just a one-time expense. But the point I want to make here is a different one.

Most customers want to have a local contact **who will be their advocate at the factory.**

A superstar sales rep has about the same "batting average" as a superstar ball player. If either one "hits" 33% of the time, they are in high demand, and other teams often want to buy or trade for them. But this high success rate still means that the rep loses two-thirds of the new business opportunities he pursues. Why? Sometimes they get outsold by the competition (some will even admit this). Other times you can't meet the required delivery, your price is not competitive, or the customer decides to punish you for mediocre past performance. In other cases, the rep simply needs to invest a great deal of time with an account before both of you learn this is a customer that you can't really serve well. All of those lost opportunities involve field sales costs, too. Of course that's no skin off of your back because you only pay commission based on orders shipped. But it should be of concern to you if you want a healthy and motivated field sales force. Paying full commission for account maintenance helps the rep to recover the cost of new account development too! Your company doesn't reduce your compensation when you have a good year, do they? You are compensated for your knowledge, management skills and long hours. Why would you want your partners in profits to take less compensation when they help to build a profitable sales territory for you? Can you hold the business if your reps are recruited away by other teams in your industry? Much like ballplayers, reps can take advantage of free agency!

More manufacturers are finding today that the best reps in the territory are not taking on missionary lines, i.e., companies who have no existing business in the territory to turn over to the agency. Some of these new principals deal with this scenario by increasing commissions for missionary work, others choose to assist the rep by paying a temporary retainer/fee and some just say "That's what I hate about reps", and don't use them. The fact is, turning over existing business to a new rep at full commission is the norm for the truly sophisticated manufacturer.

I recently had a call from the vice president of sales for a $60,000,000 division of a Fortune 500 company. He reported that he was replacing a retiring agent with a new rep, and that he was turning over $1.5 million of existing business to this rep, at full commission. He knew that this would help fund mutual growth in the territory. If that's a true incentive for a rep to invest in a given manufacturer, isn't it then a disincentive to take existing business away, or to cut commission?

An increasing number of manufacturing firms worldwide are moving to the use of outsourced sales professionals in order to penetrate new markets and geographic regions. They do so because they recognize that this is the most cost-effective way to secure new business and maintain long-term customer relationships.

Taking the agent out of the loop after landing a big account, or arbitrarily cutting commissions, has not proven to be an effective way to handle customer account maintenance nor to motivate the agent to develop new business. Those firms that practice this technique almost always learn (the hard way) that a growth territory can be ruined in a much shorter period of time than it took to build it. asm