FOR IMMEDIATE RELEASE

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Major Issues Facing Manufacturers' Representatives in the Electronics Industries

Sales credit issues as manufacturing moves offshore

One way or another, salespeople are compensated based on performance, whether they work for manufacturers, distributors or reps. Measuring performance was relatively easy when design, purchasing and production took place in essentially the same facility, and orders were placed with the component manufacturer or with the local distributor. In the early 1980s, as OEMs began expanding their own operations geographically or outsourcing production to EMS providers, the industry began to recognize that the sales organization that created a design-in was entitled to credit for the sale, even if the actual purchase took place in another territory. Also, the sales organization that was servicing the customer was entitled to compensation, even if it hadn't originated the sale. Accordingly, the industry — particularly through the joint efforts of the National Electronic Distributors Association (NEDA) and the Electronics Representatives Association (ERA) — developed sophisticated systems for point-of-sale (POS) reporting and equitable formulas for split commissions. Although the tracking of sales was complicated as EMS companies began taking on more procurement responsibilities for their OEM customers, the system remained manageable. Now, with the offshore exodus of a sizable amount of production, the tracking problem has risen to the top of the industry's agenda. ERA offers rep tracking software to help them monitor and collect the commissions they are due.

Customer pressures to exclude the representative

A recurrent issue in the electronics OEM world is a pronouncement by a "power buyer" that, henceforth, the company wants to deal directly with the manufacturer, and that the rep is no longer welcome. This "request" is often couched in terms of improved communications, quicker response time, greater confidentiality — but whatever the verbalization, the translation is, "You can give us a lower price by eliminating the commission you are now paying the rep." The vendor who succumbs to such pressure must now perform the field sales function with company payroll staff, and thus bear the increased costs. The short-sighted customer who attempts this ploy is rarely able to "pull it off" over the long haul — it makes no sense for either party to force a supplier to use the second-best sales method, nor to limit choices by squeezing out small and start-up companies who have no way into the marketplace except through reps. As often as these efforts are instituted, it's inevitably for the short term. Companies can make their own rules, but they can't overrule the way free markets operate. When this "strategy" was recently being contemplated by a major manufacturer, ERA not only intervened successfully, but also produced a "crisis prevention portfolio" for use by its members when faced with similar threats. This was subsequently produced in CD format by the Manufacturers' Representatives Educational Research Foundation (MRERF). Copies of the CD, "Outsourced Field Sales: Adding Value for the Customer," can be obtained through ERA or through the MRERF Web site at www.mrerf.org.

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Manufacturers switching from outsourced to captive sales forces
Ask any rep and you'll learn that one of the hazards of the business lies in being perceived as too successful. Sales in a given territory grow to the point where the commissions being paid seem to be higher than the cost of a salesperson devoted to the company full time. Such calculations typically ignore the costs borne by the rep (office maintenance, recruiting, training, travel, insurance and more) plus the hidden costs of exposure on a variety of legal fronts. Even more important is the cost of the business that goes away! While there have been some high-profile companies eliminating outsourced field sales forces, less heralded have been the decisions by companies to turn or return to reps.

Lack of awareness that the rep is not a channel intermediary, but a differently compensated field sales extension of the manufacturer
From the halls of academia to the shores of industry, there is a prevalent and fallacious tendency to include the rep in the category of "channel intermediary." Channel intermediaries are those outside firms and functions that intervene in the process of getting goods from the seller to the end user. The most prevalent and visible channel intermediaries in the industrial marketplace are distributors, to whom manufacturers off-load such functions as local warehousing, credit and demand fulfillment. Whether these intermediaries function by click or by brick, they purchase product for resale at a profit. The presence of distributors in the channel does not obviate the manufacturer's need for the field sales function, both to create demand at the user level and to support the distributor in filling that demand. In no way is field sales an extra operation in the channel, nor are field salespeople "middlemen." Field sales is an integral operation for the manufacturer.

Manufacturers do have a choice, however, as to how to compensate the field sales force. They may elect to have salespeople on their payrolls and to bear directly the costs for offices, travel, insurance and other employee benefits. Or they may elect to outsource the field sales activity and compensate their outsourced field sales personnel with a commission on sales achieved. The function remains the same. Only the compensation method differs. Regardless of how a manufacturer's field salespeople are paid, they are still an extension of the factory, not another or separate link in the supply chain.

Rampant confusion about the respective roles of reps and distributors
Because reps and distributors both sell the products of several manufacturers and often to the same customer base, the two functions are frequently confused. However, the multiple-line portfolio is actually the only point of commonality. The chart that follows summarizes a wide range of differences, but three points are key:

1. The rep does not sell competing lines.
2. The rep creates sales for the distributor and receives commission on what the distributor sells.
3. The rep is paid by the vendor through commissions, and the distributor is paid by the customer through mark-ups.

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Understanding the Differences between Reps and Distributors

REPS	DISTRIBUTORS
• Sell only in a defined territory.	• May sell anywhere.
• Do not handle competing lines.	• Frequently handle competing lines.
• Sell as an agent, do not take possession.	• Buy for resale; assume ownership.
• Are compensated by commission on sales.	• Are compensated by margin of sale price over cost price.
• Typically handle 10 to 14 lines.	• Often handle several hundred lines.
• Are typically entrepreneurial, owner-operated.	• Are large firms, often publicly owned.
• Interface with distributors, refer orders to distributors and receive commissions on sales through distributors.	• Rely heavily on reps for referrals, training and engineering support.
• Add value through application engineering, design-in and product synergy.	• Add value through time-place utility.
• May warehouse (for a fee), but do not maintain inventory.	• Maintain inventory.
• Focus on customer needs.	• Focus on selling what's on the shelf.
• Are not part of the supply chain but a differently compensated extension of the manufacturer.	• Perform a critical middleman function in the supply chain.

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Maintaining coverage in the face of reduced commission income
Everybody wants to reduce costs, and an easy target is the commission on sales paid to reps. The manufacturer who cuts commissions by 1 percent does not realize that the cut equates to a double-digit percentage loss for the rep. The common justification when this happens in good times is that the actual income stream to the rep will not be reduced, thanks to the large volume of products being purchased. However, in lean times, the double drop in income will force the rep to reduce staff, and thus, services. You get what you pay for.

Developing new compensation paradigms
The commission system of rep compensation — like the rep system itself — survives because it works. Both manufacturers and reps have increasingly recognized that the field sales office can be utilized to provide a variety of ancillary and support services on the manufacturer's behalf beyond the scope of the field sales responsibility. Such activities as warehousing and customer service can often be provided more effectively — and at lower cost — on a local basis because of the rep's lower overhead burden and the ability to spread the cost over several manufacturers. The extension of services to a variety of sales support arenas has led manufacturers and reps to look beyond commissions and toward new methods of activity-based compensation. In addition, fee-based compensation is often in the picture today when a rep is pioneering a new line or when the rep is providing sophisticated technical services without the "carrot" of future commission income.

Everybody wanting to get into the "design-in" act
In the traditional paradigm, the OEM engineer designed a product with application engineering support from the field sales force of a specific vendor. Field sales created the demand for the given product, and depending on quantity and/or delivery schedule, distribution was on call to fulfill the demand. As semiconductors became the dominating factor in the design process, and as semiconductor vendors tended to sell a larger percentage of their output through top-tier distribution than had been the norm in the IPE market, semiconductor companies (which typically chose not to use reps for field sales) relied heavily on their distributors to supply the application engineering support needed by OEMs. Meanwhile, as corporate America began to learn the benefits of focusing on core competencies and outsourcing functions that were directly germane to the core competencies, one of the functions outsourced to specialists was product design. The design firms still needed application engineering support, creating a new venue in which field sales had to be active. Even more prevalent has been the outsourcing of production, and often procurement, to contract manufacturers (CEM or EMS). Now the newest twist is for the EMS world — looking frantically for new income sources — to add another competency and offer design services. The EMS design center will still need application engineering support from field sales, so the rep will still be there. Obviously, application engineering support comes with a cost — but how that cost is passed along and paid for is another issue.

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