Sales and Distribution Management

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Ref. No. SDM – 11 2K4 20

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Part I

The Sales Perspective

Chapter 1

Introduction to Sales Management

In this chapter we will discuss:

- Evolution of the sales concept
- Nature and role of selling
- Image of selling
- Objectives of sales management
- Integrating sales and marketing management
- Environmental changes affecting sales management
- Entry of women in sales management
- Structure of the book

"You can take away my money and take away my factories, but leave me my sales staff and I'll be back where I was in two years."

Andrew Carnegie

Sales refers to the exchange of goods or services for an amount of money or its equivalent in kind. Selling is the most important and most difficult function in an organization. It is like fuel to an engine. Without the sales function, a firm cannot stay in business for long. Therefore, managing sales in an organization is a critical activity. A sales manager needs to ensure that the salespeople are motivated to perform the selling function in a way that will help the organization attain its goals. He also needs to constantly interact and coordinate with other departments to ensure that goods are supplied to customers on time, and deal with complaints from other departments about the salespeople. Other departments usually complain that salespeople make promises to customers that are difficult for the production, finance, and other departments to fulfill.

It is thus clear that the sales function plays a very vital role in an organization achieving its goals. But, if sales is so important to an organization, then what is the role of other activities of the firm such as advertising, marketing, public relations, and so on? Although these play a crucial role in creating a desire for the product in the minds of the customers, it is ultimately the interactions, that the salespersons have with the customers, that is critical in closing the sale. A company may spend a large amount of money on advertising, marketing, public relations and promotional activities to attract prospective customers, but all the money spent on marketing and promotion will go down the drain if the salesperson is ineffective. Thus, we need to understand that sales is an important activity that can make or mar the future of an organization.

The first chapter in this book, looks at the various dimensions of sales management. The chapter begins with a discussion on the evolution of the sales concept followed by a description of the nature and role of selling. This is followed by a discussion on the objectives of sales management and the importance of integrating the sales and marketing functions in an organization. The chapter concludes with a discussion on the environmental changes affecting sales management.

EVOLUTION OF THE SALES CONCEPT

Selling has been an important part of business throughout history and will continue to be so. To understand the sales concept better, one needs to understand the evolution of selling from the Stone Age.

Trade and selling were not common during the Stone Age. People in one group perceived the other groups as a threat and either fought with them or avoided them altogether. However, when one of these groups had to pass through the territory of another, they would leave behind some gifts or offerings in exchange for being allowed to pass through safely. This form of exchange can be considered as the first evidence of trading by human beings. Gradually, socialization between groups increased, leading to an improvement in trade and it gave rise to the concept of demand and supply. These developments were confined to negligible activities and so cannot be considered as trade or selling in the true sense. However, these activities laid the foundation for modern trade and selling.

When men started cultivating and harvesting crops around 10,000 BC, it necessitated large-scale selling and travel across territories. Thus evolved the concept of traveling salespersons who carried goods across territories for the purpose of selling them. Jewels and other valuable metals served as the currency during this period. Agricultural produce was brought to a marketplace for exchange with other goods.

This gave rise to the concept of intermediaries who sold goods produced by others in the market. This type of business prevailed for several thousand years. The development of iron tools led to ship building, that in turn led to selling goods across seas. Trading was now done by a chief trader who appointed field salespersons to sell the goods. These salespersons were paid on a daily basis or on a commission basis. Despite these developments, during the early Iron Age, trading did not take place on a large scale due to the lack of proper protection to foreign traders and the absence of currencies that were freely tradable or acceptable.

Gradually, commercial laws evolved and in 670 BC, government backed coinage was issued. This greatly facilitated foreign trade. Competition slowly evolved during this period with traders selling similar goods and reducing prices to attract customers. The profession of sales gained rapid acceptance and commission as a mode of payment became popular. With the fall of Rome in 476 AD, trade was stalled to a significant extent for several hundred years. It began once again with the origin of Islamic trade in the Middle East. Book-keeping methods were introduced for easier transactions. During the Middle Ages, the concept of door-to-door selling became popular in rural England. In the preceding years, Northern Europe had suffered extensively from plague and the markets almost went mute. Several hundred years later, art and art forms prospered in Florence, Venice, Rome, and other places, giving a boost to commerce and trade. Trade fairs became popular and salespersons, even more so. People from all economic strata visited these trade fairs to buy the goods exhibited. The salesperson occupied the most important position in these trade fairs. He played different roles – that of auctioneer, lecturer, trader and entertainer -- to sell his goods. He was considered to be highly intelligent and became immensely popular among the general public. Salespersons at this stage realized that to be successful, it was essential to foster long-term relationships.

The Industrial Revolution brought about a dramatic change in the sales scenario and gave rise to modern sales and marketing practices. The setting up of industries led to mass production of goods and the opening of a large number of showrooms and sales offices. Advancement in transport and communication technology in the form of railways, postal system, the Internet, etc., further revolutionized the selling process across the world and laid a strong foundation for selling in the twentieth century.

On the whole, the evolution of sales can be divided into seven generations.

First generation: During the first generation, selling took place in the form of exchange of goods. In other words, a barter system was followed. The barter system has been around since the beginning of civilization and is the simplest form of exchange.

Second generation: The second generation of sales involved the evolution of the store concept. Goods were stored for sale at one place from where the buyers could purchase whatever they required. Thus, rather than purchasing goods on a one-to-one basis, a stockpile of necessary or desired commodities was created. From the barter system of trade, sales graduated to the inventory form of trading.

Third generation: In the third generation of sales, traders began peddling their wares by searching for and locating customers, rather than waiting for customers to arrive and purchase their wares from stores.

Fourth generation: The fourth generation of sales can be considered as the first step toward adopting a systematic approach to selling. In this stage, traders realized that certain customers purchased goods from them repetitively and at regular intervals.

Fifth generation: The fifth generation of sales was marked by the advent of need-based selling. Thus, the sales activity became more scientific in its approach. The emphasis of the trader in this generation of sales was to identify the customer’s need and fulfill it with a product or service. This approach toward selling can be considered to have laid the foundation for modern day sales techniques.

Sixth generation: The sixth generation of sales began somewhere around the late ’60s. In this period, the sales approach underwent considerable transformation. This was because there was an increasing demand for salespersons to understand customers’ unique needs and offer solutions for them. The efforts of salespersons to understand the unique needs of customers gave rise to the ‘consultative selling’ approach wherein the salespeople and sales managers assisted buyers in their purchase decisions. In the consultative selling approach, salespeople give top priority to customers’ needs. They also play the role of experts and try to resolve consumers’ problems by identifying and offering them a product that best satisfies their needs.

Seventh generation: In the seventh generation, the salesperson assumes the role of a moderator, his aim being to make the customer realize the implications of buying the product or service. In this stage of selling, the salesperson’s focus is not on selling the product but to help the customer identify the long-term consequences of buying the product. The salesperson asks questions from the customer’s viewpoint rather than his own. What does the customer need the most? What change will buying the product make to the customer compared to the present situation? What is the potential advantage the customer might be missing by not making the change? How is the customer’s situation likely to improve by purchasing the product as a solution to his current need? Raising questions such as these help the salesperson place the needs of the customer above his own while making the sale.

Such an approach to selling helps in developing trust among the customers, thereby leading to referrals to the salesperson. And as the customer is not pressured by the salesperson to make the purchase, there is an improvement in the quality and quantity of sales, besides in personal satisfaction for both the customer as well as the salesperson.

NATURE AND ROLE OF SELLING

Selling helps an organization achieve its business goals. It has other roles as well, such as that of enhancing knowledge about both the internal and external environments, such as customers, suppliers, distributors, employees and other people; developing a positive relationship with the customers, suppliers and distributors; and negotiating with customers to sell the company’s products profitably. The sales team of an organization can play these roles effectively only when it receives the required support from other departments. All the roles of the sales team are interdependent and the success of one role depends upon the success of the others. Information exchange among the departments of the organization is very crucial and the sales department has to share necessary information with other departments such as production. For instance, if the sales team forecasts a higher sale, then such information should be communicated to the production department so that it can take the necessary steps to increase the level of production.

The sales team continuously monitors the changes taking place in the external environment regarding competitors, customers, government and other regulatory agencies; advances in technology; and industry trends. This provides the sales personnel with vital information regarding trends in organizational sales, product development, and budgets. By offering the management vital inputs pertaining to such information, the sales team helps the management in organizations to develop objectives. The management in organizations needs such information to also develop various plans regarding sales, production, and design..

There is another important role that selling has to play -- the sales team should identify potential prospects, qualify them, and develop a long-term relationship with such customers. Locating new customers while retaining existing ones is the most important function of a sales team. Sales personnel can locate new customers by obtaining information about them from personal acquaintances, existing customers, and referrals from satisfied customers. Developing and maintaining a good relationship with the customers is also an important function of the sales team.

IMAGE OF SELLING

The sales force is the company's most valuable resource since it determines the success of the company in the marketplace. It influences the profits or losses made by the company. The sales force is the principal, and often, the only revenue generator in some companies. However, despite the crucial role played by the sales force and despite millions of people across the world being employed in the selling profession, sales as a career option is viewed in a negative light. Salesmen too tend to have a negative image in society.

Many salesmen might have had the experience of being abused, shown the door in offices and homes, and worse still, of even being manhandled. The profession of selling is one of the most degraded, condemned, and ridiculed professions in the society. There may have been rare occasions when a salesperson was praised and appreciated, but the negative experiences tend to outnumber the positive ones. Thus, although sales makes a vital contribution to society and the economy, its negative image tends to overshadow the good it does.

The principal cause of the negative image associated with the selling profession appears to be the misconceptions among the public regarding the job of a salesman and the manner in which sales activities are carried out. In a survey conducted in 1958, 3000 college students were asked to write down the first words that came to their mind on hearing the word 'salesman'. They wrote down words such as travel, money, personality, sales, fast-talker, commission, appearance, products, high pressure, and aggressive. These words conveyed the picture people had about the sales profession. In reality, however, only a small proportion of salesmen travels and earns high commissions. Thus, it was clear that the respondents' reaction had more to do with public opinion about salesmen rather than actual knowledge about the working conditions in a sales job. Yet another survey conducted in 1962, covering about 1000 male college students in 123 colleges and universities, revealed that most of them considered sales as just a job and not something to be considered as a profession or career. It was also felt that a selling job brought out the worst in the personality of an individual and that salesmen had to be dishonest, deceitful, arrogant and ready to compromise on their principles and values in order to be successful. Thus, a selling job was considered as lacking in dignity and one for which no one who was intelligent and clever should opt.

However, these impressions that the students had were more their misconceptions about selling and sales as a career. In fact, in the present times, sales is a highly lucrative profession in which the salesman has considerable freedom to manage his selling efforts and link them to his desired compensation. To many, sales has been as fulfilling a profession as any other in the industry.

OBJECTIVES OF SALES MANAGEMENT

The major objectives of sales management of a company are to increase sales volume, and contribute to profits and the long-term growth of the organization. Although these are the objectives of the entire organization, the sales force in particular, plays a significant role in achieving them. Therefore, it is necessary that the sales manager clearly defines the tasks of the sales force personnel. Exhibit 1.1 discusses the importance of task clarity to ensure a motivated sales force.

Exhibit 1.1

Importance of Task Clarity

Clarity in responsibilities motivates sales personnel, more than financial rewards and compensation. Moreover, clearly specifying the tasks of each individual improves the individual's performance. A vaguely defined task demotivates even the most efficient salesperson and hampers his work. In certain types of selling, such as selling of drugs, medical representatives approach doctors and persuade them to prescribe the medicines manufactured by their company to the patients. However, it is difficult for the salespersons or their companies to analyze whether their sales efforts have actually been successful in terms of resulting in a sale. This is because one can never cross-check the prescriptions of the doctor to ascertain whether he has prescribed the medicines recommended by the medical representative.

Sales tasks such as these are by their very nature, vague. Sales managers are waking up to the fact that in order to ensure a motivated sales force, it is essential that there is clarity in the selling task. Task clarity refers to the relationship that can be ascertained between the selling efforts of a salesperson and the resultant sales that occur. Ambiguity in establishing such a relationship indicates lack of clarity of the selling task. On the other hand, if there is no ambiguity regarding the relationship between the selling efforts of the sales person and the resultant sales, the task becomes clear to the sales person.

In order to ensure a motivated sales force, the sales management should focus on three aspects of task clarity -- the definition and possibility of accurate measurement of the selling task, impact of the selling task on motivation and performance of the salesperson, and ways to enhance task clarity.

Adapted from Benson P. Shapiro and Stephen X. Doyle, "Make the Sales Task Clear," Harvard Business Review, November/December 1983, Volume 61, Issue 6, 72-73.

While the sales force can serve as a tool for achieving these objectives, the ultimate responsibility lies with the top management. Sales quotas are normally sales volume objectives. Sales quotas are set for sales personnel on the basis of the territories and regions in which they operate. The sales volume objectives are normally expressed in terms of rupee sales volume. Sometimes the sales management expects the sales force to achieve higher sales volumes for specific product categories. The sales management offers special incentives for salespersons who achieve such targets. The idea behind offering such incentives is to motivate salespersons to put in extra effort. Similarly, other important objectives of the sales management include improving the contribution to profits and attaining long term growth in the market.

INTEGRATING SALES AND MARKETING MANAGEMENT

It has often been found that the sales and marketing functions in organizations are not in tandem. This leads to a lack of coordination between the sales and marketing activities and the business of the firm gets badly affected. If the organization attempts to swap the jobs of the sales and marketing people, both sections resent the move, as they normally do not like the other job. A marketing person may perceive the sales job as one with no scope for creativity, while a salesperson may perceive sales activity to be more important than marketing because it is the one that ultimately makes a marketing program successful. Moreover, the sales department views the marketing department as being alienated from the actual market, while the marketing personnel feel that the sales personnel do not properly understand the behavior of the customers and, therefore, fail to handle them effectively. This belief makes the marketing people visualize their function as being superior to the sales function.

Exhibit 1.2

Integration of Sales and Marketing Functions at Xerox

Xerox Corporation, one of the world's largest office equipment manufacturers, employs 1,500 salespeople in its production systems group alone. These employees work at locations spread across the world and the company's marketing department has to maintain constant coordination among them. When market research revealed that a lot of demand existed for digital technology equipment, the production systems group sought the help of the marketing department to effectively communicate information about the company's digital equipment to the public. Accordingly, Xerox's marketing team developed DocuWorld, considered as the company's most complex marketing campaign ever. The company displayed all its products at an exhibition and demonstrated their features to the visitors. On the insistence of the marketing team, the salespeople were present at these exhibitions so that they could later target the visitors to these exhibitions to make their sales presentations. Besides this, the marketing team also developed a database of prospective clients and distributed it to local salespeople for follow-up action. The company's marketing team also distributed specialized kits (containing instructions on how to conduct a DocuWorld event and customize it to suit local tastes in order to attract local customers) to its branch offices across the world. These integration efforts of the sales and marketing departments helped generate a huge volume of sales for the company.

Adapted from Sarah Lorge, "Marketers are from Mars, Salespeople are from Venus," Sales & Marketing Management, April 1999, Volume 151, Issue 4, 27-32.

In most organizations, the sales and marketing functions are two separate departments. Added to this, these departments often have conflicting objectives, making them compete with each other. For example, quarterly revenues form the focus of the efforts of the sales department whereas the marketing department aims at long-term growth of the organization through brand building measures. Moreover, communication between these two departments, which is vital for the success of the organization, is often negligible.

Although issues relating to the lack of coordination between the sales and marketing functions create significant problems in most organizations across the world, companies have realized that there are no quick fix solutions for these problems. Some companies have even come up with innovative solutions to ensure long-term healthy relations between the marketing and sales departments and their working in unison. These companies have adopted methods that will help them to effectively coordinate their sales and marketing activities. For example, at Simkar, a Philadelphia-based lighting fixtures company, the vice presidents of both sales and marketing make it a point to share information about the activities of their respective departments. Both vice presidents get to attend and speak at the other department's internal meetings. This keeps the staff in both departments informed about what is going on in the other department and makes coordination of their activities possible. Measures such as these go a long way in enhancing the relationship between the two departments. Exhibit 1.2 describes the efforts made at Xerox Corporation to integrate the sales and marketing functions.

ENVIRONMENTAL CHANGES AFFECTING SALES MANAGEMENT

Over the years, substantial changes have taken place in the sales environment and the sales management too has witnessed a simultaneous change. Various trends have been clearly visible in the sales environment from the early '80s. The trends that have considerably shaped and transformed the sales profession include shorter product life cycle, longer, more complex sales cycle, reduced customer loyalty, intense competition among manufacturing companies, rising customer expectations, increasing buyer expertise, revolution in the information and communication technology sector, and the entry of women into the sales force.

Shorter Product Life Cycle

Owing to greater competition in recent times, the product life cycle of most products is getting shorter and shorter. Companies are reducing the cycle time for new product development so that they can introduce new products into the market much faster than the competition and thereby gain an early mover advantage. For instance, Xerox is known for introducing its products in the market much before the competition. It has significantly reduced its cycle time for new product development from seven years to two years, and this has helped it become the leader in the office copier market. Similarly, General Electric (GE) has also substantially reduced its new product development time, which has helped it become immensely successful in the market.

Longer, More Complex Sales Cycle

A sales job can be a strenuous one. As a result, salespeople often tend to get impatient when there is a delay by the customer in finalizing the deal. The impatience on the salesman's face becomes apparent when the customer takes a long time to make a decision. In such a situation, some salespersons might act in an over- enthusiastic manner to close the deal and instead end up spoiling the much-needed long-term relationship that could have been established with the customer.

There are, however, certain techniques that a salesperson can adopt to deal with such dilly-dallying customers and reduce the duration of sales cycles. First, the salesperson should try and clear the doubts and apprehensions that are stopping the prospect from taking a decision. Here the salesperson should assume the role of fear alleviator. He should give the prospect some time rather than pressure him to make the purchase decision. He should adjust his pace of selling to suit the customer and put him at ease. There are some customers who might like to take a slightly longer time than others to make the purchase decision. In such situations, the salesperson should maintain his calm. Once the salesperson feels that the customer has verbally agreed to the terms and conditions of the sale, he can send or put across the contract to the customer. Even if the customer takes time to sign the contract, the salesperson, by sending him the contract, reinforces the message that the company is willing and committed to offer a solution to his problem.

Reduced Customer Loyalty

It is highly important for companies to retain their existing customers, especially in today's competitive environment. If a company concentrates only on improving its market share, allocates all its resources to accomplish this objective, and fails to pay attention to its existing customers, it will have to see its profits being eroded over a period of time.

Customer loyalty is achieved by offering products that deliver the perceived value to the customer. However, customer loyalty should not be confused with customer satisfaction. It costs more to attract new customers than to retain existing ones. Over the years, customers have been increasingly shifting their loyalties from one manufacturer to another. In order to increase customer loyalty, there is a growing need for companies to analyze the reasons behind this shift.

It is generally perceived that price is the major factor that causes customers to shift loyalties. Companies thus engage in price wars, thereby eroding their profits. However, such measures are not really effective in increasing customer loyalty and customer satisfaction, as price is only an excuse for customers to shift their loyalty. There are actually other factors that cause customers to shift. So companies need to address the problem of decrease in customer loyalty by viewing it *in toto* rather than in a piecemeal manner.

Exhibit 1.3

Guidelines for Customer Satisfaction

Salespeople have to perform various functions, the most important of these being customer service. Providing efficient service to customers is one of the crucial steps toward maintaining a long-term relationship with customers. By providing quality customer service, companies can ensure customer satisfaction. Some of the important guidelines that a management can follow for delivering efficient customer service are:

Educate the customers about how to use the product and warn them of the consequences of mishandling the product. Management can also offer the customers some tips for troubleshooting, so that in the event of the product malfunctioning, the company need not allocate costly resources, such as the services of technical personnel, for carrying out minor repairs which can be handled by the customers themselves.

Train the employees on how to handle customer complaints. Most employees do not understand the significance of handling customers' complaints efficiently. The management has to make its employees realize the importance of handling customers' complaints efficiently and effectively, of respecting their criticisms, and of taking swift action to address their problems. Efficiency is a more important attribute for a salesperson than a pleasing personality. Customers prefer to have their problem resolved rather than interact with a pleasant-faced salesman who is unable to solve their problem. Therefore, companies should give maximum importance to ensuring that their customer service representatives are efficient at their job.

Standardize the response procedure. Firms have to ensure that they follow a standard procedure for handling customer complaints. This helps avoid confusion besides ensuring that a systematic process is followed.

Price the services offered to the customers. Firms need not provide free service at all times. If the service exceeds a certain level, then the firm can charge the customers an appropriate amount for the service offered. Firms need to develop different types of service contracts so that customers can easily understand and choose the contract that is most suitable to them.

Companies can outsource their service functions if necessary. Nowadays, most companies outsource their customer service activities if they feel that they cannot handle them efficiently with their available resources.

Assess the service performance and measure its efficiency. An assessment of performance standards and the variance in actual performance helps companies to evaluate individual salespersons and make necessary modifications to enhance their performance to meet customer expectations.

Adapted from Hirotaka Takeuchi and John A. Quelch, "Quality is More Than Making a Good Product," Harvard Business Review, July/August 1983, Volume 61, Issue 4, 139-145.

When customer loyalty decreases, a company loses customers. There are two categories of lost customers -- dissatisfied customers and forgotten customers. Dissatisfied customers are those who may have had a problem with the product at some point of time and who may not have been provided the necessary customer support by the company. Forgotten customers, on the other hand, are those who feel that the company is ignoring them by taking them for granted and not treating them as special any more. Customer loyalty also decreases if the salesperson fails to give the customer proper information about the value of the product or if he fails to understand the customer's needs. While failing to communicate the customer perceived value reduces customer loyalty, failing to deliver the customer perceived value makes customers shift their loyalties. Exhibit 1.3 discusses some important guidelines for companies to maintain high levels of customer satisfaction.

Exhibit 1.4

Analyzing Competitor's Selling Strategies

In this era of intense competition, the job of a salesman has become even more difficult. Normally, salespeople do not try to analyze how competitors sell their products. They are almost always worried about the pricing pattern of the competitor rather than the way he sells his products. Just as a football team aiming for the World Cup will not fail to take into consideration the strengths and weaknesses of the opponent and analyze that team from every possible dimension before playing the crucial match, likewise in sales too, it is essential to examine the selling strategy and its execution by the competitor's selling team.

In the attempt to analyze the competitor's selling approach and develop strategies to effectively tackle their competitor's strategies, companies must ask themselves the following questions:

- What is the selling process of the competitor? Has it adopted any of the popular selling methodologies and will this help the company in anticipating the competitor's moves?
- How does the competitor evaluate and compensate its sales force? Obtaining information on this aspect will help the company estimate how aggressive the competitor's sales force is.
- What is the amount of information gathered by the competitor's sales force about their customers?
- What are the aspects on which they emphasize to win the sale – Is it customer satisfaction or long-term relationship or anything else?
- Do the competitor's salespersons indulge in negative selling tactics by talking ill about competing firms?
- How good are they in keeping their promises to customers? Do they dishonestly hype up their products' attributes or are they principled and honest in their selling approach?
- How long is it since the competitor employed the current sales force? Is the sales force happy with the job or does it treat it as just a temporary arrangement prior to obtaining another job?
- How does the competitor hide any weaknesses of its product, company, or service?

Finding appropriate answers to these questions can help a company devise strategies to counter the selling tactics of competitor firms.

Adapted from Jeffrey Gitomer, "Knowing How Your Competitor Sells Can Help You Sell More," Budapest Business Journal, June 17-23, 2002, Volume 10, Issue 28, 20.

Intense Competition among Manufacturing Companies

Competition from multinational companies has been increasing over the past decade. When existing markets get saturated, companies target new markets with their products. For instance, during the mid-1960s, products from Japan, Germany, Hong Kong, and Taiwan flooded the US markets. Similarly, after the liberalization of the Indian economy in the 1990s, products manufactured in foreign countries inundated the Indian market. With the elimination of trade barriers, salespeople across the world have to put in tremendous effort to help their companies counter competition from products of multinational companies. Exhibit 1.4 discusses the strategies that companies can adopt to effectively fight their competitors in sales.

Rising Customer Expectations

Compared to the past, consumers have become more professional in their buying approach. They place a lot of importance on product performance and customer satisfaction. And the customers' expectations are only going to rise in the near future. So salespeople have to be more attentive and careful while dealing with customers.

According to a survey conducted by the US Office of Consumer Affairs during the ’80s, it was found that in a sample of 2500 households, about 70 percent of customer complaints about defective products had never been resolved. Although it is very difficult and sometimes impossible to get products that are perfect in all respects, salespeople should understand that customers will always look for better products and will immediately shift loyalties the moment they find one available in the market. Thus, salespeople should act as the eyes and ears of the company. They should always keep a watchful eye on customers and their satisfaction levels. By doing so, the sales force can immediately alert the company regarding unsatisfied customers, thereby allowing the company to take prompt action to prevent these customers from shifting their loyalty to competing firms.

Increasing Buyer Expertise

The budget allocations of companies are depleting by the day as profits get eroded. Companies are becoming more and more choosy about the products they purchase. Likewise, individual consumers, resellers, and government organizations expect to derive the maximum value from the products they buy. Consumers are willing to spend some time in searching for and evaluating alternatives rather than tolerate products or services that fail to meet their expectations.

While making industrial purchases, companies set up purchase committees comprising managers from engineering, marketing, production, and operations functions. Salespersons approaching these organizations to sell industrial products should possess the technical knowledge to be able to convince these experts about their product’s qualities and attributes. The expert purchase process of organizations thus requires that the sales force personnel be highly skilled and knowledgeable about the product. Taking this into consideration, firms selling to industrial markets need to adopt new methods of recruiting, selecting, training, motivating, and compensating salespeople in order to match this trend of increasing buyer expertise. Similarly, the increased awareness of customers regarding the various products and services available in the market makes it necessary for even salespeople selling to individual customers to be highly skilled.

Electronic Revolution in Communication

The revolution that has taken place in communication technology has made new tools and techniques available to salespeople to enhance their selling efforts. The sales force in almost every big company is now using advanced gadgets to perform their selling activities. The gadgets provided by companies to their sales force range from palmtops to laptops. Sales managers in companies are increasingly adopting new technologies as they understand the consequences of losing out on an opportunity. Some of the sophisticated tools that are being used by the sales force are notebook computers, laptops, palmtops, pocket computers, satellite pagers, cellular phones, and portable fax machines. These tools make use of sophisticated technologies such as computer graphics, desktop teleconferencing, and electronic data interchange. Using these tools, salespersons can make more effective presentations to prospective customers, communicate information from the field to the sales managers at the headquarters and be constantly accessible to the sales managers to convey important instructions. Salespeople can use these tools to continuously update and apprise the headquarters about the sales situation in the field, and about the demand status for each product in that particular location. There has also been a rise in salespersons using pocket computers to store and update customer orders to centralized computers at the regional headquarters. Software applications like MS-office are of immense help to salespeople in developing and delivering presentations, conducting what-if analysis through scenarios, developing sales graphs and charts, etc.

Teleconferencing is yet another sophisticated technology that is being used in sales management. With the expenditure on traveling and other activities constantly increasing, companies are now relying on technologies such as teleconferencing for conducting sales meetings, training programs, customer interactions, etc. Teleconferencing offers an economical way for companies operating on a global scale to conduct their sales meetings and is thus highly advantageous for them. The sales force is also making increasing use of mobile phones. These phones have proved to be immensely useful to both the salespersons as well as the companies hiring them since they allow both parties to be in constant touch with each other. The computerized sales office is yet another revolution that has taken place in communication technology. The computerized sales offices help to significantly enhance the productivity of the sales organization by eliminating paper work and automating regular sales activities such as generating reports, filing documents, etc. It is not just the salespersons but sales managers too who find extensive use of this technology in their managerial activities. It helps them to edit drafts of reports submitted by the salespersons, simultaneously issue memos containing crucial instructions to the sales force spread across several locations, and even extract required information pertaining to particular sales accounts from the databases.

ENTRY OF WOMEN IN SALES MANAGEMENT

In recent times, an increasing number of women have begun to opt for a sales career. Companies too are no longer discriminating between the genders while recruiting personnel for their sales force. As a result, women can now be seen actively involved in selling products and services, both to individual customers as well as in industrial settings. With more and more multinational companies recruiting women into their sales force, their representation in sales forces worldwide is increasing by the day. Companies like Xerox, IBM, and GE have been recruiting women into sales from as early as the 1970s. The women comprising the sales force in these companies have been either recruited from non-industrial jobs or have been promoted to managerial positions. In the US, around 26 percent of the salespeople (excluding door-door salespeople and store clerks) are women.

STRUCTURE OF THE BOOK

This book is divided into six parts, and consists of 26 chapters.

Part I, titled The Sales Perspective, is divided into five chapters. Chapter 1 presents an introduction to sales management and discusses the evolution of the sales concept, the role and image of selling, and the various environmental changes that affect sales management. Chapter 2 discusses the role of a sales organization and gives a description of the different types of sales organizations, the sales force structure, and sales culture. Chapter 3 explains the roles and responsibilities of sales managers and sales executives, besides the different policies that impact sales management. Chapter 4 discusses the various aspects of personal selling and sale force objectives, theories, and approaches to personal selling. It also examines effective selling techniques and automation in personal selling. Chapter 5 examines the role of a salesperson in international sales management along with the opportunities and challenges in the international business environment, strategic issues, and sales techniques in international sales management.

Part II, titled Planning the Sales Effort, is divided into five chapters. Chapter 6 discusses the importance of planning in sales management, the sales planning process, and the sales manager's role as a planner and administrator. Chapter 7 discusses sales budgets in detail under the heads of purpose and benefits of budgeting, types of budgets, methods used for budgeting in sales management, and the precautions to be taken in preparing sales budgets. Chapter 8 discusses the need and importance of estimating market potential, along with the various methods used for forecasting sales. Chapter 9 discusses the various aspects pertaining to sales quotas and describes the purpose, importance, and characteristics of sales quotas, the various types of sales quotas, methods of setting quotas and their limitations. Chapter 10 on Sales & Cost Analysis examines the nature and methods of sales control and the principles, elements, and steps in sales and marketing cost analysis along with a description of sales and marketing cost audit.

Part III, titled Organizing and Directing the Sales Effort, is divided into six chapters. Chapter 11 on hiring and training of sales personnel discusses the importance of recruitment of sales personnel and the personality traits that are essential in a salesperson. It presents a framework for selection of sales personnel and discusses types of training programs and their benefits. Chapter 12 explains the importance of time and territory management in sales organizations, and the criteria and methods for designing territories. Chapter 13 discusses sales force compensation, types of compensation plans, sales force expenses, and fringe benefits. Chapter 14 discusses the various aspects pertaining to motivation of the sales force and describes the theories of motivation, the effect of personal characteristics on motivation, and explains the sales motivational mix and motivation required at different stages in the career of a salesperson. Chapter 15 examines the leadership issues in sales management and describes the leadership styles of sales managers and the skills required to effectively lead the sales force. Chapter 16 on evaluating sales force performance describes the determinants of sales force performance and discusses the criteria and methods for evaluating sales force performance.

Part IV, titled Distribution Management, is divided into four chapters. Chapter 17 on logistics in sales and distribution describes the functions, technologies and strategic issues involved in logistics management and examines the challenges involved. Chapter 18 discusses the various dimensions of marketing channels and describes the evolution of channels, role of channel members, channel functions, aspects to be considered while designing market channels, types of channel flows, and the costs involved. Chapter 19 discusses the importance of channel integration, and types and benefits of vertical marketing systems and briefly explains horizontal marketing systems and hybrid channel systems. Chapter 20 discusses the various aspects pertaining to selecting, motivating, and evaluating channel members, and managing channel relationships.

Part V, titled Channel Control, is divided into three chapters. Chapter 21 discusses evaluation of channel performance. Chapter 22 discusses managing channel conflicts and the sources, types, and techniques of resolving channel conflicts. Chapter 23 discusses channel information systems and their impact on channel flow and channel member relationships.

Part VI, titled Channel Institutions & Future Trends, is divided into three chapters. Chapter 24 examines the various aspects associated with wholesaling, while Chapter 25 explains the aspects pertaining to retailing. The final chapter in the book, Chapter 26, discusses ethical and social issues pertaining to sales and distribution management.

SUMMARY

Sales is one of the most crucial functions of an organization. It is the principal, and often, the only revenue generating function in the organization. Sales has formed an important part of business throughout history and will continue to do so.

A constant evolution has been witnessed in the sales function from the early Stone Age, through the Iron ages and the Middle Ages to sales in the twenty-first century. The evolution of the sales concept can also be studied in terms of seven generations.

In addition to helping an organization achieve its business goals, the selling function performs various other roles such as enhancing knowledge pertaining to the internal and external environments, developing positive relationships with customers, suppliers and distributors, and negotiating with customers to sell the company's products profitably. Despite the crucial role the selling function plays in the growth of an organization, sales has a rather negative image associated with it. This can be attributed more to the misconceptions in the minds of the people rather than actual knowledge of the profession.

The major objectives of a sales organization are to increase sales volume, contribute to profits, and attain long-term growth. For an organization to be successful, it is essential to integrate the sales and marketing functions so that coordination of activities can be achieved.

Over the years, substantial changes have taken place in the selling environment, sparking a change in the sales function too. The various trends that have shaped the sales function include shorter product life cycle, longer, more complex sales cycle, reduced customer loyalty, intense competition among manufacturing firms, rising customer expectations, increasing buyer expertise, electronic revolution in communications, and the entry of women into the sales force.

Chapter 2

The Sales Organization

In this chapter we will discuss:

- Role of a sales organization
- Basis for designing a sales organization
- Types of organizations
- Types of sales force structure
- Sales culture

An organization is an arrangement or a framework of activities formed with the purpose of achieving certain goals. While some people think that an organization is a structure that can be developed with a one-time effort, the truth is that such development is a constant process dependent on the objectives and conditions in the business environment.

With rapid changes taking place in technology, customer preferences and competition, companies across the world look out for ways to gain an advantage over their rivals. To sustain themselves, organizations adopt various approaches like introducing a range of new products, implementing new manufacturing techniques, creating new channels of distribution and so on.

In the past, there wasn't much emphasis on sales organization. Recent studies and research have focused on the significance of sales organization or department in an organization's success. Sales organization is proving a useful way to gain competitive advantage and fulfil organizational objectives. This has prompted companies like IBM and Xerox to restructure their organizational structure giving primacy to sales.

A sales organization's main component is the sales force, which is guided and supervised by sales managers. The effectiveness of a sales organization depends on the efficiency of its sales force in increasing sales volumes, gaining market share and improving profitability. Sales personnel are closer to customers than employees in any other functional department. Large-sized sales organizations usually have a large number of sales personnel, sales offices in different locations and multiple levels of hierarchy. It is the sales organization that has direct impact on the revenues and profits of the overall organization and on employee compensation.

In this chapter, we will discuss the importance and role of a sales organization, the aspects that influence its design of a sales organization, the basic types of organizations and different sales force structures. The chapter also studies the importance, role and development of sales culture in a sales organization.

ROLE OF A SALES ORGANIZATION

To achieve success and customer and employee satisfaction, an organization must be able to match its structure, personnel relationships and activities with its corporate strategy. The role of a sales organization is important to achieve this match. The sales organization acts as a medium through which the sales manager achieves organizational objectives with the help of the sales force. A typical sales organization is mainly concerned with activities that are directly linked to selling. It must also handle the relationships between sales personnel and various sales accounts and between sales personnel and the organization. The sales organization has to create a selling environment that is conducive to motivating sales personnel to improve their individual and team performance. The exact role may vary depending upon the emphasis laid by the top management. If the emphasis is on a planning- oriented sales organization, the focus will be on analysis and development of effective organizational structures and streamlining of roles, responsibilities and reporting relationships of sales personnel. In other words, the activities and personnel are organized on the basis of the designed structure. If the emphasis is development, the focus will shift to creating programmes to improve working relationships, organizational climate, identifying appropriate leadership roles for particular situations, improving individual skills and formulating compensation plans. The stress is rather on people and their activities. Organizational structure is shaped according to the attitudes and behaviour of sales personnel.

The primary role of a sales organization is to increase shareholder value by improving the profitability of the organization. It also helps create goodwill for the company by ensuring that its sales personnel follow ethical practices of selling and give customer satisfaction by offering products or services that fulfil the customers' needs. A sales organization must also aid the achievement of corporate objectives; development of specialized selling functions and personnel and ensure coordination and balance, both among sales personnel and between sales and other management functions. It must streamline various selling activities to ensure maximum utilization of the sales force's time and costs. Let us now elaborate the specific roles of a sales organization.

1. **Permit Development of Specialists:** Rapid changes in the business environment, technological obsolescence and changes in customer expectations compel managements to gain in-depth understanding of all areas that affect the organization. This means that the company requires personnel who are specialists in these areas, are able to keep track of rapid changes and can devise appropriate methods to tackle competitive situations. The sales organization must also facilitate the development of specialists in sales management functions such as sales promotion, market research and consumer behaviour. The need for functional specialists increases as companies grow in size, as such growth is accompanied by a simultaneous increase in sales activities. Also, increasing size leads to the line of control becoming less distinct and there is less clarity in reporting relationships. The sales organization finds it difficult to handle additional task requirements under existing structures. In such circumstances, a different organizational structure has to be designed and responsibilities for specific tasks reassigned to those with expertise and ability to handle them. For example, when American Express Financial Advisors (AEFA), a division of American Express involved in selling financial products such as mutual funds and insurance, decided to focus on customer relationship as part of its long-term strategy, it arranged for 8000 of its planners (sales personnel) to undergo specialized training. It also empowered them with software skills to improve productivity and reduce response time. AEFA also redesigned its compensation scheme for planners by replacing commissions with a bonus for increasing customer satisfaction. This example makes it clear that a sales organization can facilitate the development of specialists or experts in different areas of sales management by designing appropriate structures, policies and processes.
2. **Achievement of Company Objectives:** The sales organization should help achieve the company's objectives by ensuring that the sales force structure and performance evaluation systems are in tune with overall corporate strategy. For example, if the objective is to increase market share, the sales organization's activities should be directed toward achieving this aim. For instance, to increase market share, the sales organization can decide either to increase the strength of its sales force or enter new markets. For example, Nestlé reorganized its sales organization structure so that direct selling teams from the company would call on the headquarters offices for key customer accounts instead of limiting themselves to the customer's divisional officer. The aim behind the reorganization was to enable the company and its customers to understand each other's objectives better, leading to a win-win situation.
3. **Achieve Coordination and Balance:** The sales organization must coordinate the various activities of the sales force. Sales personnel are involved in different selling activities such as making a certain number of calls per day to customers, making product presentations to them, etc. They are also involved in non-selling activities like relationship building with key customers. The sales manager must ensure that sales personnel are able to coordinate their selling and non-selling activities so that both are in alignment with corporate strategy. An effective sales organization makes such coordination easy, especially in a combination type of sales force structure. A reasonable span of control, where not more than five or six executives report to a superior, makes coordination and control simpler.. It also ensures structural balance and stability by ensuring that a high number of

reporting relationships is avoided. Also, no organizational member is overburdened. There should also be good coordination between line and staff functions as well as between sales and non-sales departments. For example, effective coordination between sales and finance helps the management to devise measures to monitor and control the expenses incurred by sales personnel. If the costs involved in selling a product offset the gross margins or net profit, achieving sales targets does not mean anything. The overall loss or profit is the key factor.

4. **Economize on Executive Time:** Proper designing of sales force structure and processes helps reduce time spent by the sales force on daily routine activities. For example, a product-based sales force structure allows sales personnel to show case a number of products to the customer in a single visit, saving the time of both parties. Similarly, a territory-based sales force structure limits the geographical area of sales coverage assigned to each sales person and helps reduce the time taken to travel between customers. The sales manager can also make use of methods like routing and scheduling to cut the time spent on non-potential activities. It is clear that the sales organization plays an important role in effective utilization of executive time.

BASIS FOR DESIGNING A SALES ORGANIZATION

Designing a sales organization is difficult in the present day business environment owing to increasing competition and ever-changing customer expectations. No set formula can be followed. Factors in the external environment, like target market segments and technology, along with internal factors, such as company objectives, culture, staffing activities, reward systems etc., influence the design of a sales organization. This influence has been explained in detail below.

Mission and Objectives of the Company: The sales organization’s design and activities must support top management strategies. Otherwise, there is a possibility that sales personnel act in contradiction to the strategies framed by the top management. For example, the sales personnel may concentrate on maximizing profits, while the top management focus may be on market development.

Target Market Segments: The sales manager must keep in mind the market segments in which the organization is operating. An awareness of market characteristics and customer needs in the target market is necessary to formulate the sales strategy (which is aligned to the corporate strategy) according to the said market. Fulfilment of the sales strategy is possible if the organization design supports it. For example, if the target market has a large number of similar or competitive products, the organization should opt for a strategy that focuses on developing long-term relationships with customers. A geographic or customer-based sales organization structure best suits the implementation of this sales strategy. Companies like Daimler-Chrysler planned their expansion programmes in Eastern Europe, a high potential market, through fully owned sales organizations. In small markets, Daimler operates through independent distributors. To sum up, target market segments are crucial while designing a sales organization.

Core Competence: The sales organization should be designed to help the company leverage its core competencies. For example, if a company’s core competency lies in introducing new products, the organization structure should facilitate streamlining of all activities to achieve this core competency. A horizontal organization structure with coordination between different functions such as production, marketing, finance and research & development will enable the company to develop and launch new products rapidly, outsmarting competitors.

Exhibit 2.1

Quasi-Sales Force

Over the last few years, some multinationals that have set up base in India have adopted a unique style to sell their products – direct selling. It involves a sales force structure that is entirely commission-based and whose personnel do not figure on company rolls. The distributors of the products (quasi-sales force) sell the entire range of the company's products. The company provides training on product knowledge and selling techniques to these distributors. Amway, Tupperware and Modicare are examples of companies that are operating successfully with this type of structure. Interestingly, Tupperware has an all-woman sales force to sell its products, which are primarily special containers used in the cooking and storage of food.

Adapted from "Catching On," Business India Intelligence, 06 January 1998.

Organizational Relationships: The sales organization should be designed keeping in mind the different hierarchical levels and reporting relationships within the department, as well as between sales and other departments. The sales organization design should complement the authority and reporting relationships within the company.

Flexibility: The sales organization design should be flexible so that it can adapt to changes in the external environment. If it is unable to adapt quickly to changes in the external environment, its ability to compete in the market place will be hampered. For example, if innovation is the core competence of a company, its inability to adapt before its competitors do so will result in it losing its competitive advantage.

Organizational Culture: Organizational culture can influence the design of a sales organization. Sales culture, a part of organizational culture, if not properly evolved, can eventually lead to poor efficiency of the sales force by affecting their motivation and satisfaction levels, skills and beliefs.

Size and Type of Sales Force: The size of the sales force depends on the resources allocated to the sales organization by the top management, and the costing method adopted by the organization. The management can have its sales force specializing in customer segments, product-lines or geographic territories. The sales manager must keep in mind the organizational resources, the corporate strategy and operations in various departments.

Terms of Employment: A sales organization can have three types of sales options in hand -- in-house sales force consisting of people who are paid a fixed salary, independent sales people or distributors' agents who sell products of several companies. Dow Corning has been using manufacturers' agents for nearly two decades to sell their products at lower selling costs. Lucent Technologies uses independent representatives to sell to small customers. Nowadays, many companies with a direct selling strategy have a quasi-sales force, i.e. people who serve as distributors for the company's products but are not on its rolls. The sales force of direct selling companies like Amway is an example of a quasi-sales force as explained in Exhibit 2.1.

Staffing Activity: The qualifications and behavioral traits required for a particular sales position depend on the type of product, customer and geographic location. For example, the sales person's knowledge of products and market segments assumes importance if the company's products are high-tech. These sales persons need to be either technically qualified or sufficiently trained to answer customer queries.

Compensation System: The type of compensation system adopted by the sales organization i.e., salaries and incentives given to sales personnel, should reflect the management's approach. For example, in a new company, the compensation system should focus on a straight salary method (refer Chapter 13) to motivate and retain sales personnel. A commission-based compensation system might discourage sales personnel, as it is difficult to achieve targets for a new product that is yet to establish itself in the market.

Market Orientation: The market orientation of a company can be understood from the management's emphasis on the customer's current and future needs. The sales organization design should complement the management's emphasis on customers. Market orientation also enhances sales force innovation and productivity. It helps the sales force understand that rather than just achieving a certain volume of sales in a specified period, understanding the right approach of selling to customers will help the company earn goodwill.

Technology: Technology too influences the design of a sales organization. It has a bearing on the kind of investment made for training and developing its sales people. Investment in technology may be in the form of providing automation tools to the sales force, implementing e-CRM programs etc. If the organization plans to enter high-technology mature markets, to succeed, it is essential to provide its sales force with advanced automation tools. Companies are also using the Internet to improve sales and profitability. Dell Corporation has reaped the benefits of using advanced technology. Using e-commerce, Dell does $40 million worth of online business everyday.

Company Size: If the company is small sized, it cannot have a product, geographic and combination-based sales force structure because of limitations in resources and personnel. As the company evolves, the scope for having a complex sales force structure increases.

TYPES OF ORGANIZATIONS

The three structural variables that form the basis on which organizations are classified are formalization, centralization and departmentalisation.

Formalization**:** Formalization refers to the extent to which the roles, authority, organizational procedures, communication and reporting relationships in an organization are influenced by its rules and policies. It depicts the extent of rigidity or flexibility in the organization.

Centralization**:** Centralization refers to the level of consolidation of decision-making authority and the span of control in an organization.

Departmentalisation: The allocation of activities to various departments is known as departmentalisation. It is one of the earliest concepts in management theory.

Based on these three criteria, four types of organizational structures can be described. They are:

- Formal and informal organizations
- Horizontal and vertical organizations
- Centralized and decentralized organizations
- Line and staff organizational structure

Formal and Informal Organizations

Organizations need a definite structure to carry on their activities smoothly and survive in competitive marketplaces. When the top management prescribes the tasks to be carried out, the organization structure is known as a formal organization structure. Project teams and committees form part of formal organization structures.

Moving to informal organizations, studies conducted in the 1930s at the Western Electric Plant revealed the value of informal relationships in accomplishing organizational tasks. The concept of informal organizations came into the limelight. An informal organizational structure comprises of a network of personal and social relationships between personnel within an organization. Let us describe these two types in more detail.

Formal organization: Formal organizations have rigid structures and reporting relationships, which sometimes result in poor flow of communication. The bureaucratic structure of formal organizations makes them inflexible and slow. Such a structure creates barriers between the organization and its customers, because the sales force is not allowed to modify or make changes in the selling approach according to situational demands. For example, it might become necessary for a sales person to offer an additional discount to a particular customer to retain business. In a formal organization structure, the sales person will most probably lack the authority to do so without directions from the sales manager. Such inflexibility can lead to delay in closing the deal and subsequent loss of business. However, this does not mean that formal structures have no benefits. Let us look at some of its advantages.

Advantages of a formal organization structure:

1. Clear-cut reporting relationships, a characteristic of a formal organization, help avoid confusion and overlapping of activities.
2. It is easier to evaluate sales force performance according to set criteria and methods of evaluation.
3. There is a structured and defined format to perform every task.
4. Clearly defined policies, procedures and hierarchical relationships allow sales personnel to have a clear idea of organizational expectations.

Some drawbacks of formal structures have been mentioned. Let us study some more.

Disadvantages of a formal organization structure:

1. In a formal organization structure, due to extensive departmentalisation, sales personnel are confined to performing activities pertaining to their functional area. There is little opportunity for them to involve themselves in activities other than selling. This tendency to limit the activities of personnel to a single functional area reduces the scope to form cross-functional teams. It also rules out leveraging of information and competencies. So, organizational members in a formal organizational structure fail to develop cross-functional expertise.

2. The rigidity in reporting relationships impedes the smooth flow of communication. It leads to lack of flexibility, making it difficult for the organization to respond to sudden changes in the external environment. The flow of communication becomes mostly upward and downward, with very little lateral communication. In a formal structure, even if a sales person possesses information about a competitor’s plan to launch a series of new products in the market, this information cannot be passed on directly to the R&D department. He or she can only give the information to an immediate superior and it is left to the superior to communicate it to the top management. Information flow is slow; there is a resultant delay in organizational response.

3. Formal structures prevent personal contact between superiors and subordinates because of notions of hierarchy and authority. These differences in hierarchy may extend into the employees’ social life as well and rule out the development of personal relationships. Employees working in formal organizations tend to maintain the same attitude and personal distance among themselves in their social life too.

Informal organization: An informal organization does not have a rigid hierarchical structure, set communication channels or reporting relationships. Though the formal structure lays down procedures on how work is to be done, it is the informal organization that determines how the work is actually done. Informal organizations are unavoidable in companies. Therefore, managers should learn to make full use of informal organizational structure to achieve organizational goals. For example, a sales manager must understand the leadership style of informal leaders, the personal values and defined norms of behaviour in informal groups and use these to achieve sales targets.

Informal organization structures allow informal relationships to develop between people who are not directly linked to each other in the organizational chart. Many times, it is such informal and personal relationships that help to get things done quickly. Let us elaborate on the advantages and disadvantages of an informal organization structure.

Advantages of an informal organization structure:

1. An informal organizational structure helps sales personnel redefine responsibilities and relationships among themselves, leading to better performance. Such a structure consists of informal groups within the organization. These groups may include personnel from different departments. The interaction between these people helps in the learning of happenings in other parts of the organization. For example, sales personnel may obtain information about competitor moves on products being manufactured, from another division of the organization, say the production department. An informal network will ensure that the information is directly passed on to the sales manager of the concerned division instead of going through long and cumbersome formal reporting channels. This reduces the response time the organization needs to come up with a strategy to counter the competitor's moves.
2. Informal organizational structures help develop positive norms and values within the organization by encouraging shared decision-making and instilling personal interest in achievement of organizational goals. For example, sales personnel frequently help colleagues in preparing quotations, provide leads about customers and guide new entrants in their territory though it is not formally required for them to do so. A shared approach toward selling develops a sense of belonging and encourages team spirit.

Disadvantages of an informal organization structure:

1. An informal organization within a company may not support the goals and objectives established by the overall formal organization. Informal groups may be interested in promoting personal interests rather than achieving organizational objectives.
2. As informal relationships develop spontaneously, it may lead to informal leaders wielding an unhealthy control over group members. This influence or control may be detrimental to organization interests and may even lead to conflicts between hierarchical levels.

Vertical and Horizontal Organizations

Organizations can also be classified into horizontal and vertical structures based on the number of hierarchical levels present in the organization and the span of managerial control.

Vertical organization: A vertical organizational structure is a traditional management structure with authority being the basis of control. Vertical organizations have more hierarchical levels. This results in a narrow span of control for managers. The management holds the power of decision-making, strategy formulation, control and allocation of capital. It directs resources and responsibilities down to frontline sales personnel.

Exhibit 2.2

WIPRO Shifts to a Vertical Organizational Structure

Wipro has revamped its organizational set up by shifting towards an industry-driven vertical organizational structure. It has aligned itself into different business units, each providing services and solutions to specific industry segments. The units have been termed retail vertical, energy utilities vertical, manufacturing vertical and health sciences vertical. With this new structure, Wipro Wipro intends to sharpen the business acumen of its sales force in each business unit by providing them in-depth knowledge about the specific industry they are operating in. The aim is to enable them to act as independent consultants and not just as sales personnel. The popularity of this type of organizational structure in the US, particularly in the technologically dependent IT industry, prompted Wipro to adopt the same structure for its domestic operations.

Adapted from Kavita Nair, "Wipro to Adopt US model in Sales Force Makeover," Financial Express, 13 October 2003.

A sales organization with a vertical structure is characterized by many rules and regulations, a strict hierarchical framework and few teams and task forces. Although this is basically a traditional management structure, modern organizations like Wipro have adopted it to have an industry-driven organization structure and meet its customer needs better. Exhibit 2.2 describes the vertical organizational structure adopted by Wipro.

Advantages of a vertical organizational structure:

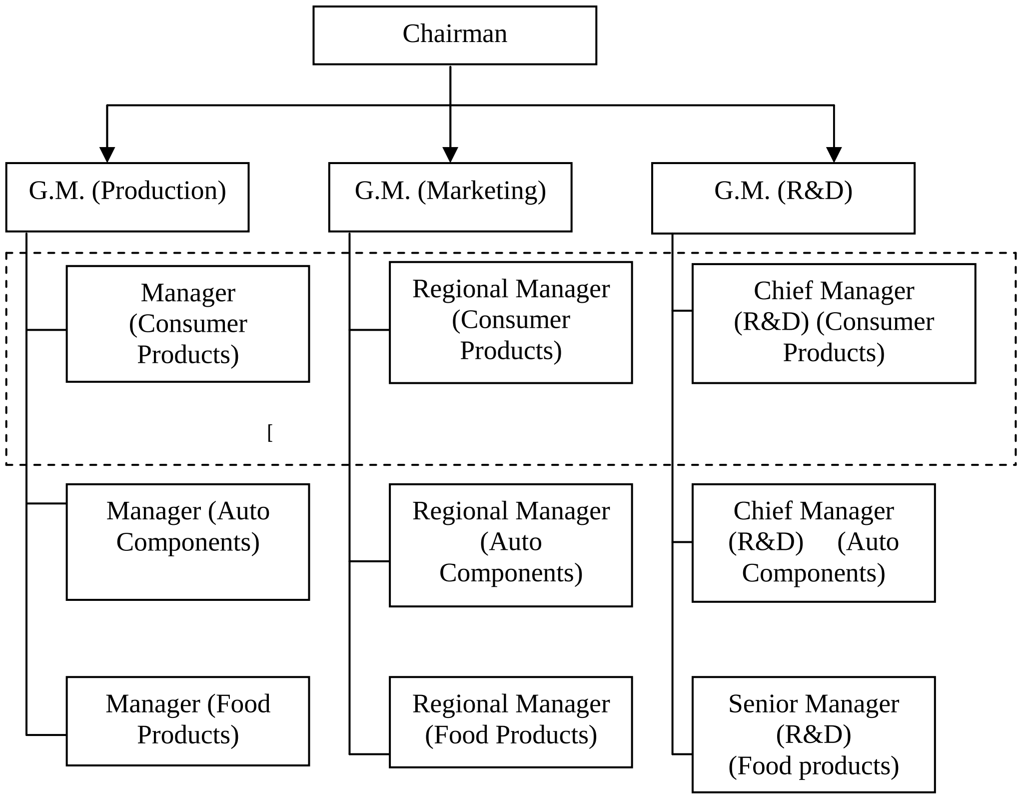
1. In vertical organization structures, work is first organized on the basis of functions, next on the basis of departments, and finally on the basis of tasks. Therefore, functional excellence is the most significant advantage of a vertical organization structure.
2. As a vertical structure has a smaller span of control, the possibility of information loss down the hierarchy is reduced. This is especially beneficial when constant flow of information from top to bottom and vice-versa is essential to success.
3. The smaller span of control leads to less chances of duplication of authority and better control over activities of subordinates.

Disadvantages of a vertical organizational structure:

1. A vertical organizational structure has many hierarchical levels. Therefore, such organizations spend more on maintaining the additional staff required to fill various posts. Likewise, the higher number of hierarchy levels makes it difficult to coordinate various departmental activities.
2. The presence of many hierarchy levels complicate the communication of objectives, policies and plans because of the possibility of misinterpretation due to information changing several hands. The large number of departments in organizations with a vertical structure also makes planning and controlling complicated. For instance, a plan made by the top management may lose its clarity as it percolates down to various levels of the organization for implementation.

Horizontal Organization: A horizontal organization is one in which both management levels and departmental boundaries are reduced greatly. In the traditional vertical structure, departments are organized as per functions such as sales, marketing, finance, human resources, etc. On the other hand, horizontal organization structures are built around natural work flows. Figure 2.1 gives a graphic representation of a horizontal organization structure.

Figure 2.1: Horizontal Organizational Structure



Source: "Teams Used for Horizontal Coordination at Rodney Hunt Company". <u><http://www.unf.edu/~gbaker/Man4201/Chapt003a.PDF></u>

The focus in horizontal structures is on meeting customer expectations. To achieve this, work is organized around company-wide processes rather than on the basis of departments, functions or tasks. Cross-functional teams are common in such organizations. A cross-functional team-based approach helps overcome the barriers of departmental boundaries. In cross-functional sales teams, reporting relationships, flow of communication, delegation of authority, resources etc., are directed across different sales units or departments within the organization. Many companies have improved their performance significantly by switching to a horizontal organization structure. For example, GE Appliances reduced its inventory by $200 million and Hallmark Cards cut product development time by 50 per cent after they adopted a horizontal organization structure.

Further, policy initiatives and decision-making in a horizontal organizational structure are lateral rather than hierarchical. In a horizontal organization, employees have an opportunity to share responsibility and make decisions that help achieve organizational objectives. To illustrate, in a horizontal organization, policy initiatives such as Total Quality Management (TQM) involve not only research personnel but also sales teams/units in improving the quality of the company's products and activities. This leads to an increase in efficiency and motivation levels of the sales force.

A horizontal organization structure encourages innovation and entrepreneurship. In Minnesota Mining and Manufacturing (3M), a spirit of entrepreneurship flows across all levels of the organization.

Exhibit 2.3

Customer Service at Ford Goes Horizontal

Ford was one of the first few organizations, which decided to change its organization structure. Ford decided to go in for a horizontal restructuring of its customer service division to focus efforts on increasing customer satisfaction. It organized the customer service division around four key processes -- giving the right service the first time, developing quicker ways to fix cars, reorienting customer handling and dealer support systems, and designing cars that facilitate easier service or repairs.

From its previous structure, Ford retained some departments, like employee relations, where expertise was necessary. Further, to increase dealer support, Ford decided to simplify its interaction with them. It trimmed down its field team totalling 25 (including parts specialists, marketing incentive specialists, and many others), to just three, consisting of an operations manager, an engineer and a customer service representative. In doing this, Ford wanted to make things easier for dealers by cutting down the number of people they had to interface with.

In the new horizontal structure, managers of different departments in conjunction with people from the finance department decide on resource allocation. This eliminates competition for resources between managers from various departments and leads to greater cooperation between work teams.

Adapted from Rahul Jacob and Rajiv M. Rao, "The Struggle to Create an Organization for the 21st Century," Fortune, 4 March 1995, Volume 131, Issue 6, 90.

The number of organizations with a horizontal structure is on the rise with many MNCs adopting this structure to increase emphasis on long-term customer relationships and develop team culture. Exhibit 2.3 describes the horizontal organization structure at Ford.

Advantages of a horizontal organization structure:

1. A horizontal organization structure reduces the number of hierarchical levels between the top management and lower level employee. This reduction greatly cuts costs.
2. This structure helps organizations to respond to market changes faster due to less number of hierarchical levels.
3. A horizontal organizational structure facilitates teamwork and collaboration among employees.
4. It helps improve decision-making in an organization. It offers employees at lower levels the freedom to make decisions and share responsibility and contribute towards achievement of organizational objectives.
5. By eliminating too many levels of hierarchy, a horizontal organizational structure provides flexibility and reduces response time in addressing customer requirements.

Disadvantages of a horizontal organization structure:

1. Horizontal organization structures involve trimming the number of hierarchical levels. However, excessive reduction in levels may result in the organization losing people with experience and expertise. This, in turn, would result in the organization losing competitiveness.
2. A horizontal organizational structure is not suited for all operations in an organization. Deciding which operations are most suited to have such a structure is difficult and time-consuming.
3. As employees work in cross-functional teams, they have to be trained on teamwork. Training employees requires investments.

Centralized and Decentralized Organizations

Organization structures can also be classified on the basis of delegation of authority, into centralized and decentralized organizations.

Centralized organization: A centralized sales organization is one where there is a common sales force to sell the products of more than one division of the company. A centralized organization typically consists of a corporate headquarters and various divisions under it. The authority and decision-making power lies entirely with the top management, which controls all organizational activities like recruitment, training, and performance evaluation. This type of structure is common in small firms because the size makes it easy for the top management to supervise, control and ensure smooth flow of operations. A centralized organization structure is well suited when the products too are sold in similar markets.

In a centralized sales organization, the sales force may not be given the authority to take decisions. This makes it difficult to for them to act independently and convert new prospects into customers. They also lack the freedom to make concessions to customers in the form of higher discounts to retain them and induce them to make repeat purchases. Let us now look at the advantages and disadvantages of this type of structure.

Advantages of centralized organization structure:

1. Since decision-making is restricted to the top management, it is easier to align sales force activities with the corporate mission and objectives.
2. A centralized organization structure is suited to small-sized organizations as it allows the top management to monitor and control all activities and operations.
3. There is no conflict between different functions because decision-making is centralized and there is no possibility of difference of opinion.
4. An organization with a centralized structure has a centralized sales force. This is economical as it eliminates the need for a separate sales force for every product, territory or market.

Disadvantages of a centralized organization structure:

1. The retention of all authority by the top management inhibits skills development in sales personnel.
2. In this structure, top management approval is necessary for all actions. This increases the response time of the organization, which may irritate the customer.
3. The decision-making authority rests with the top management. So, decisions might be taken without consulting sales personnel or taking their opinion. This could affect the latter's morale and fail to address problems at the sales front.

Decentralized organization: A decentralized sales organization is one in which each division within the organization has its own sales force to sell the products of that division alone. The top management delegates authority and resources to lower levels of the organization. The sales department functions as an independent entity and the sales force has the freedom to independently take decisions pertaining to sales accounts. This structure is suited for large organizations where it is not possible for the top management to supervise all activities and for markets that differ from each other considerably.

Advantages of decentralized organization structure:

1. Decentralization allows the sales force to take decisions on its own, based on the information it possesses, experience and judgment. Decentralization leads to better utilization of information and personnel skills at the lower levels of the organizational hierarchy.

2. This structure places the responsibility of formulating strategies on those who are closer to the scene of action. It helps increase the morale and job satisfaction of these personnel and motivates them to function with greater enthusiasm and zeal.
3. The structure allows organizations to capitalize on the expertise and knowledge of divisional managers or managers of business units with regard to products, markets, competitors and customers in the local market.
4. There is greater flexibility and the organization can adapt itself according to requirements and changes in the local business environment.
5. The top management can focus on more strategic issues instead of monitoring routine matters.
6. As decisions can be taken at the divisional level rather than referring everything to the top management for approval, the response time of the organization is reduced. Such organizations can respond to environmental changes, counter threats and seize opportunities much faster.
7. A decentralized organization structure encourages innovation and risk-taking in divisional managers thanks to greater resource autonomy and fewer regulatory controls. The managers feel confident as faith has been placed in them.

Disadvantages of decentralized organization structure:

1. A decentralized structure increases the organization’s costs. Maintaining a sales force for every division hikes overhead costs.
2. This structure places the responsibility for achieving organizational goals on divisional managers rather than on top management. This can lead to organizational inefficiencies because of competition between various divisions. Competition can also cause non-cooperation between divisions, which will harm the organization.
3. There may be a loss of control over divisional managers by the top management. The former may tend to misuse their autonomy by placing more importance on the objectives of their own division rather than on organizational aims.
4. The top management in a decentralized organization structure might often be unaware of ground realities on the sales front. This makes it difficult for the top management to address problems faced by the sales personnel.

Line and Staff Organizations

Line functions involve all activities that directly contribute to creating, developing and delivering an output. They are directly related to the achievement of organizational objectives. Production, marketing, sales and finance are examples of line functions. Staff functions, on the other hand, are of a supportive and consultative nature. They support line functions and, their contribution to reaching objectives is indirect. Human resources activities such as hiring, staffing, training and compensating sales force are examples of staff functions.

While deciding the sales organizational design, awareness of line and staff relationships is necessary to avoid confusion and disruption in selling activities. In a sales organization, all primary activities related to selling, such as personal selling, sales planning, sales forecasting, budgeting and assigning sales territories, come under the line function. All related non-selling activities like gathering information, sales training and sales advertising are supporting or staff functions. A line organization is the simplest form of organization, in which authority flows from the top to the lower levels. The field sales force reports to a sales manager who reports to the sales/marketing director. This arrangement is known as line arrangement. A line organizational structure can exist in very small companies or within small- sized sales departments within large organizations.

Advantages of a line organization structure:

1. A purely line sales organization is less expensive and facilitates easier coordination of activities as it has a very simple structure with clear-cut demarcation of positions, authority and responsibilities.
2. It helps quick decision-making because of a well-defined hierarchy.
3. It prevents conflicts from arising due to differences in thinking between personnel in charge of different functions.

Disadvantages of a line organization structure:

1. Decisions made by sales managers may lack the staff perspective. This can cause problems like unsuitable recruitment and training of personnel, inappropriate compensation and other human resource problems. Decisions on such things should be left to HR personnel who are specialists in this field.
2. It is very difficult for a line manager to handle multiple activities because of their inherent complexity. While handling multiple activities, the line manager may get too involved in operational matters and lose the strategic or competitive focus.

Nowadays sales organizations do not opt for a purely line structure due to many reasons. First, front-line sales personnel have too much responsibility. Next, since there is no staff function to assist them, sales managers have to oversee activities other than selling, like market research, which can take away focus from their core competence. The line and staff type of organizational structure is probably the most common and popular form of sales organization structure today. It has the added advantage of staff specialization where activities not directly related to selling, like market research and advertising, are handled by qualified people. . Generally, companies that have a large sales force, a wide range of products to be sold and which operate in various markets adopt this type of structure.

Unlike in line organizations, where the field force reports to a sales manager who, in turn, reports to the sales/marketing director, in a line and staff organization, reporting relationships vary according to the importance of staff activities. For example, in a conventional sales organization, the sales personnel report to the sales manager. In a sales organization having both line and staff personnel, sales personnel may report to an AGM (Assistant General Manager) or a Regional manager, who may not be associated with the sales department.

Figure 2.2 gives a diagrammatic sketch of a line and staff type of sales organization structure.

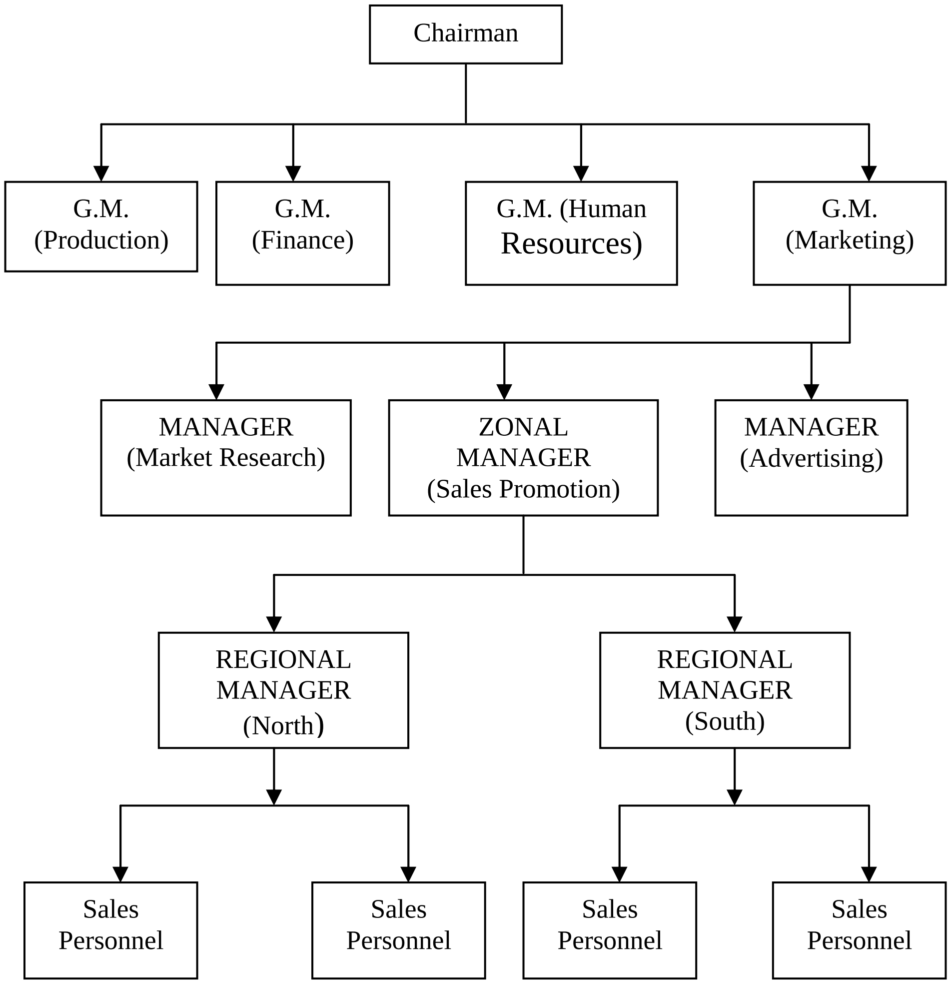
Let us now discuss the advantages of a line and staff organization structure*:*

1) The presence of staff personnel adds expertise and a staff perspective to strategic decisions made by sales managers. This improves the quality of decisions.
2) This type of structure is best suited for organizations with few products. This is because, with a large number of products, there is possibility of coordination going haywire and also an increase in conflicts between various functions.
3) This type of structure is also suited for organizations operating in a stable environment because any change that is initiated will take place very slowly.

Let us now analyse the disadvantages of a line and staff organization structure:

1. In a line and staff organization structure, the probability of problems arising is high because of conflicting objectives of line and staff personnel.
2. Lack of coordination between different functions may lead to dilution of focus on the customer.
3. Each function may try to further its own objectives, resulting in organizational goals being ignored.
4. If there is poor coordination between departments, the chances of innovation of products and processes is reduced.

Figure 2.2: Line and Staff Structure



TYPES OF SALES FORCE STRUCTURE

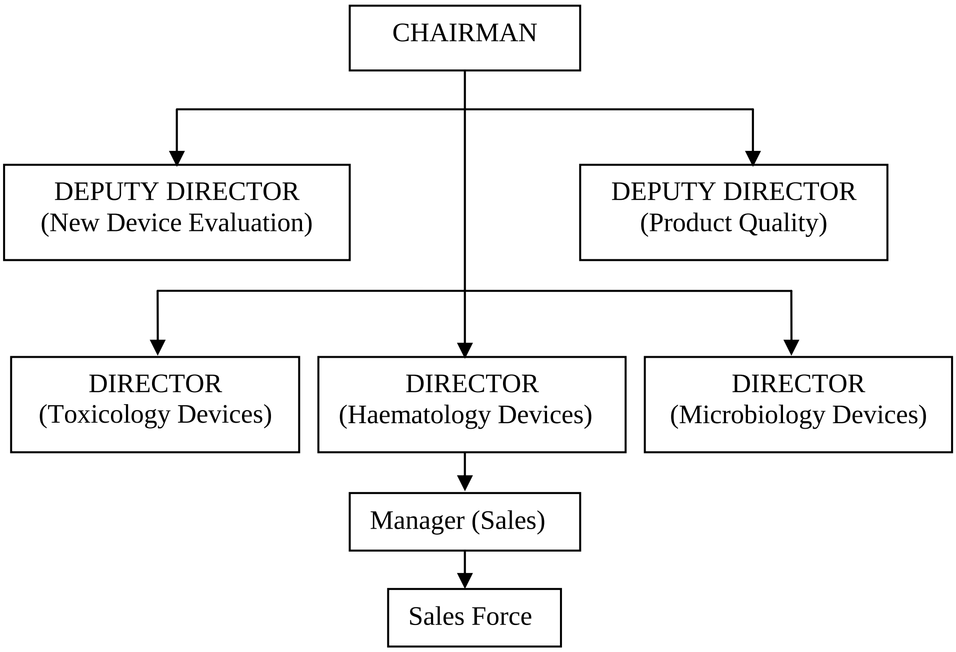
Developing a successful sales organization involves adapting organizational processes and structure to meet the demands of the ever-changing market place. A company decides on a particular type of sales force structure depending upon factors such as type of market (developing or fully developed), region or country, type of industry being operated in, customers to which it caters, level of sales desired, size of the sales force and the width and depth of the product mix.

On the basis of these factors, there can be four types of sales force structure – product-based structure, geographic structure, customer-based structure and combination structure. Usually organizations select the type by weighing the profits that can be accrued from each structure against the costs involved in coordinating the sales effort using that structure. They then choose the best option.

Product-based Sales Force Structure

In a product-based structure, sales force responsibilities and activities are divided according to the type of product sold. There can be a single (product/product line) sales force or a multiple (product/product line) sales force. This structure is suited for companies that manufacture a variety of complex technical products or products that are dissimilar and unrelated. 3M corporation uses separate sales personnel to sell its wide range of product lines. IBM and Xerox have also switched over from a divisional type of sales force structure to the product type. However, while adopting this type, care should be taken to avoid duplication of the sales effort. Figure 2.3 gives a diagrammatic representation of a product-based sales force structure.

Figure 2.3: Product-based Sales Force Structure



Source :< http://www.fda.gov/cdrh/oivd/org/orgchart.gif>

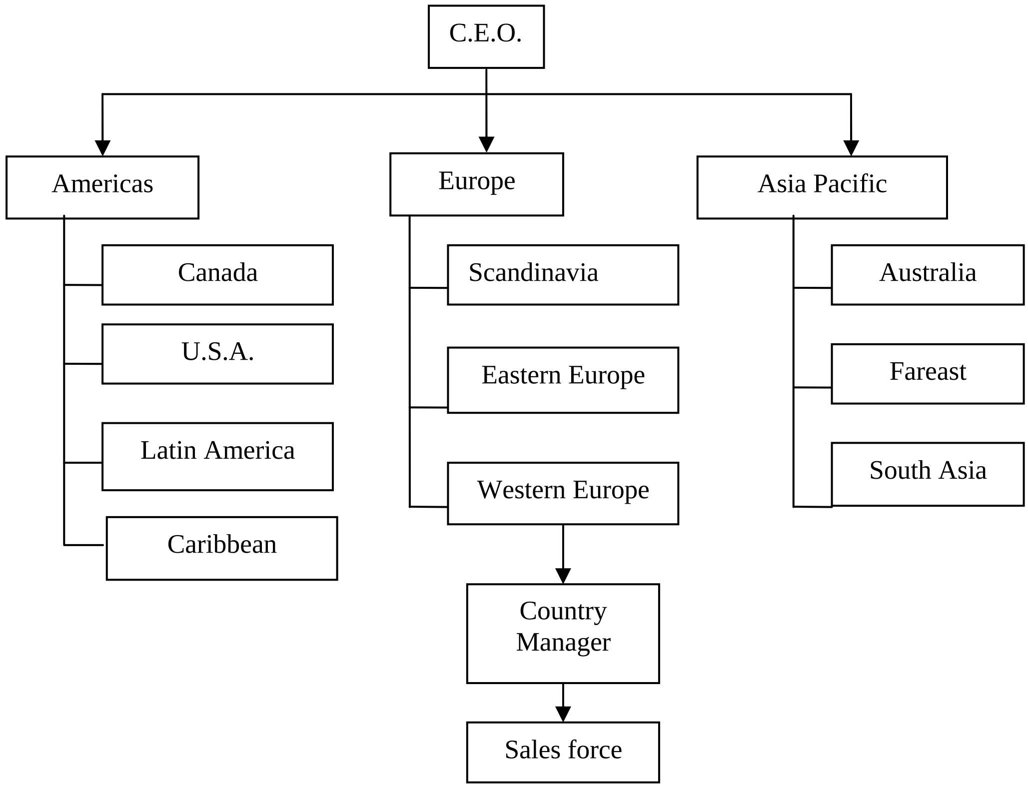
Advantages of a product-based sales force structure:

1. In this type of structure, since the sales person simultaneously handles more than one product and can promote many products in a single sales call, it reduces the frequency and number of calls the sales person needs to make on a customer.
2. This structure is suitable when purchase rates and frequency of buying are high and customers buy from a set of closely related and complementary, competing products.
3. When the territory assigned to sales personnel is large and a lot of time is spent travelling to clients, a multi-product based sales force structure reduces costs and saves time.

Disadvantages of a product-based sales force structure:

1. There is a possibility of duplication of activities at the corporate and regional levels in the organization due to sales personnel handling multiple products. If the products to be sold by the sales persons are not clearly defined, there is a chance that more than one sales person may approach the same customer with a particular product.
2. There is also the possibility of clash of objectives between the product division and the top management. Sometimes the former's aims may not be in the strategic interest of the organization. For example, there can be conflict of objectives if the product division follows a market skimming strategy to earn rapid profits at a time the organization is planning a frontal attack through a price war.

Figure 2.4: Geographic based Sales Force Structure



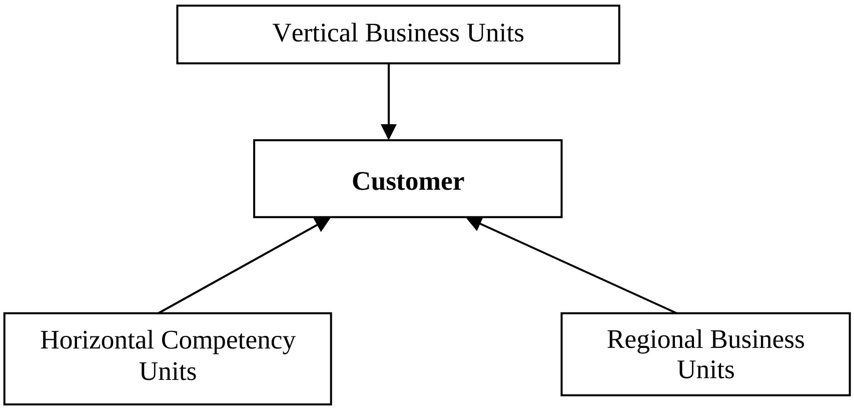
Geographic-Based Sales Force Structure

In a geographic sales force structure, the sales force is grouped by physical territories. It is the most widely used system in dividing responsibility and authority among sales forces. Each sales person is assigned a separate geographic territory and each territory is headed by a regional or a zonal manager. This structure is suited for companies that have mature product lines with several products targeted at the same market. It is also ideal for companies that manufacture products with a high degree of similarity. Generally, pharmaceutical, automotive and FMCG companies prefer this type of structure. Figure 2.4 gives a diagrammatic representation of a geographic sales force structure.

Advantages of geographic sales force structure:

1. It reduces time and expense on travel because sales personnel are based in their respective territories and limit their sales efforts to that region.
2. It is the simplest method by which a company can equalize territories among sales personnel, in terms of current and potential business. It helps companies to delegate responsibility among sales personnel equitably and ensures coverage of the entire market.
3. Every sales person has an assigned territory and customer base. This helps the company and its sales force to meet local requirements better and make changes to suit local conditions. This contributes to better relationship building and customer satisfaction.

Figure 2.5: Customer-based Organizational Structure



Source: www.satyam.com/about satyam/a_moreaboutur.html

Disadvantages of geographic sales force structure:

1. The sales personnel lack specialized training pertaining to the product and may not be as efficient as their counterparts in a product-based sales structure. As the sales personnel will handle many products in a territory, there is less chance of their developing competency and technical expertise for products.
2. In a geographic structure, local managers lack supporting staff for non-selling activities like market research, advertising and sales promotion. Doing these jobs is an additional responsibility for the local managers. This can lead to loss of focus on specialized marketing activities.
3. Sales personnel are limited to their respective territories, leading to poor coordination of sales efforts across different product lines. This makes integration and standardization of selling activities across product lines difficult.

Customer-based Sales Force Structure

In this type of structure, the sales force is divided on the basis of customer needs. This structure is preferred when specific customer groups require special attention due to differences in their needs. Figure 2.5 gives a diagrammatic representation of a customer-based sales force structure.

In the pharmaceutical industry, organizations adopt a customer-based sales force structure to target customers in different market segments. For example, Merck along with Astra AB has formed Astra/Merck to sell drugs. The new organization has a much smaller sales force than a typical pharmaceutical company. It has only three levels of hierarchy between the CEO and front-line sales people. Based on customer requirements, the sales force sells products belonging to either company. Asea Brown Boveri (ABB) is another example of a customer-based organization. In 2001, ABB reorganized itself around customer groups to increase the pace of growth in a globalized market. It divided the business groups into four customer segments – Utilities, Process industries, Manufacturing and Consumer industries, and Oil, Gas & Petrochemicals. ABB was among the first in the industry to organize itself around customers rather than technologies. To build strong customer relationships, many organizations have advanced to using strategic account management. In such a sales force structure, sales personnel are allotted a certain number of high potential customers with the potential to bring big business to the company. The sales personnel concentrate exclusively on meeting customer requirements with tailor-made sales programmes.

Minnesota Mining and Manufacturing (3M) established a strategic account with IBM Storage, a division of IBM, which manufactures hard disks for computers. Fifteen different divisions from 3M studied the processes at IBM Storage. After the research, the 3M personnel were able to provide effective solutions to IBM Storage to help it improve profitability. This led to an increase in 3M's business with IBM Storage from $ 1 million to $10 million.

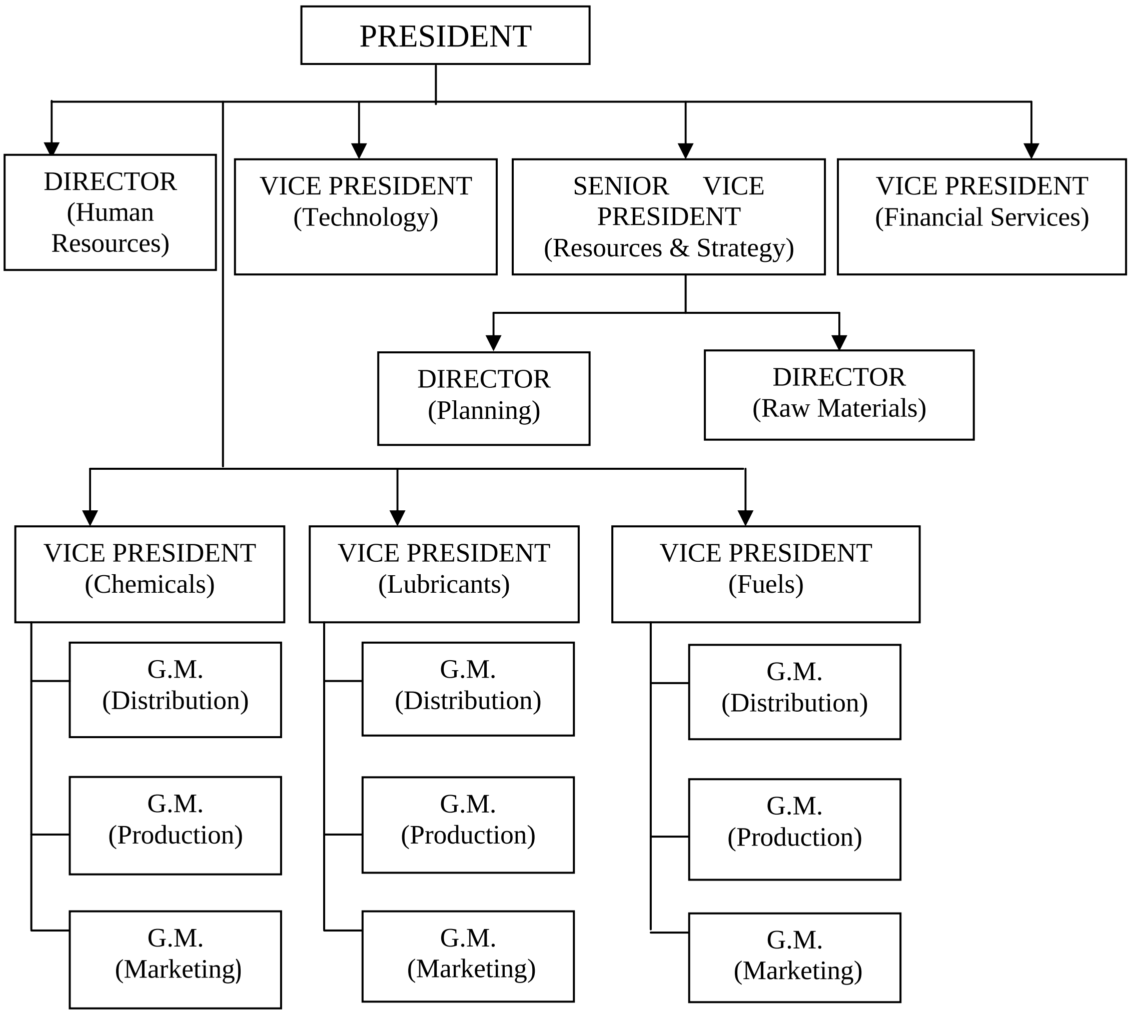
Advantage of a customer based sales force structure:

1. This structure is advantageous when the company has a wide range of products to offer to customers. A customer-based sales force will be able to accurately assess customer needs and offer those products, which will meet customer requirements.

Disadvantages of a customer-based sales force structure:

1. In a customer-based sales force structure, the sales function and the finance and production functions may have difference emphasis, resulting in lack of coordination.
2. Further, some sales personnel may pressurize the management for special favours like higher discounts and credits tailor-made to specific customers. This can lead to dissatisfaction among other sales personnel. Giving such extra concessions to some sales persons makes it difficult to uniformly evaluate the sales force.

Figure 2.6: Combination-based Sales force Structure



Combination-based Sales Force Structure

A structure that combines various types of structures and takes the best of each structure's individual merits, while eliminating the demerits associated with it, is called a combination-based sales force structure. Nowadays, companies are adopting a mix of product, customer and geography-based sales force structures. This is effective for companies with a large sales force, a wide range of products and widely dispersed customers. Figure 2.6 gives a diagrammatic representation of a combination-based sales force structure.

As companies grow, more product lines are introduced, new markets are tapped, and the geographic and product-based sales force structures lose their efficacy because of coordination and control problems. In such circumstances, the combination-based structure is well suited as it can support a specialized sales force in large, high volume markets. Philips has a combination structure in the form of a 5-tier organization with 14 product divisions, a global product service organization, a central management board overseeing all operations and a regional bureau coordinating major geographic operating units.

For a company using a combination structure, it is essential to have collaborations and networking relations between various departments and business units. Otherwise, there may be differences if various departments have different objectives. For example, pricing decisions for products would be different for a geographic-based and customer-based sales force, especially in discounts offered. The former may have to offer higher discounts to retain customers than the latter, where meeting sales target is more important than customer retention.

Advantages of a combination based sales force structure:

1. A combination-based sales force structure offers flexibility to handle diverse product lines, operate in territories with varying potential and operating conditions and cater to customers having diverse needs. The appropriate structure can be used based on the variation in product lines, territories and customers.
2. Thanks to the adaptability and flexibility of this structure, balance can be maintained between corporate and divisional goals. This may be absent in a purely product or customer-based sales force structure.
3. This structure combines the advantages of all other structures while taking care to avoid their shortcomings.

Disadvantages of a combination-based sales force structure:

1. A large number of staff with specialized skills is required to handle different functions within the organization. This means high administrative costs.
2. It may be difficult to coordinate different structures within the combination-based sales force structure because of differences in operational styles. There is a potential for conflict to arise over allocation of resources between various functional and divisional departments.
3. If the top management formulates a new corporate level strategy, it may take a long time for individual structures within the combination to respond and implement at the operational level. This is because of the complex inter-relationships between various structures.

Companies are no longer relying totally on traditional sales organization structures to sell their products. Along with existing structures, they are using the Internet Selling System, a new technology that helps companies derive maximum advantage from the Internet's potential. Exhibit 2.4 describes the use of this technology in selling.

Exhibit 2.4

The Internet Selling System

Following increasing global competition and differences in consumer tastes, many corporations have started looking for alternate ways to shore up sagging revenues. A preferred alternative is to sell products and services over the Internet using B2B websites. Such websites have become a part of the selling technique for many companies. Companies like Cisco Systems, the global networking giant, are making use of a new artificial intelligence-based technology known as Internet Selling System. The Internet Selling System is a specialized software tool, which uses artificial intelligence to provide accurate and relevant need-based information to customers and help them select products suited to their requirements. Its efficiency lies in the fact that it can deliver exactly what the customer wants. It interactively assists customers by identifying, selecting, pricing and preparing quotations, apart from fulfilling their service needs. It is also highly cost efficient in comparison to maintaining a large sales force across countries and markets.

Will this technology pick up in India? Will electronic selling systems dominate the way companies sell products to customers? Is the efficacy of the sales person under threat? These are pertinent questions that await answers down the line, especially as India is a country, which has to provide jobs to a large number of people.

Adapted from B.N Kumar, "Perfecting Sales Systems," Business India, 16 October 2000.

SALES CULTURE

Culture is a set of values and beliefs that pervades all levels of an organization. It is a shared assumption of the moral, social and behavioural norms an organization follows, based on the beliefs, attitudes and values of its members. Every sales organization has a unique culture that is created unconsciously, based on the values and beliefs of top managers. Sales culture can be successful only if sales personnel imbibe it and accept it. Many companies have created sales cultures that have become their core competence. For example, Xerox has a culture that is based on respect for the individual and service to the customer. Similarly, Hewlett Packard has a culture ("the HP way") that is based on – respect for others, community spirit and hard work.

Sales culture directly affects sales personnel by impacting many areas of sales management. It motivates sales personnel to share the vision of the organization and affects various business outcomes like productivity, profitability and customer loyalty. There is also a significant but hardly acknowledged impact of sales culture on employee retention. Therefore, sales organizations must have an extensive understanding about different aspects of sales culture and its influence on the sales force. The example of Dow Chemicals illustrates the importance of understanding and preserving the sales culture in organizations. In Dow Chemicals, initially, specialty chemicals units formed a part of the bulk chemicals division. When the management realized that the bulk chemicals culture was dominating and negating the culture of the specialty chemicals units and its sales force, it decided to group all specialty chemicals units under one division. This enabled the preservation of the sales culture of the specialty chemicals units. Significantly, it gave the sales force of these units the freedom to adopt selling techniques suited to their branch of the industry.

Components of Sales Culture

Sales culture has a number of components. These include symbols, language, ceremonies, routine activities, role models, tales and stories, and values and beliefs.

Symbols: These are in the form of pictures, pins and trophies. In some companies, sales personnel are given tiepins, trophies, specially designed coats, etc on achieving sales targets. Receiving such visible acknowledgements of success encourages sales personnel to continue to perform well and maintain a good work ethic.

Jargon: This is a common set of words or phrases used by employees within an organization and conveys a distinct and unique meaning only to them. The use of a common language or jargon improves coordination, increases integration of common values and beliefs and facilitates cooperation among organizational members. Every organization has its own jargon and so too with sales organizations. Sales organizations and sales force personnel have their own sales jargon, which has a special meaning for the sales force and others in the organization. Examples of sales jargon include cold calls, closing, shelf space, etc.

Ceremonies: Annual achievement award ceremonies are a part of an organization's culture. They help communicate its image and position, both to its members and to external stakeholders.

Rituals and Rites: Rituals are routine activities in an organization, such as formal evaluation and reward procedures, monthly sales meetings, etc., which help in developing a sales culture. Rites differ from rituals in that they are planned activities and more formal. Annual sales meetings are an example of a rite in a sales organization. A lot of planning takes place before the meeting and includes organization-wide publicity by means of presentations, internal publications, etc. In annual sales meetings, sales persons who display exemplary behaviour are rewarded. This helps reinforce the desired beliefs and values in employees throughout the organization and development of an effective sales culture.

Role models: Role models are individuals within the organization whose excellent behaviour and performance make them worthy of emulation. Role models indirectly communicate sales culture to other employees in the organization by projecting the most desired behaviour. Former and current outstanding sales performers can act as role models for sales personnel.

Tales and Stories: Tales and stories of past events, actions of predecessors and management practices are also instrumental in moulding sales personnel. The time period between initial prospecting and closing a sale is painfully long and often, there is a possibility of the sales person becoming de-motivated during this time. At such times, tales and stories of past achievers help maintain morale.

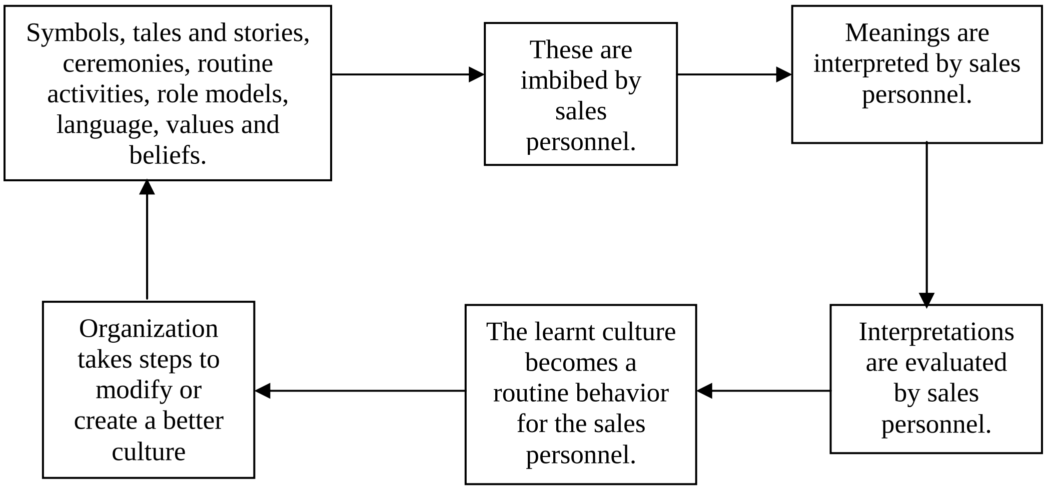
Values and Beliefs: Values refer to an individual's recognition that a certain mode of conduct or style of behaviour is socially acceptable compared to other possible modes of conduct. Values are judgmental in nature as they convey an individual's ideas regarding what is right, good, or desirable. Beliefs, on the other hand, refer to the way in which an individual organizes his or her perceptions and cognitions. They may be unfounded. The values and beliefs held by sales personnel help communicate sales culture.

Values and beliefs cannot be directly observed but can be perceived from the language, symbols and stories that prevail in the organization. The socialization process of new recruits is a method of disseminating these values. In a sales organization, during this process, a new sales person learns about life in the organization and how well he or she can achieve a good fit between individual needs and skills, and the organizational role that has to be performed.

Role of Sales Culture in Developing a Sound Sales Organization

Sales culture forms a part of organizational culture. Numerous studies have been undertaken to identify, manage and measure sales culture and understand its relationship to different aspects of sales management.

Figure 2.7: Stages in Formation of Sales Culture in an Organization



Sales culture in an organization affects the behaviour of its personnel and is in turn influenced by their behaviour. Figure 2.7 represents a schematic representation of this relationship.

The success of sales culture depends on two factors:

1. Strength of sales culture
2. Direction or fit of the culture

Strength of sales culture: The strength of sales culture in an organization is measured in terms of intensity and depth. Intensity or depth refers to the number of shared values and beliefs among sales people and the extent to which they are shared. A strong culture is one where there is more number of shared values and these are widely shared. Organizations that have a strong sales culture have clear beliefs and values and make serious efforts to uphold and disseminate them using stories, anecdotes and legends. These organizations reinforce the sales culture by communicating these stories and ideas throughout the organization through rallies and competitions. Companies with strong cultures stress greater sharing of cultural values more than companies with weak cultures. GE, Xerox and IBM are examples of companies with strong cultures.

Direction or fit of the culture: The direction or fit of the sales culture refers to whether or not it suits the environmental context in which sales persons operate. If the values and beliefs propounded by the sales culture oppose or are contrary to environmental requirements, it might lead to sales force inefficiency. For example, if a sales organization has changed from a product-based structure to a geographic-based structure, it is necessary to develop a culture that encourages initiative and independence. The sales culture should reinforce a sense of autonomy among the sales force, enabling them to work independently in their respective territories.

The sales culture, if properly developed, improves the effectiveness of the sales force by allowing free flow of communication, minimizing dissonance and incompatibility in expectations. The right sales culture also helps establish clarity of job description and guide sales people’s beliefs along the same lines as the organizations.

Sales culture can be consciously developed and defined to suit organizational requirements. It can be ethical, aggressive, team-oriented, empathetic, customer-centric or revenue focused. Effective sales culture helps develop team spirit, mutual accountability and role clarity among sales personnel, apart from reinforcing appropriate behaviour. Sales culture is even more important when there is significant diversity among sales personnel with regard to religion, social background and upbringing. A well-defined sales culture acts as a unifying factor that overcomes barriers.

SUMMARY

Owing to intense global competition, slow growth in markets and different customer expectations, sales organizations have to reengineer their organization structures and streamline their processes. An inefficient organization structure can frustrate top managers as it may result in strategic plans going astray due to absence of clearly defined responsibilities and reporting relationships. Developing customer-centric organizations, building strong relationships within and outside the organization, modifying the traditional top-down hierarchical structure and introducing cross-functional teams are some steps companies are taking to improve their efficiency and profitability.

The organizational structure should fulfil the purpose for which it has been designed. The role of a sales organization is to achieve company objectives, streamline reporting relationships, facilitate effective coordination and control and develop an efficient sales force structure to ensure effective selling strategy. .

Designing the sales organization plays a crucial role in a company's overall success. One must consider the influence of external and internal factors while designing a sales organization. External factors include the markets targeted and the technology prevailing in the target market. Internal factors influencing the design of a sales organization include the company objectives, the size of the sales force, core competence of the company, compensation system, reporting relationships, etc.

Based on the span of control, authority, hierarchical levels and departmentalisation, four basic organization structures are possible. These are formal and informal structure, centralized and decentralized structure, vertical and horizontal structure and line and staff organization structure. To efficiently serve the ever-changing needs of customers in the best possible manner, a company can have a product-based, geographic-based, customer-based or a combination-based sales force structure. The type of customers, the market size and its potential, the type of industry in which the company is operating, level of sales desired, size of the sales force and the width and depth of the product mix are some factors that influence the decision on the type of sales force structure to be adopted.

Sales culture plays an important role in the success of a sales organization. Sales culture is a collective impression of the values, attitudes and personality of top management in an organization. It pervades down to the lower levels of hierarchy over time. Sales culture has a significant influence on sales force activities and attitudes. The various components that make up sales culture include symbols, language, ceremonies, rites and rituals, role models, tales and stories, and values and beliefs. The strength and direction or fit of the sales culture also play a crucial role in developing a sound sales organization.

Chapter 3

Sales Functions and Policies

In this chapter we will discuss:

- Role of a sales manager
- Responsibilities of a sales manager
- Role of a sales executive
- Responsibilities of a sales executive
- Policies that impact sales management

It is 11 in the morning and you are getting ready to go out. Suddenly, the doorbell rings and you mutter something about no one but you having to go to see who is at the door. As soon as you open the door, you find a smartly dressed guy with a pleasant smile on his face greeting you a very good morning. With annoyance written all over your face for being disturbed at that time in the morning, you reluctantly wish him back and enquire what he wants. The look of annoyance on your face, however, fails to dissuade him. With all enthusiasm and the same pleasant expression on his face, he tells you that he is a salesman from a soap manufacturing company and is here to sell you the introductory brand of the soap at a throwaway price. Since the price at which he is offering the soap is temptingly low, you end up buying the soap. The salesman leaves your house with a victorious smile on his face and moves on to ring the doorbell of your neighboring flat…all set to lure the next target with his sales talk.

What differentiates a successful company from a not-so-successful one is the effectiveness of its sales force. The sales force of a company is a major determinant of its bottom-line performance in the market. Hence, it is not surprising that on an average, companies invest about 12 percent of their revenues in developing their sales force.

The sales force of an organization comprises sales representatives, (also called salesmen) sales managers, etc. All of them have distinct roles to play, and responsibilities to fulfill. The effectiveness with which these roles are played and responsibilities fulfilled determines the profitability of an organization.

In this chapter, we will discuss the role and responsibilities of these personnel in an organization. We will also discuss the policies that impact the performance of various sales activities by these personnel.

ROLE OF A SALES MANAGER

Sales managers occupy middle level positions in an organization with the top management above and the sales personnel below them. The activities of a sales manager are influenced by the demands and expectations of various groups of people, both internal and external to the organization. While those internal to the organization include the top management, the sales personnel, and other sales managers, people external to the organization who influence the activities of a sales manager include customers, competitors, advertising agencies, suppliers, society, etc. This places the sales manager in an unenviable position of having to meet the demands and expectations of these varied groups of people.

Sales managers, not only perform sales management functions, they also perform other functions of marketing management to effectively achieve the strategic marketing objectives of the organization. They plan, direct and control the personal selling activities of the sales personnel. They also organize, recruit, select and train the sales personnel, assign them necessary resources and aids, allocate territories, set sales targets, route, and supervise their sales efforts. Sales managers also play a vital role in designing compensation plans for sales personnel. They motivate the sales personnel by designing attractive financial and non-financial incentive schemes for them and evaluate their performance objectively.

Other roles of a sales manager include that of a sales forecaster, a strategic planner, an observer of buyer behavior, a market analyst, a leader, a cost and profit analyst, a budget manager and a communicator. As a sales forecaster, a sales manager forecasts the likely sales of the organization. As a strategic planner, he devises strategies that would help in achieving organizational objectives. As an observer of buyer behavior he observes the buying behavior of prospective and existing customers on the basis of which he plans future sales strategies for the sales personnel. As a market analyst, he

Exhibit 3.1

What a Sales Manager Can Learn from Internal Sources

One of the roles of a sales manager is to serve as a communicator. In this role, the sales manager tries to obtain information on various segments of a market and sales statistics that he can possibly gather from various sources. He gathers information related to products, customers, and the costs involved in selling the products. However, in his zeal to obtain information from outside sources, he often tends to overlook a very vital internal source of marketing information – the accounting department of the organization. This department is not an easily available source of information, but it also happens to possess information on various aspects of sales.

The accounting department can provide the sales manager with crucial data that he can use to plan and evaluate the sales of the organization. The income statements generated by the accounting department can help the sales manager understand the contribution made by each product and product line of the company. Similarly, the production, administrative, and distribution costs involved in each product can also be identified. Such a split-up and allocation of costs to various sources helps the sales manager identify the non-profitable products in a product line. Such information can then be provided to the top management to help them in the long-term planning for the company.

The accounting department can also provide the sales manager with information on contribution to sales made by individual territories and not just by product alone. Such income statements help the sales manager divide the costs traceable to individual territory into two categories – variable and fixed.

The information obtained from the accounting department also helps to measure the contribution per salesman. The accounting statements can clearly identify the net sales made by each salesman, along with the direct fixed and variable costs. While direct fixed costs include salaries and travel costs, the direct variable costs include commissions, freight expenses, and costs of products sold.

In addition to the above types of contribution reporting, the accounting department can also provide the sales manager with information on contributions made by customers and by vendors. It is up to the sales manager to clearly convey his precise requirement to the accounting department. The accounting department, in turn, can glean the particular information from the daily income-and-expense reports, summarize it, and provide it to the sales manager in the desired format. The sales manager can, in turn, utilize this information to recommend product-line changes, changes in sales efforts, sales quotas, commissions and incentives given to the sales personnel.

Adapted from John P. Chaplick, "What the Sales Manager can Learn from Accountants," Management Review, May 1973, 56-58.

continuously monitors and analyzes the marketing environment and identifies opportunities and potential threats. A sales manager is a role model for the sales personnel and has to lead by example. He is expected to be a super-salesperson in order to be able to show other sales representatives how to sell. At the same time, a sales manager is also required to push the sales personnel under his supervision to perform to their maximum capability to achieve sales goals. As a cost and profit analyst, he analyzes the cost and profit involved in various segments of the market. As a budget manager, he sets the budget requirement of the sales organization for carrying out various activities involved in the personal selling process. He also plays the role of a communicator by transmitting information from the marketing/strategy planners to the sales force. The role of a sales manager as a communicator also involves gathering information from various sources, both external and internal to the organization. Exhibit 3.1 describes the importance of tapping internal sources of information by the sales manager for planning and evaluating the sales effort.

RESPONSIBILITIES OF A SALES MANAGER

Sales managers are the front-line managers of a sales organization. The quality of a sales organization is directly dependent on how well its sales managers fulfill their responsibilities. Sales managers have several key responsibilities. These include hiring, training, coaching, motivating, setting targets for the sales personnel, tracking the results, recognizing and rewarding performance, providing leads and sales support, organizing the sales effort, and conducting sales meetings.

Hiring

The sales manager plays a key role in hiring sales personnel for an organization. He is responsible for preparing job descriptions for various sales positions. A carefully worded job description prevents the management from hiring the wrong kind of people for the sales position thereby reducing the sales force turnover.

Training

It is the responsibility of a sales manager to train the sales persons in his team to achieve their sales targets. Sales training in a company may differ from that in another company. Some organizations conduct formal training programs for their sales force. The training may be offered by a professional sales trainer, the sales manager, or by some other employee of the company having wide experience in sales. Training may even be in the form of simple role-plays. As part of the training, the sales managers should address basic issues such as key attributes of the product, potential customers, competitors and how to make the sale. The sales manager should also train sales persons on how to handle objections and close a sale by summarizing the key attributes of the product.

Most organizations are willing to invest in sales training because they view it as a return-on-investment. However, a direct correlation cannot always be established between sales training and increased sales or enhanced performance of sales personnel. Exhibit 3.2 describes how some companies like Xerox and Motorola are viewing sales training from an entirely different perspective and not just as an investment on which returns have to be generated.

Coaching

The sales manager should observe how his sales team performs in the field to identify the training needs and gauge the effectiveness of the sales training. By unobtrusively observing the salesperson’s efforts and taking care not to take over the call from the salesperson, the sales manager can examine the salesperson’s techniques of selling and note down the aspects on which the salesperson needs to be corrected or the aspects which the salesperson needs to improve upon. The sales manager should provide honest and constructive feedback to the salesperson. Thus, the coaching function of the sales manager involves identifying the reasons why the salesperson is not performing satisfactorily and devising a solution to correct the problem. To accomplish this, it is essential that the salesperson agree with the sales manager that a problem exists. After having made the problem evident to the salesperson, the sales manager can discuss it with him, agree on remedial measures and set a deadline for taking action. Follow-up measures are necessary to ensure that remedial action is being pursued by the salesperson.

Exhibit 3.2

Training Results – No Longer an ROI

Companies have increasingly realized that the training organizations claim that sales training helps boost sales and enhances sales performance has become difficult to substantiate. Some of the noted companies like Xerox and Motorola look at training from a different perspective.

In the case of Xerox, although the company would like to establish a quantitative relationship between the money invested on training and the returns generated, it realizes the difficulty involved in capturing the required information as well as in deciding how exactly to analyze such a relationship. Therefore, the company decided to view training from a different perspective. It terms training as 'learning' and rather than expecting to attain a ROI, the company emphasizes 'knowledge verification' and 'performance support.' It is the company's philosophy that a training program must begin with an assessment of the critical skills and knowledge its personnel should possess to carry the business forward. Then, the company must assess the competencies of its sales personnel to judge where they stand in terms of required competencies.

Motorola Inc. is another company that eschews the traditional notions of training. The company emphasizes removal of the distinction between 'training' and 'doing' and is of the view that training should not be separate from sales activities. It advocates the integration of training with work results and states that the training results should be measured as close to the training event as possible. At Motorola, the sales managers are also made a part of the 'knowledge community' in support of salespersons. While sales managers are trained on how to monitor and review the performance of salespeople, salespeople are encouraged to post their account plans on the company's intranet which are later modified and fine-tuned by the sales managers or sales trainers.

Adapted from William Keenan Jr, "Sales & Marketing," IndustryWeek, 06 December 2000, < www.industryweek.com/Columns/ ASP/columns.asp?ColumnId=628 - 26k>

Motivating

The following three factors play a role in increasing the productivity of an employee – the belief that his work is important, recognition of his accomplishments and a motivated leader. The sales manager should ensure that it is not just the top performers in the sales force who require to be praised. On the contrary, the salespersons who display only a slight improvement in performance should also be praised to ensure that they show further improvement. Different individuals are motivated by different factors. For some, money may be the only motivator while for others, receiving praise and recognition, incentives, gifts, awards, challenging assignments, etc may serve as motivators. Exhibit 3.3 describes how sales managers in companies are thinking of innovative ways to motivate their sales personnel.

Setting Targets and Tracking the Results

A sales manager sets targets for the salespersons under his supervision. The sales targets may be in the form of new accounts, amount of revenue to be generated, or it may even be in the form of the ratio of sales per customer. The sales manager may even set additional targets for the prospecting efforts of the salesperson. This may be in the form of number of phone calls made, number of letters mailed or number of visits made in a week. However, the sales manager should ensure that the targets set by him are realistic and achievable. After setting the targets, it is the responsibility of the sales manager to constantly track and publicize their achievement by posting the results on the company bulletin board or the intranet, as the case may be. This acts as a great morale booster for those who have worked hard to achieve their targets.

Exhibit 3.3

Changing Trends in Sales Incentives

Salespersons in organizations are no longer being rewarded only in monetary terms for achieving or surpassing their sales targets. Sales managers are now coming up with innovative ways to reward their sales personnel. These rewards serve as great morale boosters making them perform even better than what they would have ordinarily done on receiving cash incentives. The incentives can take the form of challenging assignments, electronic gifts, gift vouchers, opportunities to upgrade their skills at the company's cost, recognition within the organization, all-expenses-paid holidays, opportunities to have their picture splashed across newspapers, opportunities to model for the company, and foreign assignments.

In the year 2000, Procter & Gamble, featured its best salesperson for the year in an Ariel advertisement. Modi Xerox featured six of its best salespeople in an advertisement that appeared in The HINDU in 2001-2002. Modi Xerox and Eureka Forbes were the first to reward their salespersons with electronic goods and paid holidays instead of offering them the usual cash incentives. Now, expenses-paid holidays have become quite common in organizations. Companies like Hindustan Lever Limited (HLL) and Procter & Gamble have taken sales incentives to a much higher level. These companies offer foreign assignments to salespersons who are high performers and who exceed their sales targets. This was unheard of earlier in the field of sales.

Adapted from Joydeep Ghosh, "The Changing Trends in Sales Incentives," Monster.com, <http://sales.monsterindia.com/articles/sa010717_006/>

Recognizing and Rewarding Performance

Sales managers keep track of the performance of the salespersons under their supervision and recognize and reward excellent performance by offering them tangible incentives. These may be in the form of a rolling trophy, extra leave, paid vacations, gift certificates, plaques, membership to exclusive sales and achievement clubs, etc. Salespersons may also be rewarded with public appreciation at sales meetings for showing excellence in performance.

Providing Leads and Sales Support

It is the responsibility of the sales manager to clear all the hurdles that salespersons are likely to face in achieving their sales targets. These hurdles may be in the form lack of adequate secretarial support, lack of appropriate sales aids and tools to make effective presentations, etc. The sales manager's task doesn't end with observing and tracking the performance of the sales staff but goes much beyond it. The sales manager has to continuously develop new business through the contacts he develops in the community, through his personal selling efforts, and by constantly making visits to prospective customers. The sales manager needs to identify leads, and then hand them over to the sales staff to follow-upon. The ultimate objective of the sales manager is to make the sales task easier for his team.

Organizing the Sales Effort

A sales manager helps salespersons organize their sales effort. The manager helps salespersons maintain active ticker files and ensures that they plan their calls in advance. The sales manager also ensures that the salespersons follow a systematic process of call reporting and filing of expense reports. This helps sales managers keep tabs on the activities of their sales staff and give them appropriate sales advice. Thus, by organizing the sales efforts of salespersons, sales managers can help enhance their efficiency by enabling them to meet their targets.

Exhibit 3.4

Ineffective Sales Meetings

Sales meetings may become counterproductive and ineffective under the following circumstances:

1. The participants fail to come on time or skip the meeting altogether.
2. The sales manager doesn't have specific objectives to achieve through the sales meeting.
3. The participants view it as a mud-slinging contest and blame their non-performance on lack of support from other departments of the organization.
4. The management uses the sales meetings as a venue to openly humiliate poor performers.
5. The meeting lacks a clear agenda thereby resulting in waste of productive time of a whole lot of salesmen who would otherwise have been in the field doing what they do best – selling.

Adapted from Dick Gorelick, "The Outstanding Sales Meeting," American Printer, January 2001, Volume 226, Issue 4, 62.

Conducting Sales Meetings

One of the prime responsibilities of a sales manager is conducting sales meetings. These meetings when conducted effectively serve as great morale boosters for the salespersons. The frequency of sales meetings can depend on various factors. Some of them include availability of key players, frequency of requirement of progress update. To conduct effective sales meetings, sales manager should send the agenda beforehand to the participants so that they come prepared for the meetings. The sales manager while conducting sales meetings must take care to cover the following aspects – review of the sales performance of the organization, review of the performance of each individual salesperson, recognize and reward excellent performers, offer effective sales tips, organize guest lectures by eminent sales personalities to help the salespersons learn from other's experiences in sales, present motivational lectures and video presentations, etc. Sales managers also need to ensure that during the meeting, participants do not lose focus and issues and problems are resolved by the end of the meeting.

Not all sales meetings tend to be productive and useful to the participants and the company. Exhibit 3.4 discusses the circumstances in which sales meetings tend to become ineffective.

Allocation of Scarce Resources

Sales managers are responsible for allocation of scarce organizational resources among the sales personnel. They may take the aid of sophisticated technology in fulfilling this responsibility. For example, companies like General Mills use software packages to enable their sales managers to evaluate various scenarios to allocate resources with the help of "what-if" analysis.

ROLE OF A SALES EXECUTIVE

A salesperson's job is a multifaceted one in which he is required to play a variety of roles such as a persuader, a service provider, an information-gatherer and reporter, an advocate, a traveler, a coordinator and scheduler, a problem-definer, a customer-ego builder and a display arranger for the wholesaler or retailer. The salesperson may play one role at a time or several roles simultaneously if necessary.

In addition to these roles, the salesperson also plays the role of a merchandiser and an ombudsman. As a merchandiser, the salesperson presents to the customer the products which are most appropriate and suit the customer needs. In industrial selling, the salesperson often needs to customize the product to precisely match the requirements of the buyer. Such customization is possible due to the large-scale purchases that take place in industrial selling.

As an ombudsman, the salesperson acts as the customer's representative to the selling company and handles various problems that the customer might be facing. These problems may be in the form of late arrival of shipments, damaged merchandise, credit arrangements, etc. The greater the effectiveness of the salesperson in fulfilling this role, the greater is the help he is able to offer the customer.

A salesperson interacts with several role partners in performing his jobs. Typical role partners with whom a salesperson interacts may range from production workers, engineers, personal assistants and secretaries to the top brass in a company including the CEOs.

Further, a salesperson links at least four groups of people. These include people from his own sales-management team, the customers whom he serves, others in the organization on whom the salesman has to depend for the fulfillment of his sales orders, and other salespersons, both within the same organization or external to it. Since the salesperson needs to interact with these various groups of people he may also be required to fulfill their demands and expectations. The pressure to fulfill the expectations of these various groups of people creates problems for the salesperson because very often the expectations of one group of people may be in conflict with the expectations of another group. For example, when a salesperson is successful in tapping a new prospect and convincing him to place an order, in his enthusiasm to acquire a new sales account, the salesperson tries to ensure that the order placed by the customer is delivered to him on time. In doing so, the salesperson is quite likely to create resentment among people from other departments such as the production department, the dispatch department etc. by placing undue pressure on them to deliver the product at short notice.

With increase in competition and the use of sophisticated technology in sales and marketing, the role of the salesperson has also undergone a dramatic transformation. Companies now expect their salespeople to do much more than achieve the company's targeted revenue goals. Salespeople are expected to play a critical role in supporting changes in the company's business strategy by directing their sales efforts to establish a continuing and mutually beneficial relationship with important customers and thereby delivering a targeted profit performance. Procter & Gamble, for example, has redefined the role of its salespersons to focus on customer business development as a part of which the salesperson has to help the customer in matching his requirements with the company's products.

RESPONSIBILITIES OF A SALES EXECUTIVE

The sales force of a company communicates the value of the company's offerings to the customers. An effective salesperson not only encourages customers to place repeat orders, he also gets an order from a customer who has been sourcing his requirements from the competitor. In order to do so, it requires strategic thinking by the salesperson as well as an understanding of the customer's needs.

Identify potential customers from currently available databases

Salespersons continuously find potential customers to achieve their sales target. Various databases, such as Yellow Pages are used by salespersons to generate initial leads. Sometimes, the existing customers may also provide leads. Though the success rate of cold calls is quite low, it is an effective method to generate initial leads because the cost for each lead is quite low.

Identifying prospective accounts and deciding upon the priority and frequency of making calls

One of the major responsibilities of a salesperson is to identify prospective customers from the existing database and to prioritize the sales calls to convert these prospects into customers.

Deciding upon the selling approach

Salespersons need to prepare presentations for certain calls. Moreover, if they happen to be making a repeat visit to the customer, they need to ensure that they are equipped with the required information the customer may have sought from them during their previous visits.

Administering the sales order

When a customer places an order, the salesperson has to ensure that the product is delivered on time. Accordingly he coordinates with the employees in other departments who play a role in order fulfillment.

Service provider

After the order has been placed, the salesperson should ensure that the product is properly installed at the customer's location and the customer is given an orientation on how to handle the product. He should also advise the customer as to how to make profitable use of the product, and also address any complaints or warranty problems that the customer may face in future.

Information gathering and reporting

Salespersons also provide the company with relevant data about the customers. The sales manager can then make efficient use of this data to devise appropriate sales strategies to address the future buying needs of the customers.

Skill upgradation

The salesperson has to constantly upgrade his technical or product knowledge by attending sales training programs. Attending trade shows can also help the salesperson learn about the latest developments in technology.

Administrative responsibilities

As part of his administrative duties, a salesperson needs to regularly attend sales meetings and conferences, and fill in call reports and expense reports providing details about the calls made by him during a week and the expenses incurred during these calls.

POLICIES THAT IMPACT SALES MANAGEMENT

Different companies have different product, distribution and pricing policies. The sales management policies of a company also vary depending on these policies. The operations and functions of the sales departments vary with the sales-related marketing policies of these companies. For example, sales-related marketing policies of companies would take into consideration what to sell, whom to sell, how to make the product available to the customers and at what price the product should be sold to the customer.

Exhibit 3.5
Product Recall by Multinational Companies

Firestone tire recall:

In July 2000, Ford conducted a data analysis on tire failures which revealed that Firestone Radial 15 inch ATX and ATX II tires produced in North America and Wilderness AT tires produced in Decatur, Illinois plant had very high failure rates with the treads peeling off. When the tires failed, the vehicle often rolled over and killed the occupants.

In August 2000, Firestone amid concerns over tread separation, accidents, injury and death announced a voluntary recall of all Radial ATX, ATX II, and Wilderness AT tires. Around 6.5 mn tires were recalled which included 3.8 mn Radial ATX and ATX II tires, and 2.7 mn Wilderness AT tires. These tires were original equipment on certain Ford Explorer SUVs, Mercury Mountaineers, Ford Ranger pick-up trucks and Mazda Navajo and B-series pick up trucks. The Firestone tire recall was perhaps the biggest auto safety crisis in the US history.

Johnson & Johnson's recall of Tylenol:

In September 1982, Johnson & Johnson (J&J) had to recall 31 million bottles of extra strength Tylenol worth over $100 million from all retail stores in the US following reports of several people dying due to intake of extra-strength Tylenol. In addition to the product recall, the company also offered to exchange capsules for tablets at no extra cost to all its customers.

According to an analyst, J&J suffered a loss of $1.24 billion due to the depreciation of the company's brand value. Tylenol's share fell from 37% of the US analgesics market in early 1982 to just 7% by late 1982. According to media reports, the sudden deaths occurred because the Tylenol capsules had been laced with cyanide. The capsules had been opened and filled with 65 mg of cyanide (about 10,000 times more poisonous than a human body can resist). In spite of the deaths, J&J was praised for its prompt action and sincere efforts in recalling Tylenol and giving consumer safety top priority.

Product Recall by Coke:

On June 13, 1999, Coca-Cola (Coke) recalled over 15 million cans and bottles after the Belgian Health Ministry announced a ban on Coke's drinks, suspected to have caused more than 100 school children to fall ill in the preceding six days. This recall was in addition to the 2.5 million bottles that had already been recalled in the previous week. The company's products namely Coke, Diet Coke and Fanta had been bottled in Antwerp, Ghent and Wilrijk, Belgium while some batches of Coke, Diet Coke, Fanta and Sprite were also produced in Dunkirk, France.

Children at six schools in Belgium had complained of headache, nausea, vomiting and shivering which ultimately led to hospitalization after drinking Coke's beverages. Most of them reported an 'unusual odor' and an 'off-taste' in the drink.

In the same week, the governments of France, Spain and Luxembourg also banned Coke's products while Coke's Dutch arm recalled all the products that had come from its Belgium plant. The entire episode left more than 200 Belgians and French, mostly school children, ill after drinking the Coke produced at Antwerp and Dunkirk. By June 15, 1999, Coke had recalled about 30 million cans and bottles, the largest ever product recall in its 113-year history.

After the crisis, Coke investigated the problem by testing the suspect batches for chemicals. The company claimed that the tests showed nothing toxic in the beverages. However, the company claimed that the strange odor in the products from the Antwerp plant was due to some fungicide having accidentally fallen on the exterior of the cans. In addition, Coke had determined that the strange taste was the result of a sub-standard gas used to carbonate the products. The plant in Dunkirk had some cans which had been contaminated with a wood preservative during shipping.

Source: ICFAI Center for Management Research.

The sales-related marketing policies laid down by a company influence the operations and functions of the sales executives. This influence is evident in the way the sales function tries to achieve the personal-selling objectives of the organization, manage the sales force and organize and control the sales efforts. Thus sales-related marketing policies establish the basic framework within which the sales function operates.

Sales-Related Policies Pertaining to the Product

The sales-related product policies of a company determine what products the company should be involved with what products to add, what products to drop, and whether to add or remove a product line. These policies also lay down the company's stand with regard to product design and quality, after-sales service, product recall, warranties, and repair.

Multinational companies, for instance, have clearly laid down policies regarding product recall. Some of the well-known examples of product recall by multinational companies have been given in Exhibit 3.5. The objective behind product recall policies of companies is to place unsafe and defective products beyond the reach of consumers as early as possible.

Very often, manufacturers or distributors voluntarily take action to recall the product when any incidence of defective quality comes to their notice. The standards laid down by government agencies such as Bureau of Indian Standards also play a role in making companies follow a code of ethics in manufacturing their products.

The most common product-related policies that impact sales management of a company are policies that pertain to the product-line, to product design and quality, and to service related to the product.

Product line policy

A product line is a set of related products sold by a company. The product line of one firm may vary from another. Some firms may have a narrow product line while others may have a broad product line. A firm may decide to have a broad product line and leverage the corresponding increase in revenue the firm is likely to experience against the production and engineering costs.

Both narrow as well as broad product lines have their advantages. Firms with narrow product lines enjoy economies of scale due to product specialization and thereby lower production cost per unit, reduce inventory or holding costs, and lower costs of designing the product. This may possibly be the reason behind some computer manufacturing firms trimming their product lines.

Likewise, firms with a broad product line also have certain advantages. These firms are able to meet the needs of a wider range of customers and at the same time, deter other firms from entering the market. Therefore, they are able to charge high prices for their products. Companies like Hindustan Lever Ltd (HLL) enjoy many of these advantages of having a broad product line in each product category. However, such companies also face a higher risk of suffering great losses if a new competitor arrives on the scene with a substitute product.

The product line policies of a company are also influenced by the amount of risk the company is willing to undertake. A company with a narrow product line takes up a large amount of risk. On the other hand, a company with a full product line spreads out its risks over a wider range of products.

Moreover, a company's decision to have a broad product line is also dependent on the ability of its sales force to effectively sell each of these products. Likewise, customer demand and expenses involved in the production and promotional activities of these products also influence a company's decision to adopt a product line policy.

If a company wants to add a new product to an existing product line, it needs to make significant changes in its sales management policy. The company, for instance, may have to train its sales force so it becomes aware of the new characteristics of the product. The sales force should also learn to identify the best prospects for the product as well as their needs and buying behavior. The addition of a new product to the product line may make it necessary for the sales manager to alter the standards for measuring the performance of the salespersons. Traditionally sales quotas were used as a basis for evaluating the performance of salespersons. Now the sales managers have to measure the performance of the salespersons on the basis of the number of sales calls made and number of demonstrations given. Adding to the product line may require the salespersons to spend more time on each sales call to explain the product characteristics of the new product as well as to make the customer aware of the lesser-known products in the product line. In some cases the sales manager may have to accompany the salesperson on sales calls. The sales manager may also form special sales teams and hold special sales orientation meetings to ensure that the salespersons are well versed with information related to the new product.

Product design policy

Product design policies indicate the frequency at which the company may make changes to its product design and also refer to the extent to which product design should be protected from imitation.

Companies make changes to their product designs to accommodate the changing tastes and preferences of customers and increase product sales by inducing customers to trade-in their existing models of the product which may still be in a usable state, in exchange for an advanced model of the same product or a related product. Changes in the product design force companies to alter their sales management policies. Sales teams need to be trained as and when product designs change. The advertising and promotional policies are also influenced by the changes in product designs.

Companies lay down specific policies to safeguard themselves from imitation of their product designs by competitors. The protection of product design is made possible by patenting the design and establishing copyright protection regulations.

Sales-Related Policies Pertaining to Distribution

The success of a product in the market depends on a combination of several factors. The distribution of the product determines the sales of a product and it must be effectively coordinated with various other factors such as product quality, its positioning, the marketer’s reputation, marketing efforts and product promotion to ensure successful sales of the product. Ineffective distribution can result in a massive drop in the sales of even established products.

The sale of products through distributors is dependent on the consistency in the supply of the products to the distributor. Instances of lack of stock or late delivery of supplies to distributors make it difficult for the latter to meet the demands of the buyers and lead to a significant drop in the sales of the product. Hence, the frequency and the regularity of distribution play a vital role in efficient sales management.

To a large extent, the promotion of the product by the channel members depends on the relationship that the manufacturer has with its channel members. It is essential that the manufacturer maintains an ethical relationship with channel members to ensure that they actively promote his product. Moreover, the commission offered by the manufacturer to the channel members also determines their interest in promoting its product. If the manufacturer offers a low commission, it is likely that channel members will no longer be interested in promoting the products. Instead they may opt to promote the products of the manufacturers who offer them a higher commission.

A recent example of companies making changes in their distribution policies to the disadvantage of their channel members is the slashing of travel trade commissions by airline companies operating in India. With Lufthansa leading the way by slashing travel trade commission to agents from 7 percent to 5 percent to reduce its distribution costs, three other airline companies operating in India, British Airways, KLM, and Air France, also followed suit. If the rest of the airline companies operating in India adopt the same policy, the travel agents will have no option but to quietly accept the move. However, if the slashing of commission on ticket sales is confined to a few select players, it is but natural that the travel agents will seek to promote the sales of other airline companies which offer them a higher commission.

Sales-Related Policies Pertaining to Pricing

Products fall into three general categories, namely, substitute products, complementary products and neutral products. Substitute products are also known as competitive products and include those products whose sales affect that of other product. Complementary products are the products whose sales boost the sales of other product. For example, the sale of a camera boosts the sale of photographic films; the sale of a shaving razor boosts the sale of blades and shaving gel. Neutral products do not have any effect on the sales of other products.

While setting the prices of products, one must consider the fact that the differences in the prices of products in the same product line directly influence the proportions in which these products are sold. Companies offering multiple products tend to create a situation wherein each product begins to compete in terms of sales with other products offered by the company. For example, if a company manufacturing various models of refrigerators begins to promote one particular model, it affects the sales of other models of refrigerators. The sales management should make appropriate changes in its sales strategy and selling tactics when a change in the price of one product in the product line begins to have an effect on the sales of other products in the line. This is particularly true when the products are substitutes of each other. It is but natural for customers to opt for a product that costs less when it serves as a substitute for the product that the customer is seeking.

SUMMARY

A sales person’s professional life is characterized by various highs and lows. At times he may clinch a deal and close a sale, at other times he may have to face the customer’s rejection. Thus, the life of a salesperson is certainly not an easy one. What differentiates a successful company from a not-so-successful one is its sales force.

The sales force of a company comprises the sales managers and the sales personnel. Both have distinct roles to play and responsibilities to fulfill toward the achievement of the sales objectives of the organization.

The sales manager who occupies a middle-level position in an organization satisfies the demands and expectations of not only those above him and those whom he is supervising, the sales persons, but also various other groups of people. These include people who belong to the organization as well those who are external to it. The sales manager has several functions to perform, which fall in the sphere of sales as well as marketing management. Likewise, a sales manager also plays a variety of roles - planner, recruiter, leader, controller, market analyst, sales forecaster, budget manager, and communicator.

In addition to playing a variety of roles in sales management, a sales manager also has a set of responsibilities to fulfill. These include the responsibility of hiring, training, coaching, motivating, setting targets for sales people and tracking the results, providing leads and sales support, organizing the sales effort, conducting sales meetings, and allocate scarce resources.

The salesperson’s job is also a demanding one. He has to play the role of a persuader, a service provider, an information-gatherer and reporter, an advocate, a traveler, a coordinator and scheduler, a problem-definer, a customer-ego builder, a display arranger for the wholesaler or the retailer, a merchandiser as well as an ombudsman. Like a sales manager, a salesperson too has his own set of responsibilities to fulfill.

Further, the operations and functioning of a sales organization is governed by certain policies. The sales-related policies that have an impact on the sales achieved by an organization fall into three categories, namely, policies related to the product, policies related to the distribution aspects, and policies related to the pricing of the product.

The product related policies determine the products and product lines the company should be involved in, and whether to add or drop a particular product or product line. The product-related policies also help specify the company's stand regarding product design and quality, after-sales service, product recall, warranties and repair.

The distribution-related policies in a sales organization deal with how the distribution of a product affects its sales. These policies also highlight the relationship between various factors such as product quality, its positioning, the marketer's reputation, marketing efforts, product promotion and sales, and the need for coordination among these various factors. The policies that relate to pricing of the product discuss the relationship between product or service pricing and its impact on sales.

Chapter 4

Personal Selling

In this chapter we will discuss:

- Buyer seller dyads
- Types of selling jobs
- Sales force objectives
- Sales force strategies
- Theories of personal selling
- Approaches to personal selling
- Personal selling process
- Customer related issues in personal selling
- Automation in personal selling

In the new millennium, companies are coming up with innovative ideas to attract customers to buy their products. They are equipping their sales forces with the latest gadgets to enable them to respond quickly and effectively to customer requirements and sell their products profitably.

Personal selling is the process in which a salesperson has a face-to-face interaction with the customer for the purpose of selling a product or service. Personal selling is one of the tools in a company's promotional mix. It has greater significance than any other form of promotion as it allows the sales person to converse in detail with the customer about the product or the service. Personal selling is a highly interactive tool for promotion and is particularly suited to complex products or services.

Personal selling has become highly challenging in the 21st century, owing to the rapid changes in environmental factors such as technology (sales force automation, mobile electronic gadgets, expansion of the Internet), behavioural (increasing customer expectations, globalization of markets, changing customer attitudes), and managerial factors (outsourcing sales activities, integrating sales and marketing).

The advent of advanced telecommunication facilities has provided greater mobility and accessibility to sales personnel. Earlier, sales personnel had to spend considerable time in their offices as well as take care of paper work associated with their job. Advancements in technology have facilitated their operating from a virtual office. They can now connect to their office from anywhere in the world, using advanced gadgets such as palmtops, personal digital assistants (PDAs) and so on. They can now focus their energy on serving customers better. While, on the one hand, such innovations have made the job of the sales person easier, on the other hand, they offer fresh challenges to sales managers. Sales managers face the difficult challenge of coordinating the efforts of the traditional sales force with those of hybrid marketing channels such as distributors and private sales persons.

Flexibility and adaptability are the need of the hour for the sales function of an organization to succeed in the 21st century. Although in recent times there has been a view that sales persons and personal selling have become insignificant due to technological advancements, the fact of the matter is that it is not possible to eliminate personal selling. In recent times, the increasing competition in the business environment and the struggle by companies not just to make profits but to survive has made them focus on personal selling efforts. Companies across the world are trying to come up with new means to utilize their sales force to the fullest potential.

In this chapter, we will discuss various aspects of personal selling. Beginning with the concept of buyer seller dyads, we will proceed to the various types of selling jobs, sales force objectives and strategies. This will be followed by a description of the various theories of personal selling, approaches and the process of personal selling. The latter part of the chapter discusses customer related issues in personal selling and concludes with a look at sales force automation.

BUYER SELLER DYADS

The effectiveness of communication between the salesperson and the customer during the sales process decides the success of a sales call. Appropriate and relevant communication between the buyer and the seller enables easier and better mutual understanding.

Whenever a seller and a potential buyer interact, they constitute a dyad, which is called a 'buyer-seller dyad.' Research conducted by H. Lee Mathews, David T. Wilson and John F. Monoky, Jr.[1] and published in the Journal of Marketing Research (February 1972), found that the relationship between the customer and the salesperson

[1] H. Lee Mathews is Associate Professor and David T. Wilson is Assistant Professor of Marketing at The Pennsylvania State University. John F. Monoky, Jr., is Assistant Professor of Marketing at the University of Toledo.

Figure 4.1: The Prisoner's Dilemma Matrix

		You	
		Co-operate (Stay Silent)	Compete (Give Evidence)
Your Partner	Co-operate (Stay Silent)	1 Year	Get Out of Jail Free
	Compete (Give Evidence)	5 Years	3 Years

Source: Ben Lieberman, "Project Scope Management: Effectively Negotiating Change," Rational Software, 2001, www.therationaledge.com.

is affected by the latter's principles, expectations and communication skills. The study conducted on about 300 college students revealed that individuals sharing common views cooperated well among each other, while individuals, who are dissimilar in their views, would not cooperate among themselves.

A certain number of dyads was selected on the basis of a computer program. The students were divided into similar and dissimilar categories and told which category they belonged to. The game "Prisoner's Dilemma" (see Figure 4.1) was administered. In this game, success is dependent on strategy as well as level of cooperation. The results showed that there was a lot of cooperation between individuals who were told they were similar and less cooperation between dissimilar groups. In other words individuals who perceived themselves as similar made greater attempts to cooperate with each other while those who perceived themselves as dissimilar made fewer attempts to cooperate.

In the control group, the individuals were not told about similarity or dissimilarity. They displayed greater cooperation than individuals belonging to the group, which perceived itself as similar, and greater non-cooperation than individuals, who perceived themselves as dissimilar. To sum up, the study clearly revealed that people who were told beforehand that they were similar increased cooperation with others in the group, while those who were told they were dissimilar were highly non-cooperative.

It can be concluded that the likelihood of a salesperson making a sale to a customer is higher if he shares some characteristics with the customer. These characteristics may be in the form of demographic aspects, physical features, etc.

TYPES OF SELLING JOBS

For decades, businesses have been constantly searching for new customers and innovating new products to satisfy customer requirements. Acute competition and globalization have made the job of marketers even more difficult. For most firms, personal selling is a vital component of business transactions. Despite its growing importance, personal selling is still organized around traditional criteria such as sales territories, products and sometimes customers. Strangely, it is not planned on the basis of tasks or activities involved in personal selling. It has been analysed why salespersons are assigned duties and responsibilities on the basis of territories, products and markets rather than on the basis of tasks or activities involved in the job. The analysis brings to the surface certain misconceptions held by top management. The management does not recognize that salespeople perform two very different kinds of activities or tasks, which require entirely different approaches. It also fails to appreciate that the manpower requirement for these two types of tasks is totally different. The tasks referred to here are sales maintenance and sales development. They are also termed as service-oriented selling and developmental selling.

Usually, the job of a salesperson comprises serving existing customers, maintaining good relationship with them and procuring business regularly. The aim of sales maintenance is to procure business from existing customers. On the other hand, sales development involves locating new and potential customers and persuading them to try the company’s product. This is indeed a difficult task. Cutting edge skills are required to develop and sustain new accounts and only those who have these skills can excel in a sales development job. It is evident how different these two selling jobs are, necessitating two different kinds of individuals to perform them. However, most companies expect the same set of salespersons to carry out both tasks simultaneously. When this is the case, often, salespeople do the job that is relatively easier and ignore the other task. Sales development, being more difficult, often gets left by the wayside.

Sales Development

As noted earlier, developing a new account requires a different skill set and is difficult because the salesperson needs to be creative and have knowledge about the customer, the economy and the market. The focus is on the customer and not on the product. The product is the centre of attention in the case of service-oriented selling or sales maintenance.

In sales development, the salesperson needs to generate a perceived need for the product in the customer’s mind. The salesperson has to essentially act as a change agent by making the customer feel a need to change the status quo.

In industrial or organizational sales, a salesperson develops a new account by taking the following steps. First comes the search for potential accounts, which the salesperson can target in his or her territory. Next, is the determination or identification of the key decision-maker, who makes purchase decisions for the organization. The salesperson tries to gain access to that individual. The salesperson should then project himself as a potential problem-solver for the client company. Doing so demands a lot of groundwork by the salesperson, who should understand the prospect’s needs and potential problems. The salesperson should then develop a feeling of dissatisfaction about present product usage and make the prospect perceive the need to change. Subsequently the salesperson should explain to the prospect the need for change and what the prospect would lose if he maintains the present status quo. The next step is to ensure that the prospect’s perceived need to replace the existing product is converted into an action of actual replacement. The salesperson should create conviction in the prospect’s mind that the decision to change to the new product is right and should coax the prospect to act on the decision. However, the job is not done once the customer places the order. The salesperson must try to develop a long-term relationship with the company. The customer should be reassured that the decision is indeed wise and that a better bargain could not have been got.

Sales Maintenance

After successfully developing a new account, a salesperson has to maintain the account. After converting a prospect into a customer, the priorities of the salesperson change. The main concern now is to retain the customer and ensure that he increases purchases from the company. The major objective at this stage is to maintain the company's position in the market and defend it from probable threats from competitors. To maintain this dominant position, the salesperson should acquire thorough knowledge of the customer's organization, operations and human and financial resources. He should always be available to customers to solve their product-related problems.

SALES FORCE OBJECTIVES

The marketing department develops sales force objectives in coordination with the sales department. These objectives may be qualitative or quantitative. Qualitative objectives are long-term while quantitative objectives are short-term in nature.

The following are some qualitative objectives of a sales force:

- Effective time management – managing sales calls, sales presentations and closing the sale within a reasonable time frame.
- Possessing sufficient knowledge – about the company, its products, policies, competitors and customers.
- Maintaining efficient customer relations –provide assistance and advice on product usage and give all such information that may be needed by the customer.
- To project an attitude and appearance that will please customers.
- To secure all relevant market information that may be needed by the company.

The following are some quantitative objectives of a sales force:

- Increase the market share of the company and subsequently manage and retain it.
- The number of sales calls made per day and the number of days worked.
- Sell the optimum mix of the company's products, to achieve maximum profitability.
- Generate a certain number of new accounts in a specified time.
- Minimize sales expenses.
- Procure a certain quantum of business from a certain number of clients.

It is essential for a sales force to achieve both quantitative and qualitative objectives. These objectives help the management assess the performance of the salespeople and identify weaknesses of individual salespersons and help overcome them.

SALES FORCE STRATEGIES

Sales force strategies fall into two categories. These are to gain market access and to maintain account relationships. Gaining market access can take place by using distributors, developing hybrid marketing systems and establishing alliances. The account relationship strategy deals with the management of sales accounts in an organizational set-up, apart from individual sales accounts.

Market Access Strategies

Before planning to gain access to a specific market, it is important for an organization to analyze market potential and the size of different prospective accounts.

Companies normally use different approaches to enter various target markets. These include the company's own sales force, the distributor's sales force, telemarketing, the Internet and so on. For instance, IBM used the services of about 5,000 salespersons initially to sell products directly to customers. When lower priced computers entered the market, IBM altered its strategy and included 18 other channels so that it could enter more markets and sell its products. Let us now list the various approaches, which can be adopted by companies to gain access to new markets and then discuss them.

- Company's use of its own sales force
- Use of distributors
- Telemarketing
- Independent sales agents
- The Internet
- Developing hybrid marketing systems
- Establishing alliances
- Account relationship strategy

Company's use of its own sales force

To gain market access, companies need to ensure that their sales force is geared to meet the challenges of new market conditions and new technology. They need to impart training to their sales force at regular intervals to enhance their selling skills and increase their efficiency. Companies can then use the sales force to gain market access, by creating a demand for products.

Use of distributors

For manufacturers, especially those catering to industrial markets, it is very important to maintain a good relationship with distributors, because manufacturers sell the maximum proportion of their products through distributors. Only a small proportion of products are sold by manufacturers directly. A marketer should develop a thorough understanding of distributor needs and develop a working relationship with them. Managing the relationship efficiently and effectively is as important as developing it.

Understanding distributor needs

Generally, marketers who are not familiar with the distribution function find it difficult to identify distributor needs. To overcome this difficulty, marketers must gather as much information as possible about distributors through various methods. The company's field sales people can collect information about changing needs of distributors by interacting with them. The information generated can help the marketer analyze micro and macro environmental factors. Based on this, the industrial marketer can alter and develop strategies to effectively satisfy distributor needs. For example, to efficiently manage the distribution function, DuPont set up a marketing steering committee consisting of a distributor marketing manager for each of its 35 divisions. These managers were responsible for managing the company's relationship with distributors. The discussions among the distributor marketing managers helped Dupont learn about distributor problems, changing trends in the distribution function and new requirements. Apart from setting up such steering committees, some companies hold distribution councils once a year to recommend strategies for effective distribution management.

Developing a working relationship

Developing a working relationship with distributors is a crucial part of the distribution strategy. A firm can maintain a better working relationship by offering its distributors greater benefits than those offered by competitors.

For a good working relationship, it is always beneficial to seek the help of experienced consultants, who understand the needs of distributors as well as manufacturers. Another method is to align sales policies according to distributor needs. For instance, during the 80s, Cherry Electrical Products, a manufacturer of electrical switches, electronic keyboards and other related products, observed that the sales of distributors dealing in electronic items was increasing, but the sales of its own distributors were plummeting. To improve sales, the company employed a new distributor marketing manager who studied the market and found that distributors desired higher discounts. He then altered the sales policies of the company by revising its discount programs, helping the company improve sales.

A distributor marketing plan should also include a situation analysis (explaining the activities of the partnership), a SWOT analysis and what the distributor and the manufacturer expect from each other.

Maintaining proper two-way communication between the manufacturer and the distributor, along with sincere commitment from both sides, will result in an effective working relationship.

Managing the relationship effectively

Relationships with distributors can be managed effectively if manufacturers meet delivery schedules, maintain quality standards and support distributors with timely promotional and advertising campaigns. Finally, amicable resolution of disputes that may arise is also important to manage relationships effectively.

Such measures will encourage both parties to enhance their performance and overcome any minor problems. It will also help retain the distributors with the company and prevent them from switching to competitors.

Telemarketing

Identifying new accounts is an important activity for salespersons. Telemarketing is one of the most efficient tools for identifying new prospects and turning them into profitable accounts for the company. Telemarketing involves contacting customers using telecommunication technology. The main aim of a telemarketing executive is to sell products to customers over the telephone. In-house telemarketing is supplemented by outsourcing these activities to BPO firms that take up the responsibility of finding potential customers and increasing their clients' market access. India is one of the emerging markets in the field of telemarketing and customer services.

Independent sales agents

Compared to previous decades, there was a significant change in the selling process in the 90s. Independent sales agents were meant to cover a given territory and develop sales relationship with customers. The trend changed and independent sales agents began handling accounts rather than territories. Companies decided to use either in-house sales forces or independent sales agents, or both, on the basis of various factors like territory, market segment and customers. The primary reason behind the decision was the cost-to-sales ratio. For independent sales agents, this ratio remained constant. For an in-house sales force, it varied. When the market slumped, the cost-to-sales ratio rose for in-house sales force and vice-versa. In the case of independent sales agents, the commission is given, if a sale is made.

The Internet

The growth of the Internet has been phenomenal and it is still growing at an astronomical rate. This has given a significant boost to business on the Internet. Sales worth millions of dollars are nowadays being conducted online over the Internet. The biggest advantage in online sales is that they do not require heavy investments. Costs come down substantially. Also, these sales are not limited by geographical boundaries.

Developing hybrid marketing systems

Previously, companies used either direct sales forces or distributors to sell their products in the market. In recent times most companies are using a combination of several marketing channels or hybrid marketing systems. When a company uses more than one channel for marketing its products, it is termed a hybrid marketing system. Significant increase in competition in almost all industries during the last decade has compelled companies to adopt a hybrid marketing system and increase their reach. Companies are now selecting channels for different segments of customers. An example is IBM, which has a hybrid marketing system. Initially, IBM depended on its sales force for distributing its products. In the late 1970s, it realized that this was not enough to exploit the growing market. IBM switched to a system with various channels such as dealers, value-added resellers, catalogue operations, direct mail and telemarketing. These new channels allowed IBM to effectively sell products to a larger customer base and increase its market share significantly. Companies are increasingly adopting hybrid marketing systems to decrease costs and reach more people.

To adopt a suitable hybrid marketing system, the company has to decide on the number of channels it wants to use to sell its products. This can be decided if it analyzes the marketing tasks it has to perform.

Establishing alliances

Another major sales strategy that companies adopt to gain access to new markets is to establish alliances with other companies through mergers, acquisitions, consolidations, take-overs and joint ventures. For instance, IBM has strategic alliances with 153 companies across the globe. In India, many companies have established strategic alliances for developing business. Examples are Maruti-Suzuki and Hindustan Motors-Mitsubishi. In strategic alliances, both partners should share a commitment to achieve a common goal, as well as allocate necessary resources towards achievement of that goal.

Account Relationship Strategy

Managing account relationships is yet another sales force strategy. The sales force of an organization should develop and manage long-term relationships with customers. It is very important in the case of organizational selling because continuous transactions take place between the salesperson and the customer. The customer makes repeat purchases of the same type of products at frequent intervals of time. The sales person has to meet the same customers often due to the limited market available for the products this is not the case with consumer goods. There are several types of consumer goods available for purchase and repeat purchases are infrequent for goods such as television, washing machine, refrigerator, and so on.

Organizational buying, by nature, is complex as several people are involved in the purchase process. In contrast, purchase by individual customers is different. It is less complex and involves less number of people in the buying decision. In an industrial set up, due to the involvement of a number of people in the purchase process, their individual tastes and preferences, authority and power and a host of other factors affect the final purchase. This requires a sales person to put in considerable effort to understand the various dimensions of the organizational set-up before trying to make a sale.

THEORIES OF PERSONAL SELLING

While some people consider selling an art, others call it a science. Certain theories have been developed for personal selling, based on experiential knowledge rather than on a scientific or systematic basis. These theories are based on approximation. They are called the AIDAS Theory, Buying Formula Theory of Selling, Behavioural Equation Theory and Right Set of Circumstances Theory.

AIDAS Theory

AIDAS is an acronym for Attention, Interest, Desire, Action and Satisfaction. Attracting customers is the most important function of a firm. For doing this successfully, it is essential to understand customer behaviour. The AIDAS theory says that a prospective customer's mind passes through five stages before making the actual purchase. The five stages are attention, interest, desire, action and satisfaction. For a sales presentation to be successful, it has to lead the customer through these five stages. The point to note is that the customer goes through these stages consciously and not sub-consciously.

Obtaining attention

The initial stage of securing the customer's attention is very difficult. A salesperson should be highly skilful to successfully cross this stage. Usually, customers are highly defensive when they come across a salesperson because of their inherent feeling that the salesperson is bent upon selling something. This tendency among customers makes the initial stage of selling difficult to handle. Salespersons should search for ways to overcome this problem. One quite often suggested solution is for the salesperson to start the discussion by talking to the customer about himself or discuss the business environment. Such conversations are most likely to be successful starters, as people often like to hear or talk about themselves. Once the salesperson gets the customer's attention, it becomes easier to guide the customer through the other stages of selling. Exhibit 4.1 discusses some effective ways that can be used by salespersons to secure the attention of the prospect.

Creating interest

After obtaining attention, the salesperson tries to enhance this attention to an extent that it will get converted into interest. Salespeople should give the prospect a clear description of the product attributes and benefits and try to gain the prospect's interest in the product. During these discussions, the prospect might ask certain questions, which may reveal interest on some specific product attributes. The salesperson should be skilful enough to catch these hints and stress them to gain maximum interest. Similarly, sometimes the prospect may talk about his apprehensions about certain attributes of the product or the product itself. In such situations, the salesperson should look at the issue from the prospect's perspective and allay fears.

Stimulating desire

After obtaining attention and gaining interest, the third stage is to stimulate desire in the prospect's mind. At this stage, the salesperson should carry on the discussion to generate a desire to purchase, in the prospect. Sometimes, the prospect will have certain objections regarding the product, its qualities or perhaps of the entire selling process. Here, the salesperson has to deal with the objections tactfully and clarify them without leaving scope for further objections.

Exhibit 4.1

Effective Opening Statements

The manner of introduction is particularly important if the salesperson does not have an appointment. While making cold calls, the salesperson should remember that it is he who wants to see the customer, and not the other way round. In such a situation, it is very important to gain the customer's attention. If there is no attention, then there will be no interest. If there is no interest, there will be no sale. Given below are some effective attention-gaining statements.

1. Question opener. The salesman should start the opening statement by asking a question. If the prospect responds, it indicates that he will pay attention. For instance, insurance agents often gain attention by asking customers whether they know that the sum they need to be insured for depends on their money-value. Such questions should be relevant to the prospect, otherwise there is danger of losing the sale.
2. The startling opener. A statement that will startle the prospects or a good punch line will also do the job as an opening statement. For instance, a sales representative of an insurance company can start the discussion with his prospects by saying that they are sure to run away if he tells them the business he is dealing in. This type of startling statement will immediately catch attention.
3. The mystery opener. The salesperson can also start the conversation by arousing the curiosity of the prospect. For instance, a salesperson may say that he has heard something very strange about the prospect's business. Such statements are sure to attract attention.
4. The big-name opener. The salesperson can start by using the name of some big personality and associate it with his product or company. For instance, someone selling pens can say that the first Prime Minister of India, Pandit Jawaharlal Nehru had used his company's pens.
5. The service opener. If the salesman is selling products that may need after sales service, he can try to gain the prospect's attention by offering to check his equipment and carrying out some minor servicing on the equipment.
6. Gaining attention by exhibiting. The salesperson can attract attention by showing a part of a product. For instance, when microchips were first introduced, salespersons from computer companies would exhibit the chip to their target audience, while stating that the new gadget would revolutionize the world one-day.
7. The referral attention gainer. Salespersons can utilize the names of old customers as references, with their permission, to target new prospects.
8. The insult. Although this is not a recommended strategy, except in the rarest of rare cases, there might be people who can be targeted with a subtle insult. For instance, there is the story of the salesperson who went to a prospect who would never entertain salespersons. Naturally, he was denied a meeting, but this salesperson persisted and waited a week to see him. Finally, the prospect called him and yelled at him demanding why he was waiting, in spite of knowing that he (the prospect) would never see a salesperson. The salesperson replied with a smile "Just to say that you can go straight to hell." After an hour, the salesman returned with a very big order.
9. The compliment. Salespersons can effectively use this safe approach of giving the prospect a sincere and genuine compliment, which will automatically lead to gaining his attention.

Adapted from Ted Pollock, "How To Command the Prospect's Attention," American Salesman, August 2003, Volume 48, Issue 8, 22-26.

It is always better for the salesperson to anticipate objections and clear them even before customers raise them. Doing so increases the chances of stimulating desire in the prospect's mind.

Leading to action

The next stage is to lead the prospect to act. In this case, buy the product. After a careful sales presentation, it is the salesperson's duty to ask for an order. It is good strategy to ask for an order politely and straightforwardly. Some salespeople hesitate to ask for an order for fear of losing the prospect and instead prolong the discussion. This hesitation might lead to a prospective client being lost. Experienced and successful salespersons know when to close a sale and they will close it just when the time is ripe.

Develop satisfaction

After closing the sale, the salesperson should try to positively reinforce the customer's decision and generate a conviction in the customer's mind that he has done the right thing. The salesperson should thank the customer for purchasing the product and ensure that the supply will satisfy requirements. Subsequently, the salesperson should ensure that proper after-sales service is offered. The bottom line here is that the customer must be satisfied at all times with the product and the service.

Buying Formula Theory of Selling

The buying formula theory of selling discusses various aspects such as the mental state of a purchaser, the factors that lead him to decide whether or not to buy a particular product and so on. This theory describes the stages of the purchase process along these lines. The purchase process is said to be characterized by a psychological sequence of events that take place in the prospect's mind. The sequence of events includes – Need recognition – Solution – Purchase.

Usually, sellers are on the lookout for opportunities to establish long-term relationships with customers. Customer satisfaction is an important element that helps establish such relationships. So, satisfaction can be added as the last stage in the sequence of events that characterize the purchase process. The sequence becomes – Need recognition – Solution – Purchase – Satisfaction.

The solution can be a product/service from a manufacturer. Therefore, the manufacturer can also be considered a part of the sequence of events that characterize the purchase process. The sequence of events will then be represented like this -- Need recognition – Product/Service or Manufacturer – Purchase – Satisfaction. It is possible that the solution (a product/service) may satisfy the customer's need and create a favourable opinion in his mind. The reverse too is possible.

It is important that the consumer understands why a particular product or service satisfies his needs fully and how he would benefit by purchasing the product from a particular seller. Having such knowledge will help the customer in effectively defending his purchase decision against competitor's sales force and in reducing post purchase dissonance.

Behavioural Equation Theory

The Behavioural Equation theory is based on a stimulus-response model and involves four elements of the learning process – drive, cue, response and reinforcement. According to the behavioural equation theory, customer decision making comprises different stages of the learning process and consists of the elements mentioned above.

Drives are strong internal forces that induce a response in the buyer. They are of two types – innate drives and learnt drives. Innate drives arise from unmet physiological needs such as hunger, thirst, pain and so on. Learnt drives arise from a craving for fulfilment of social needs such as status or recognition.

Cues are a form of weak stimuli that decides the response patterns of the buyer. Cues are again of two types – triggering cues and non-triggering cues. Cues that activate the customer decision process are known as triggering cues. Non-triggering cues, as the name suggests, do not trigger or activate the decision process but have an impact on it.

Response is the behaviour exhibited by the buyer.

Reinforcement is the process of making the buyer's response patterns stronger.

The relationship between these four elements is represented by the following equation:

$B = P \times D \times K \times V$

where,

B = the act of buying a product

P = internal response factor or force of habit

D = the level of motivation or the present drive

K = the value of the product to the buyer

V = the intensity of all the cues combined.

As the variables in the equation, P, D, K and V, share a multiplicative relation with each other, if any of them is zero, then B will automatically become zero, resulting in no response. Whenever a purchase gives the buyer enough satisfaction, it will increase the value of his internal response factor, thereby resulting in the likelihood of future purchases. The salesperson will try to influence the behaviour of the buyer by stimulating his internal response at various stages of the selling process. Initially, the salesperson explains the benefits of the product to the buyer to influence a purchase. However, the greatest influence on the buyer will come from usage of the product. At a later stage, when the customer has gained significant knowledge about the product and its features, the salesperson has to induce the buyer to make repeat purchases by projecting the positive aspects of the product such as new features or its superiority over the competitors' products. At this stage, the salesperson's responsibility will be to continuously influence the buyer.

Right Set of Circumstances Theory

This theory is based on the assumption that creating the right set of circumstances will make the buyer respond positively and buy a product. However, this depends on the skill and experience of the salesperson. A highly skilled and experienced salesperson would know how to create the right set of circumstances, which will make the buyer take a positive decision.

Creating the right set of circumstances depends on internal and external factors. These can be best explained with the help of an example. Consider a situation in which a salesperson goes to meet the purchasing manager of an industrial firm. The salesperson, to create the right set of circumstances or a favourable impression, invites the customer for a cup of coffee at the local coffee house. In this situation, both external as well as internal factors will influence the customer's purchase decision. The external factors include the salesperson himself and the invitation for coffee. The internal factors include whether the customer desires to have coffee, whether he desires to have coffee at that point of time, whether he wants to go out, and whether he wants to go out with that particular salesperson. This can be considered as the initial phase of creating the right set of circumstances by the salesperson. Salesperson thus gradually builds rapport with the customer by meeting with him quite often.

APPROACHES TO PERSONAL SELLING

To develop and maintain account relationships, salespersons can adopt any of three approaches to personal selling. These are the

- Stimulus-response approach
- Need satisfaction approach
- Problem-situation approach

Stimulus-Response Approach

In this approach, the salesperson makes positive statements about the product, to elicit a positive response from the customer. The salesperson translates the features of the product into benefits that will be of value to the customer. The objective of the salesperson in the stimulus-response approach is to elicit a positive response from the customer by using statements such as ‘user friendly product’ or ‘satisfaction guaranteed’ etc. while describing the product.

Here, the salesperson has no idea about the customer’s needs. He assumes that the customer’s exposure to the product features will generate a need and elicit a positive response. There is very little involvement of the customer in the selling process. This approach is adopted when products are largely standard or benefits are similar for all customers. It is suitable when the salesperson is short of time or experience.

Need Satisfaction Approach

The need satisfaction approach focuses on the customer’s needs. The salesperson identifies the customer needs, gets the customer to agree on the needs and offers products that satisfy them. The need-satisfaction approach of personal selling involves two-way communication between the salesperson and the customer, where the former asks the latter relevant questions to identify his needs. In this approach, there is greater involvement of the customer in the selling process.

It is important that the salesperson should be skilled and experienced enough to ask the customer relevant questions that will help identify exact needs. Lack of finesse may cause the salesperson to lose the sale and irritate the customer.

Problem Situation Approach

The problem situation approach to personal selling is a combination of the need-satisfaction approach and the scientific technique of problem solving. In this, the salesperson helps the customer identify the problem situation, suggests various alternative solutions to address the problem, examines the pros and cons of each solution and then helps the customer identify the best solution.

This approach takes longer to practice than other approaches. Computers, telecommunication equipment etc are sold using this approach of personal selling.

PERSONAL SELLING PROCESS

A study of the personal selling process is essential to understand the various stages through which a lead passes before culminating in actual sale. The process consists of seven stages. At each stage, the salesperson adopts different selling techniques, which depend on the product and the type of customer. The following are the stages involved in a personal selling process:

- Prospecting
- Pre-approach
- Approach
- Sales presentation
- Handling objections/sales resistance
- Close
- Post sales follow-up

Prospecting

Prospecting is the first stage in the selling process and involves the search and identification of potential customers who may be willing to buy a product and have the ability to do so. The salesperson obtains contact information about the prospect and makes cold calls to him. Information about prospects can be obtained from four different sources – external sources, internal sources, personal contacts and miscellaneous sources.

Some techniques that salespersons use to get information from external sources include community contacts (asking friends and relatives to refer potential prospects), contacting organizations (obtaining references from social and recreation clubs), contacting non-competing salespeople (seeking information on prospects from salespersons of other non-competing companies), referral approach (asking the prospect to give references of other potential prospects), introduction approach (asking the prospect over the phone, mail or in person to introduce other prospects) or by cultivating visible accounts (developing major and influential accounts that will serve to influence and attract other customers).

Sourcing of information from internal sources includes examining company and sales records (obtaining information about prospects from telephone directories, company records, membership lists and other such documents) and by obtaining information about prospects who enquire about the company’s advertisements over telephone, by post or in-person.

Information can be obtained from personal contacts through observation and by making cold calls. The final source of information, miscellaneous, includes information obtained by organizing or participating in trade shows and exhibitions. Miscellaneous sources also include information from ‘bird dogs’ i.e. junior salespersons, who search and locate potential customers and pass on the information to their seniors for making sales calls.

Pre-approach

In this stage, more detailed information such as the tastes and preferences of prospective customers is gathered. Salespersons need this knowledge to prepare sales presentations. It can also help them avoid making serious errors during the sales presentation. They can also qualify the prospects for approach. Techniques like interview approach are used by salespersons in the pre-approach stage to gather additional information about the prospect. In this approach, the salesperson seeks an appointment with the prospect by taking the help of intermediaries (such as mutual friends) by sending a letter to the prospect (requesting an interview), contacting the prospect over telephone for an appointment, or by asking an existing customer to write to the prospect seeking his consent for an interview.

Approach

This is the stage when the first official contact takes place between the salesperson and the prospective customer. The sole purpose of the salesperson is to catch the prospect's attention and instil an interest in him about the product. The prospect's attention can be got by asking him an open-ended question or by giving him a sincere compliment. Having aroused attention, interest can then be triggered by stating the benefits of the product. Some methods that can be used to obtain attention and generate interest in a prospect are:

- ✓ Non- product related approaches
- ✓ Peaking interest approaches
- ✓ Consumer directed approaches
- ✓ Product related approaches

Non-product related approaches include

The referral approach: using the name of a current customer as reference to approach the prospect.

The introductory approach: approaching the prospect by introducing himself.

Shock approach: Putting fear in the prospect's mind.

The premium approach: offering a gift to the prospect for consenting to a sales interview

Showmanship: dramatizing an aspect to gain attention and interest.

Peaking interest approaches include

Arousing curiosity: highlighting a product benefit,

Consumer directed approaches

Question approach: where the salesperson starts the interview with a question to gain the attention of the prospect.

Survey approach: offering to do research for the prospect and the

Compliment approach: paying the prospect a compliment.

Product related approaches

Showing the product to the prospect with little or no explanation about it. This helps a salesperson gain the attention of the prospect and generate interest about the product.

Sales Presentation

This is the most important stage in the selling process. The salesperson demonstrates the product to the prospective customer, explaining its features and stating its benefits. The objective is to induce a desire for the product in the customer's mind.

The techniques used by a salesperson to make the sales presentation include visual display techniques, presentation techniques and non-visual clarification techniques.

Visual display techniques

Visual display techniques include

Visualizing -- helping the prospect visualize the product by using pictures or graphs

Demonstrating -- demonstrating the utilities of the product to enhance its appeal.

Presentation techniques

Presentation techniques can be of three types –

Customized sales presentation -- the presentation is tailor made to suit the prospect.

Partially standardized -- a sales presentation that is slightly different for each prospect.

Standardized sales presentation -- making the same sales presentation for all prospects.

Non-visual clarification techniques

Non-visual clarification techniques include

Questioning -- asking the prospect questions during the presentation to make sure that he understands what is being said.

Comparisons -- comparing the product with that of the competitors' and

Showmanship -- dramatizing the sales presentation.

Handling Objections/Sales Resistance

In this stage, the salesperson tries to clear the negative perceptions about the product in the customer's mind and create a positive image by reiterating its benefits and techniques that can be used to handle objections/sales resistance include

- Create strife techniques,
- Offset objection techniques,
- Clarify objection techniques
- Miscellaneous techniques.

Create strife techniques: These include

'Coming to that' method -- telling the prospect that the salesperson will answer any questions in a short while.

Comparative item method -- the salesperson should be prepared with more than one product or variations so that if a defect is pointed out, the salesperson can show another one.

Indirect denial method -- inoffensively denying the prospect's objection), use of humour (releasing pressure by telling a humorous story.

'It's in your hands' method -- accepting the objection and asking the prospect to decide and the

Pass-up method -- smiling and passing off the prospect's objection.

Offset objection techniques include

'Yes-but' method -- agreeing to the prospect's objection but offsetting it

Compensation method -- accepting the prospect's objection but highlighting the product benefits that compensate

Comparison or contrast method -- minimizing the prospect's objection by comparing or contrasting it with something acceptable and

Case history method -- describing benefits accrued by another prospect by buying the product.

The clarify objection technique includes

Demonstration method – demonstrating the utility of the product to the customer

Boomerang method -- converting the prospect's reason for not buying into a reason for buying and

Purpose trial-use method -- asking the prospect to use the product on a trial basis.

Miscellaneous techniques to handle objections and sales resistance include answering the objection by putting a question pertaining to the objection and comparing the product with the competition.

Close

This is naturally the most important step in the personal selling process. The salesperson asks for an order and tries to close the deal after negotiating and convincing the customer to buy the product. Some techniques used for closing sales effectively are

- Clarification closes
- Psychologically oriented closes
- Straightforward closes
- Concession closes.

Clarification close

A clarification close involves making

A comparison close -- comparing the product's features and benefits with that of a well-known competitor

A demonstration close -- demonstrating the product to the customer

A report close -- informing the prospect how another customer with a similar problem benefited by using the product

A choice close -- asking the customer to choose between product alternatives prior to closing the deal) or

An assumption close -- assuming that the prospect is ready to purchase and therefore, concentrates on other details of the transaction such as billing.

Psychologically oriented close

A psychologically oriented close involves the salesperson adopting different techniques such as

Silence -- leaving the purchase decision to the prospect

Minor decision close -- seeking the prospect's approval on a minor issue concerning the sale such as asking whether payment will be in cash or by card

'Buy-now' close -- creating urgency in the prospect's mind to purchase the product

Emotional close -- appealing to the prospect's emotions to lead him to make the purchase.

Straightforward close technique

A straightforward close technique involves the salesperson opting for

A direct close -- asking for the order directly

A summary close -- summarizing benefits described in the sales presentation to induce purchase

A single obstacle close -- the prospect is ready to make the purchase but there is a single obstacle preventing the decision and the salesperson has to clear this obstacle before closing the deal.

Concession close

A concession close involves the salesperson, after making the presentation, offering the customer certain concessions in terms of price discounts to close the deal.

Post-Sales Follow-up

This is the final stage in the personal selling process. The salesperson focuses on reducing any negative feelings the customer may have about the product, by stressing that the customer has taken the right decision to purchase the product and that it is a very good product. Such follow-up action leads to customer satisfaction, which in turn results in customer loyalty. Post sales follow-up has to be done at periodic intervals if the company wants to improve customer loyalty levels. Training the customer about how best to use the product, arranging for credit, etc. are other factors that form post-sales follow-up. Techniques used for effective follow-up are customer service activities, customer satisfaction oriented activities and customer referral activities.

Customer service activities include providing the customer the services of a consultant who will give specialized advice for his problems, explaining the billing process and other policies and procedures of the company to the customer, training him on the correct usage of the product, and arranging installation of the product at his place when required.

Customer satisfaction oriented activities include handling complaints effectively after the customer has signed the order, follow-up calls after the product is installed and is in use, building a long-term relationship, reassuring the customer about his purchase decision and thanking him for the purchase.

If the customer is happy with the product performance, the salesperson can ask the customer for references. This is the third aspect of post-sales follow-up.

CUSTOMER RELATED ISSUES IN PERSONAL SELLING

Organizations need to understand and manage customers effectively to be successful in the market. Customer related issues have to be dealt with so that they help the company improve profitability. Companies should devote significant time and attention to customer satisfaction, so that customers remain loyal to the company for long. Some critical customer related issues that confront a company are understanding types of customers through different styles of selling, finding customers, researching customers, communicating effectively, providing customer service and finally, creating customer satisfaction. Let us discuss each of these.

Understanding Customer Types through Different Selling Styles

Customers can be of different types. They can be understood by analyzing the four prominent styles of selling -- trade selling, missionary selling, technical selling and new business selling.

Trade selling

The most important function of a trade salesperson is to improve a company’s sales volume by providing promotional assistance. These sales people help retailers, who are the customers of manufacturers, in their promotional efforts. They help them to restock and rearrange products to create more shelf space, set up displays and assist with in-store demonstrations. They also distribute free samples to the store’s customers and at times perform the function of an order taker.

Missionary selling

The primary responsibility of a missionary salesperson is to promote the product to indirect customers of the manufacturer and encourage them to buy from the manufacturer’s direct customers. These salespeople are hired by manufacturers to disseminate information on new products. Medical representatives are an example of missionary trade salespeople. In the pharmaceutical industry, wholesalers are the direct customers of pharmaceutical companies and retail drug stores are indirect customers. The job of a missionary trade salesperson is to approach the retail drug store owner and inform him of new products manufactured by the company and persuade him to place an order with the wholesalers for those drugs. The term 'missionary' is used because their function is to assist the manufacturer in his selling efforts. Securing orders is not the core aspect of their job and it is incidental that missionary salespeople help increase the sales of a company. They also help sales rise by promoting the product to those who can influence its sales. For example, a medical representative's duty is to make visits to private practitioners and hospital administrators, promote a company's products and give out free samples to them.

Technical selling

Technical salespeople have specialized knowledge in their field, which helps them provide technical assistance to customers. These salespersons cater to the needs of existing customers of the company and advice them on the characteristics of the product. They provide them with details on installation procedure and use. Technical salespersons are mainly hired by companies that manufacture products involving sophisticated technology, such as computers, photocopy machines, scanners, X-ray machines and heavy machinery. For example, companies that manufacture and install elevators and escalators in India such as Otis, Kone, etc. send their technical engineers to provide the technical assistance needed by the customer.

New business selling

In new business selling, the company salespersons make cold calls on prospects and try to convert them into the customers.

This brings us to the question of how to find customers, what research should be done, effective communication and customer service.

Finding Customers

Prospecting, that is, searching for new customers, is the most important and difficult task in personal selling. Salesmen have to face a lot of rejection in their search for prospects. In recent times, salesmen have got some help. This help comes in the form of CDs developed by specialized agencies, which contain complete lists of people with their contact information and other details. Further, not all prospects become customers. Therefore, it becomes essential for sales persons to qualify their prospects before pursuing them. In organizational sales, salespersons also have the additional challenge of identifying the people who influence the purchasing process in the organization.

Researching Customers

After identifying prospects, the sales representative has to research prospects to learn their tastes, preferences and underlying needs. Conducting detailed research of customer's attitudes and buying habits helps a company to develop products that will appeal to potential customers. The process of collecting data and analyzing it can be carried out by developing a questionnaire and appointing professional researchers.

Communicating Effectively

Personal selling is an effective form of communicating to the customer, as it involves two way communication, unlike advertising. The intended message can be customized according to the customer's requirements. The effectiveness of the company's communication to its customers depends on the communication skills of its sales force. It is the sales force which has to tell customers of the benefits of the product or service and create a perceived need in the mind of the customer. Therefore, organizations should provide training to their sales force in effective communication skills.

Providing Customer Service

Another major customer related issue that needs to be addressed by companies is providing efficient customer service. With the spread of the Internet and other technological advancements, customers are now more demanding than ever. They are in a dominant position and can dictate terms to sellers. The customer is king and companies have to constantly find ways and means to please him or her. Firms are nowadays using software tools such as CRM (Customer Relationship Management) to establish and maintain better relations with their customers. Exhibit 4.2 describes the implementation of CRM in the insurance sector to improve customer relations. By maintaining good relations with customers, companies can judge the exact requirements of both existing and prospective customers. The most important aim of a customer relationship strategy is to maximize their (customers') long-term value to the firm. Firms should identify their most valuable customers and concentrate on serving them.

Exhibit 4.2

CRM in the Insurance Sector

CRM has been successfully implemented in the telecom and banking sectors. The growing insurance sector is eyeing for CRM solutions to improve business. Owing to intense competition in the insurance industry, the customer turnover ratio is very high. It has become essential for insurance firms to retain existing customers. These firms are therefore focusing more on selling their new products to existing customers rather than targeting new customers. Insurance companies feel that CRM tools, coupled with business intelligence, will help them assess all aspects of customer behaviour. In India, insurance firms spend around 12 per cent of their IT budgets on CRM tools. The IT investment in insurance is expected to grow substantially.

A report from India Infoline in January 2004 states that India has the highest number of Life Insurance policies in force in the world. Advanced CRM tools are being used by insurance companies like ICICI Prudential Life to retain existing customers and capture new customers. These tools help companies gather minute details about customers and help design tailor-made products for targeting them. Using these tools, ICICI Prudential Life has been able to capture five lakh customers. Other companies like Aviva Life Insurance Company India, Birla Sun Life, HDFC Life and MetLife too are using CRM tools to attract customers.

Adapted from Akhtar Pasha, "Insurance Sector to Drive Indian CRM Market," 16 February 2004, <http://www.express-computer.com/20040216/indiatrends02.shtml>

Creating Customer Satisfaction

Competition has never been as intense earlier as it is now. Once efficient customer service is provided, it paves the way for customer satisfaction. Maintaining high levels of customer satisfaction is essential if a company wants to sustain itself in the market for a long time. Customer satisfaction leads to customer loyalty.

Usually, companies have three types of customers -- customers who are in distress, customers who are just satisfied and delighted customers. The first category will not remain with the company for a long time. The second is vulnerable to competition and may shift to a competitor's product easily. Delighted customers, on the other hand, are those who are extremely satisfied and will be loyal to the company. It is vital that a company delights its customers and not merely satisfies them. To create customer satisfaction, companies should first identify customers who are not happy with the firm and try to resolve the problematic issues. Subsequently, they should try to identify factors that will delight customers. For instance, offering free accessories to an automobile buyer might delight him. So will a life time free warranty on household goods.

AUTOMATION IN PERSONAL SELLING

Over the past few years, sales personnel are being increasingly exposed to a number of advanced technology options. Innovations, particularly in telecommunications, have tremendously influenced the field of personal selling and sales management. Sales force automation, virtual sales offices and electronic sales channels have had a direct and positive impact on sales force effectiveness.

These tools have made the job of salespersons easier, and at the same time challenging. The first has happened because it allows the sales person to remain in contact with his office as well as his customers at all times and from anywhere. The second has occurred because constant connectivity requires constant alertness and better response skills than competitors' sales force. Imagine a situation where a sales representative, while on a sales call, receives a call from a dissatisfied customer seeking a clarification on an order he has placed with the company. In the past, the salesperson would not have been able to answer satisfactorily. The customer would have been dissatisfied and there would have been loss of business. Nowadays, the availability of automation tools means that a particular customer's details can be retrieved from a central database and made available to the salesperson on his mobile phone or laptop. Armed with this information, the salesperson can quickly resolve the issue and pacify the customer. Not only do such efforts by sales persons earn goodwill for the company but also lead to increase in business due to positive word-of-mouth publicity.

Some widely used sales force automation tools are pagers, cell phones, notebook computers, laptops, palmtops and personal digital assistants (PDAs). These tools make wide use of technology such as e-mail, fax, telephone, desktop videoconferencing and the Internet.

The diminishing size of computers from desktop to laptop, notebook, palmtop and pocket computer, accompanied by the increasing ability to operate sophisticated software applications has brought about a significant change in the buyer-seller interactions in sales. Using these tools means that the salesperson can spend less time in the selling process and more on building customer relations. It has also become possible to eliminate much of the paper work that salespeople were traditionally involved in like filing sales call reports, order forms, etc. Sales administration tasks like sending brochures, pamphlets and other information customized to meet the needs of prospects has also become easier with tools such as notebook computers.

However, most of these tools are expensive and should be used judiciously. Exhibit 4.3 describes some companies that have implemented sales force automation to enhance their sales performance. Some other companies are using low cost alternatives to automate their sales force. Exhibit 4.4 discusses the use of one such automation tool.

Exhibit 4.3

Handheld Devices for Sales Forces

A typical sales representative gets less than three minutes on an average to talk to a doctor. An FMCG salesman gets virtually the same time to talk to a retailer. When the span of attention a salesman gets is so less, it is very difficult to get orders. More so, if the salesperson is ill-equipped to answer the queries of customers and give them the information they seek.

To overcome these problems, companies like Procter and Gamble (P&G), Hindustan Lever Limited (HLL), Marico Industries, Microsoft, Life Insurance Corporation of India (LIC), ICICI Prudential, Allergan and GlaxoSmithKline are equipping their salespersons with PDAs (Personal Data Assistants) to record the orders and identify the availability of stocks at the retail outlet. PDAs help the salespersons of Allergan record the complete interaction they have with doctors and also take stock of the chemist's inventory. PDAs help not only help the salespersons save significant time on paper work and utilize this time to make more sales calls, but have it has been successful in increasing sales of many companies using it by about 10 per cent.

The software applications used in these devices have to be customized according to the requirements of the salespersons. Companies should ensure that salespersons spend less time feeding-in details in the PDA and more time interacting with the customer. At the same time, it is necessary to feed adequate information into the PDA. A balance has to be achieved. Another issue is the cost of these PDAs. With prices ranging from Rs.6,000 to 25,000, these devices cannot be given away like freebies. Firms are giving these tools to their top achievers in sales, to derive maximum benefit from these tools.

Microsoft in India has about 65 sales staff equipped with the HP PocketPC. These devices cost Rs.30,000 and above. They can capture all the specific details of individual customers like frequency of purchase, most preferred suppliers, factors determining purchase process and so on. These devices also help salespeople to download the latest information as and when they need.

Adapted from Shishir Prasad, "Handhelds for Foot Soldiers," Business World, 18 November2002, 24-26.

Benefits of Sales Force Automation

Let us now look at some other benefits of sales force automation. Automating the sales force helps a company forecast sales orders, keep track of them and ensure that they are met to the satisfaction of customers. Sales automation tools also help sales managers analyze sales and competitor trends.

Exhibit 4.4

Sales Force Automation

Some pharmaceutical companies are looking at low cost alternatives to automate their sales forces. Reliant Pharmaceuticals LLC, which cannot compete with major drug companies in the US to automate its sales force, has developed a new technological alternative. The CIO of the company, Ronald J Calderone, has developed new technology, which he named Victor, standing for (Voice Interactive Tracking & Operations Repository). This is an interactive voice response system that makes use of speech recognition technology and provides updated information to sales personnel. The salespersons respond to a series of questions posed by the system and the data gets stored in an SQL database. This data can be retrieved later by the sales manager to assess the sales calls made by his team. It can also be accessed by sales representatives to obtain information on specific clients. The money spent on developing this system has been recovered in less than a year. Now, the CIO of the company is thinking of marketing this new technology as an alternative to the usual automation tools that cost around $4 to $6 million.

Adapted from Bob Brewin, "Reliant Gets Fast Sales Data with Interactive Voice Response System," Computerworld, 15 March 2004, Volume 38, Issue 11, 6-8.

Exhibit 4.5

Sales Force Automation for Better Customer Relationships

Sales force automation tools can be used for forging better customer relationships. Relationship marketing, also called consultative selling, helps companies maintain long-term relationships with customers by interacting with them regularly and offering them necessary information and services. Sales force automation tools use digital and wireless technology. Tools include mobile phones, voice messaging systems, fax machines, e-mail, notebook computers, personal digital assistants (PDAs), interactive websites and CRM data warehouses. These are being used by salespersons to improve customer loyalty and customer service.

Some important utilities of sales force automation that aid CRM are Contact Management, which involves identifying details of all those in the client organization, who are decision makers. There are also other tools that help effective communication with customers by sending them customized mail. Efficient lead management and opportunity management tools assist salespersons to convert leads into profitable customers. To sum up, detailed data capture using sales automation tools significantly contributes to better relations with customers.

Adapted from Khalid Sheikh, "Using Sales Force Automation to Build Customer Relationships," 10 May 2004, <http://www.express-computer.com/20040510/technology01.shtml>

Information sharing

Software applications that facilitate information sharing are immensely beneficial to a salesperson, who needs constant and real time access to information pertaining to his company's products and services, price or product changes, status of orders, stock availability, hot leads and market trends. A representative who does not have ready access to such information will lose out to competitors' sales force, which may be armed with the latest and updated information. Tools such as notebook computers empower sales forces by giving them direct connection to large databanks of readily available information. They do not have to source information by contacting their sales managers or headquarters. Ready access to information allows a salesperson to concentrate on sales calls instead of wasting time in unnecessary paperwork.

A good illustration here is IBM. The company equips its sales force with notebook computers that give access to the complete cost data pertaining to products. This helps salespeople calculate the profitability of every transaction. Apart from profits, IBM also wants its salespersons to play the role of a consultant to customers. These notebooks help in that specialized activity. IBM's salespeople are involved in anticipating the changing needs of customers, identifying market trends and developing strategies to meet them.

Handling customer alerts

Whenever customers want information or a clarification regarding products or a sales order, they expect the sales representative to be ever available for a reply. In reality, salespeople are most often not available in their office but out on calls. In the past, the customer had no other option but to leave a message and wait for the salesperson to get back to him. Sales force automation has solved this problem by enabling salespeople to get alerts about customer queries or complaints via the salesperson's e-mail account, pager, cell phone or PDA. They can then respond as soon as possible, preventing the customer from thinking of shifting to another firm. Exhibit 4.5 describes how companies use sales force automation tools to improve customer relations.

Reporting sales force activities

Sales force automation tools also provide an added advantage to sales managers by enabling them to track the activities of their sales representatives. Keeping count of the number of sales calls made in a day, the number of customer complaints received and attended to, the time and place of meeting customers and so on has become possible by the activity reporting capabilities of sale automation tools. Having these details on hand helps sales managers to assess the salespersons' performance, apart from improving the sales process.

Tracking the progress of leads

These tools also offer lead tracking capabilities by allowing sales managers to generate detailed reports on how leads are progressing. Most leads start with bits and pieces of information regarding customers such as an email-ID or a telephone number. The salesperson then has to put in substantial effort to introduce himself, sell the product and build long-term relationships with customers. Reports generated by sales force automation tools help sales managers determine which leads will be profitable to the organization and which will be non-profitable. This information is invaluable in determining which leads salespeople should follow-up and which will be a waste of time and energy.

Accurate routing of leads

In a sales organization, leads are routed to representatives on the basis of his or her expertise, territory of operation and other specified criteria. Routing leads to the wrong salesperson, can prove disastrous. Sales force automation tools help route the right leads to the right sales person. This allows the company and the representative to effectively exploit the potential of every lead profitably.

Internet based facilities

Sales force automation tools make effective use of the Internet to help sales persons in their daily job activities. Some companies make customer information available on the Internet, so that sales people can log on to the Web to access information from anywhere.

These tools also help companies to exploit sophisticated technology such as desktop videoconferencing to conduct sales meetings, training and customer interactions with salespeople and sales managers. Desktop videoconferencing overcomes the hurdle of geographic distances and made it possible for vital market information to be exchanged from far off locations. For example, General Electric uses a system known as Quick Market Intelligence (QMI), which allows its sales managers to communicate with salespeople spread across 12 different markets. The field sales force of the company, in weekly videoconference meetings, interact with personnel at headquarters and exchange information on market opportunities and challenges and decide on prompt action.

Using specific software packages, sales force automation tools also help sales persons to access large amounts of online sales information. An instance is the seeding approach, where salespeople mail relevant information in the form of newsletters to prospects prior to making a sales call, in the hope of making a sales harvest.

Customer profiling

Most companies ensure that their sales representatives have a complete and detailed profile of their customers, such as the customers' past buying habits, past complaints and so on. This information, when updated regularly in a central database accessible to all sales representatives, provides them with current information on every customer. Nobody is left with outdated information.

Comparison of historical data

Predicting the behaviour of an individual customer is an easy task for a salesperson compared to predicting the behaviour of a group of customers. For the latter, comparison of historical data becomes useful. By such comparisons, salespeople can predict the purchase patterns of a group of customers. The analysis will help salespersons to suitably modify or update their sales processes and attain success.

Competitive intelligence

Sales automation tools help the sales force to keep track of competitors and analyze their moves and strategies. Sales teams can identify the strengths and weaknesses of competitors by evaluating which of their strategies were successful and which failed. Such analysis helps organizations to avoid mistakes made by competitors.

Sales forecasting tools

Sales force automation tools help sales managers forecast sales patterns in the near future and set sales targets accordingly. These forecasts help the sales person to assess his performance against targets.

SUMMARY

Personal selling is the process of selling goods and services directly to customers. Personal selling is far more significant than other forms of promotion as it allows the salesperson to describe the product in detail to the customer in person. Personal selling is therefore a highly interactive tool of promotion and is best suited for products or services that are complex in nature.

The effectiveness of communication between the salesperson and the customer during the sales process decides the success of the sales call. The interaction between a buyer and a seller comprises a buyer-seller dyad. The likelihood of a salesperson making a sale to a customer is higher if he or she shares some characteristics with the customer.

As a part of the selling process, salespersons perform two entirely different tasks – sales development and sales maintenance. These tasks require different skill sets and different approaches, making it tough for salespeople. As most companies require the same salesperson to carry out both tasks simultaneously, salespersons often tend to ignore the more difficult of the two tasks, that is, sales development. Sales management has to differentiate between these two selling jobs for the company to be successful.

The objectives of the sales force are of two kinds, qualitative and quantitative. Qualitative objectives relate to the methods of sales force operations while quantitative objectives are the measurable actions of the sales force.

The sales force strategies of a company fall into two categories – strategies for gaining market access and account relationship strategies. Market access can be gained by using distributors, telemarketing, independent sales agents, the Internet, developing hybrid marketing systems and by establishing strategic alliances. Account relationship strategy deals with ways to manage sales accounts in an organizational set-up and individual sales accounts. It is essential for the sales force to develop and manage long-term customer relationships. This is especially important in the case of an industrial sales force, because there is a continuous transaction between the sales person and the customer here. The customer buys the same type of products from the sales person at frequent intervals of time. Maintaining strong relationships with customers will definitely boost repeat purchases. Offering discounts occasionally will significantly improve the chances of repeat purchases.

The theories of personal selling include the AIDAS theory, the buying formula theory of selling, the behavioural equation theory and the right set of circumstances theory. AIDAS is an acronym for Attention, Interest, Desire, Action and Satisfaction. This theory states that a prospective customer's mind passes through these five stages before he makes the actual purchase. The buying formula theory states that the purchase process is characterized by a psychological sequence of events that take place in the prospect's mind. The sequence of events includes need recognition - solution - purchase - satisfaction. The behavioural equation theory says that decision making by a customer comprises stages of the learning process and consists of drives, cues, response and reinforcement. The right set of circumstances theory is based on the assumption that creating the right set of circumstances will make the buyer respond positively and will result in a sale.

Further, in order to develop and maintain account relationships, a salesperson can adopt any of three approaches – stimulus response approach, need satisfaction approach or problem situation approach.

The selling process consists of a series of seven steps – prospecting, pre-approach, approach, sales presentation, handling objections/sales resistance, close and post sales follow-up.

Companies should devote significant attention to customer satisfaction, so that customers remain loyal to the company for a long time. Some critical customer related issues in personal selling include understanding types of customers through different styles of selling, finding customers, researching customers, communicating effectively, providing customer service and finally, creating customer satisfaction.

Over the years, sales personnel are being increasingly exposed to a number of advanced technology tools. Today, salespeople have a number of tools and techniques available to them that have made their jobs easier, and at the same time challenging. Sales force automation tools have made it possible for sales representatives to remain connected to their office and with their customers at all times. Connectivity not only provides the sales force with a competitive edge in selling but also improves their effectiveness and productivity.

Chapter 5

International Sales Management

In this chapter we will discuss:

- Role of the sales manager in the international market
- International sales and marketing opportunities
- Challenges in international sales management
- Strategic issues for international sales and marketing
- International sales techniques
- Structures for international sales organizations
- International sales management practices

There has been a major growth in international business since the early 1980s, with companies expanding their operations across the globe in various markets. Due to this spurt in export activities of companies, sales management has become more global-oriented in nature. Multinational companies have begun to view sales management as a tool to implement their marketing policies in foreign markets. This is because it is the sales force that primarily helps develop dealer- and distributor-networks, maintain win-win relationships with them, identify customer needs and collect information on changes in the market environment. Most of the functions in international sales management are similar to those in domestic markets. The difference lies in the expansive approach needed in managing the various aspects of sales at a global level.

In this chapter, we shall first study the role of the salesperson and the sales manager operating in international markets and the opportunities and challenges faced by organizations when they enter these markets. This is followed by a discussion on the strategic issues involved in international sales and marketing, and the various sales techniques that can be employed to attain success in foreign markets. The chapter concludes with a discussion on the structures of international sales organizations and the management practices adopted by managers responsible for international sales.

ROLE OF THE SALES MANAGER IN THE INTERNATIONAL MARKET

The role of a sales manager in a foreign market, in terms of basic managerial functions involving planning, training, compensation and evaluation, is more or less similar to his role in the domestic market. However, the management approach varies from country to country due to differences in culture. The importance given by sales managers to ethics, hierarchical relationships, aversion to risk and short-term profits varies in different cultures. The international sales manager must look beyond the traditional management approaches followed in his home country. The various roles of the sales manager in the international sales scenario can be studied in terms of basic and advanced level functions.

Basic-Level Functions

The basic-level functions of a sales manager include training and evaluating the sales force as well as planning. Compensation packages for the sales force also falls within the purview of his responsibilities.

In order to be effective in a foreign market, a sales manager must not only be well-versed in these functions, but must also have a detailed understanding of the impact of the political, economic, legal and socio-cultural environment of the host country on them. Further, the sales manager must have an in-depth knowledge of the activities of the company across the world. Familiarity with the global operations of the company helps a sales manager in effective decision-making in the host country.

For a sales manager to successfully manage local operations and ensure profitability, he must have a good knowledge of the local conditions and work place rules. This is of particular significance because there are variations in the compensation and perks offered to sales personnel in different countries.

For example, in Belgium it is mandatory for companies to provide healthcare facilities, social security and four weeks vacation to employees. A cell phone and a car are part of the perks for the sales manager and the sales personnel.

In Japan, the compensation plan offered to the sales personnel should comprise a straight salary and individual performance bonus should be avoided. A two-week vacation is mandatory under the law. Sales managers must have a high expense budget since clients expect to be entertained five days a week.

In South Korea, the sales personnel are customarily given a lump sum as expense amount. These sales personnel prefer a commission-based compensation plan and the law stipulates that they be given a minimum of three days vacation in a year.

Customers in developed nations have a tendency to keenly compare alternative options of purchase and display impatience with limitations in product benefits and service offerings. The international manager must be able to put in place a selling team which can respond suitably to the varying needs of customers.

The sales manager must lay more emphasis on relationship selling than persuasive selling. To cater to this requirement, he has to use suitable methods of recruiting, training, compensating and evaluation to develop the right skills in the sales force.

Advanced Level Functions

The advanced functions of an international sales manager include developing customer relationship strategies like strategic account management, conducting negotiations and arranging agreements with distributors. An international sales manager must try to meet the requirements of the local customers, improve profitability and, at the same time, maintain selling costs. He must be able to leverage the strengths of the home country as well as those of the host nation.

International sales managers have to negotiate with the local government officials, distributors and customers. This requires a pretty high multi-cultural awareness and experience. Companies like IBM and Xerox train their managers to operate at the advanced level by offering them international assignments right from the outset. The sales management tasks performed by the international sales manager in the host nation should not have any nationalistic undertones.

The sales manager must work towards identifying the latent needs of the local population and devise ways to improve the company's credibility among the local officials, business community and the common man. Hence, he needs to spend time on developing relationships and networks locally. On the whole, the skills and awareness required by the international sales manager are of a very high level and the role of an international sales manager is one of the most challenging roles in selling.

INTERNATIONAL SALES AND MARKETING OPPORTUNITIES

International sales offers numerous opportunities to companies planning to enter foreign markets. The primary reason for companies looking for opportunities outside the home country is the saturation in demand in the domestic market. Faster growth rates of other nations because of a vibrant economy, low manufacturing and labor costs in developing nations, the necessity of securing a first-mover advantage, achieving economies of scales, bilateral trade agreements, presence of niche markets and need for higher profits are some of the other reasons why companies enter foreign markets. We shall now briefly discuss some of the reasons for the entry of companies into foreign markets.

Diversifying market base: The customer- or market base for companies in the home nation is very limited. This prompts them to expand into foreign markets. Another reason for doing so is to obtain foreign exchange in the form of profit repatriation. Japanese companies are the best example of companies entering foreign markets to diversify their market base. After the Second World War, Japanese companies concentrated on serving and developing local markets. Once local markets were saturated, these companies began to look for opportunities beyond the shores of Japan. Most of them entered developing countries in order to sell excess output and reduce production costs. Once they achieved production standards and product quality in the late 1960s, they entered the developed markets.

Emulating the Competition: Companies tend to imitate the competition. When some companies enter foreign markets, their rivals too feel the need to look for demand outside domestic markets. One major reason for companies deciding to go international is the desire to avoid being designated a local player. In the computer industry, Japanese companies had to go global in order to compete with IBM, which had begun operations in the Japanese market. Japanese computer firm Fujitsu entered into an agreement with Siemena HG, a German company, to sell computers in eleven European countries and compete against IBM.

Thus, although following the competition is not the only reason why companies enter foreign markets, it is often the primary cause. Most companies expand their markets overseas to overcome the long-term disadvantages that might arise because of not being a global player.

Achieve Economies of Scale: Another principle reason of entering overseas markets is to gain economies of scale. Increased production leads to faster movement along the experience curve, together with a reduction in manufacturing costs. For example, Airbus took 3,40,000 man-hours to manufacture its first plane while its 87th plane took just 78,000 man-hours. The opportunity of achieving economies of scale by itself is not sufficient reason to enter foreign markets. A thorough cost/benefit analysis on all aspects is necessary before making the final decision to spread wing. The Japanese were the first to take full advantage of economies of scale as part of their global selling strategy. It helped them to reduce their prices and compete aggressively with competitors in the market of the host nation. In the early 60s, Hitachi entered developing markets like Brazil and Hong Kong, and the economies of scale it had gained over the years enabled it to sell its computers at prices 50% to 60% less than those of IBM. By 1980, the Japanese had 70 machinery manufacturing plants, 44 electronic products plants and eight precision instruments plants in the US itself.

Though there is a range of opportunities available for companies to enter foreign markets, a company must undertake a thorough cost/benefit analysis on various aspects before it makes such a move.

CHALLENGES IN INTERNATIONAL SALES MANAGEMENT

There was a sudden increase in companies entering foreign markets in the early 1980s when many large organizations shifted their production activities to developing nations to offset rising labor costs and competitive pressures in the domestic market. Selling in foreign markets is fraught with unknown risks. The success of an international sales manager depends on the extent to which he is aware of the environmental conditions prevailing in the markets into which the company plans to expand. It is absolutely necessary that the international sales manager be aware of the economic, political, social and cultural conditions prevailing in the proposed country of operations.

Economic Environment

The economic conditions prevailing in the host nation play a major role in influencing the success of an international sales manager in handling the operations of the company in that country. For example, the per capita income of the nation has a direct influence on the sales of large consumer goods like refrigerators and cars. A country having a high per capita income provides a good market for a manufacturer of such goods. Similarly, the population of the host nation has an impact on the sales of staple food products. Hence, it is necessary for the international sales manager to be aware of the economic nuances of the country of operations. Some economic factors that have a significant impact on international sales include tariff barriers, non-tariff barriers, and other economic factors such as exchange rate fluctuations, profit repatriation, etc. The impact of these factors on the operations of a foreign company is discussed below:

Tariffs barriers: The principle purpose of a country imposing tariff barriers is to protect the domestic industry. Tariff barriers are the most common restrictions that a company faces when it enters a foreign market. These barriers usually involve either partial or complete restrictions on the sale of foreign goods in the domestic market. A minor benefit of such tariffs is that they serve as a means of income generation for the host government. Different countries may impose different types of tariffs. The various types of tariffs include specific duty, compound duty and ad-valorem duty. Specific duty comprises the fixed percentage that must be paid to the local government based on the volume, length or weight of the products entering the country. Ad-valorem duty is calculated as a percentage of the value of the goods entering the country. Compound duties include imposing both specific and ad-valorem duties on a single product. The extent of tariffs imposed determines the costs and risks a company will have to face when entering a foreign market.

Non-tariff barriers: These are the indirect means of restricting the entry or sale of foreign goods in the domestic market. Many countries use non-tariff barriers to protect the domestic industry by impeding the ability of foreign companies to compete with domestic ones. Non-tariff barriers can be divided into three types, namely – regulatory barriers, industry barriers, and cultural barriers. Regulatory barriers take the form of policies and regulations imposed by the host country's government to restrict the entry or operations of foreign companies. They may be direct or indirect in nature. Direct regulations include quotas, duties and customs regulations that impede the entry of foreign companies. Indirect regulations are regulations imposed in the name of national security, environmental protection, exchange controls, profit repatriation, local content requirements and foreign investment ceiling. Industry barriers are another mode of restricting foreign companies from operating in the domestic market.

Companies wanting to enter foreign markets may face barriers like knowledge, capital or competitive reaction. Knowledge, in the form of expertise or technology awareness needs, forms a barrier to companies wanting to set up operations in a foreign country. This is especially applicable in the case of high-technology industries like biotechnology and microchips. Capital requirements -- large investments or providing capital security to the government -- also make up industrial barriers. The third type of industry barrier consists of responses by competing firms to restrict entry of other players into the market. For example, a firm may resort to price wars by cutting down prices for its products to prevent the entry of new firms into the industry. If the degree of product substitutability is high, then the response may create serious problems for the new entrant. Cultural barriers also play a major role in entering foreign markets and are discussed in more detail later in this chapter.

Other economic factors: Exchange rate fluctuations, restrictions on profit repatriation and credit control are some other economic challenges faced by organizations entering foreign markets. Inflation and adverse gap in balance of payments can lead to a fall in the host country's currency value. Under these conditions, the value of investments made and profits earned by the company in the host country get eroded. Inability to repatriate profits is another area of concern. The host government may impose restrictions on the amount of profit that a foreign company can send back to its country of origin. It may also impose restrictions on companies ploughing back profits into the business.

Many of these challenges may be unforeseen. However, it is always necessary for an international sales manager to have contingency plans ready to overcome such situations, should they arise.

Legal Environment

Countries differ in their legal framework and laws. It is imperative for any company entering a foreign market to be fully conversant with all the legal implications of conducting business in the market of choice. Since most multinationals enter foreign markets through alliances with local distributors and agents, it is necessary for an international sales manager to have a thorough knowledge of laws pertaining to partnerships and contracts. Lack of knowledge on these aspects increases the possibility of misunderstandings. The most common problem that arises with alliances relates to the termination of the distribution agreement. In countries like France and Austria, a company cannot terminate an agreement with its distributor unless the distributor is suitably compensated. In addition, in order to terminate its agreement with its distributor, the company must have a just reason, that is, a reason that is acceptable under the local laws. The definition of a just reason may be very ambiguous. In Germany, a distributor's poor performance is not considered sufficient reason to terminate a contract unless there is a prior agreement in this regard. In countries like Belgium, an agreement is considered to be automatically renewed unless the company gives a legal notice at the end of the contract period.

US-based companies have to comply with the Foreign Corrupt Practices Act of 1977. Under this Act, it is illegal for any US citizen to offer bribes in any form to officials in the host nation to obtain undue favors. This holds good even if a local distributor of the American company has offered bribes to local officials. Goodyear International Corporation had to pay a fine of $250,000 because one of its former employees was found guilty of making payments to Iraqi government officials to get additional business.

The influence of legal factors can be further understood by examining the problem of licensing and related legal implications pertaining to Intellectual Property Rights, patents and copyrights. According to the International Intellectual Property Alliance, a Washington-based organization, US companies lost US$ 15 billion in 1995 due to lack of proper legal frameworks in the countries of operation. Asia-Pacific countries accounted for 41% of this loss with China and Japan accounting for a major proportion, followed by South Korea, India, Philippines, Malaysia and Hong Kong. Legal frameworks may differ from one country to another. For example, in China, trademarks are registered in the name of the first applicant despite the rights being held by another company in other nations. Thus, companies intending to begin operations in such countries must register their trademarks with the appropriate authority in order to prevent such problems.

Singapore, Macao and Hong Kong have very weak laws to prevent illegal production of compact discs. Thus, piracy of computer software in Indonesia, piracy of motion pictures in Philippines and violation of intellectual property rights in Thailand are the result of absence of proper legal frameworks in these countries.

A sales manager must be aware of the legal environment in the country of operation. Otherwise it leads to failure in attainment of the sales objectives. For example, if a sales manager develops a sales quota for a software product based on forecasts and actual market potential without considering the impact of piracy on sales volumes, the quota developed will not be accurate.

Cultural Environment

International sales management requires companies to operate in various countries having different cultures. Cultural variations also occur in nations with a large number of traditions and languages. However, such wide differences are limited to certain countries such as India, USA and the African countries. The domestic market in most countries is more or less culturally uniform. When operating in foreign markets, cultural sensitivity is crucial to ensure successful sales. Many corporations have failed in foreign markets due to a lack of awareness of cross-cultural issues. For most organizations, cultural factors are a significant barrier in the path of international sales. Hence, it is necessary for international sales managers to have an understanding of the implications of culture on sales plans, policies and practices.

Culture is a way of life and includes all those attitudes and learnt behavior that is commonly followed by a society. The significant elements of culture that are important in sales management include religion, education, social organization, language and values. Let us try and understand how these elements influence the success or failure of an organization.

Language: Language is a major challenge for companies entering foreign markets. In countries like India, where over a hundred different languages and dialects are spoken across the country, salespeople must know the local language to communicate effectively. Even during sales training programs, a direct translation of English reading materials into the local language will not suffice since there is always a chance of the meaning being lost during translation.

Religion: Religion plays a significant role in international sales management. South-east Asian countries follow Buddhism or the Confucian philosophy. Both these religions stress suppression of desire and emphasize virtues and social relationships. Hence, in countries where Buddhism is the major religion, it is necessary for the sales manager to lay emphasis on the means of achieving sales targets rather than on just the end results. Selling approaches like hard-selling will not be taken in good spirit by either the local sales personnel or the customers in these countries because sensitivity to other's needs is given much importance.

Education: Education is another factor that can pose a problem for a foreign entrant. Companies require educated sales personnel, especially when they plan to sell technical products. Companies planning to set up manufacturing facilities also require qualified local manpower. The level of education of people in the host nation thus plays an important role in the success of a company's product. High-end products like computers sell more when the population is computer savvy. In east-African countries like Kenya, Ethiopia, etc., low-end high volume generic products such as soaps and detergents are sold successfully due to the low literacy rates in these nations.

The level of education also influences the level of the consumers' sophistication. This has an impact on the selling functions of the company entering the market. For example, low levels of education prevent the introduction of sophisticated products that makes it necessary to educate the consumers about the benefits of the product. Sales promotion activities in these countries must make more use of the electronic media rather than brochures, point-of-purchase material etc.

Social attitudes and behavior: An awareness of local business customs is necessary to ensure success in business transactions. For example, a large US-based manufacturer of household items failed in the Taiwanese market due to its rigid management system. This is because the salespeople were paid a commission and asked to sell the products on a credit basis. In Taiwanese society, the type of job and income of an individual decides the individual's social position. Salespeople are ranked low in the job hierarchy. Also, commission-based compensation is considered the lowest form of earning. Because it adopted an ethnocentric approach that did not give importance to the host country's sentiments, the US-based manufacturer failed in its bid to capture the Taiwanese market.

Cultural factors may also influence the managerial styles and business performance of sales managers coming from different cultural backgrounds. Since countries are culturally not homogeneous, international sales managers must take note of the differences in sub-cultures and their influence on the overall performance of the business. For example, a study measuring the influence of sub-cultures in terms of five cultural dimensions (achievement, enjoyment, self-direction, security, and conformity) on the performance of businesses, conducted in Brazil, showed differences. The sub-cultures were the Mineiros, Cariocas, Paulistas and the Gauchos. It was found that the Gauchos were more individualistic and emphasized personal achievement more than the reserved and introvert Mineiros. The Paulistas are more business-oriented and are not averse to taking risks. The Mineiros have a low sense of security and rarely take risks in their job or business. From these aspects, we can infer that it is preferable to have distributors and suppliers who belong to the Paulistas sub-culture. Similarly, it can be taken as advantageous to have Gauchos as sales personnel since they are go-getters.

Social norms in China require the dignity and respect of the individual is protected. This face-saving principle makes the Chinese sales personnel defend their product strongly when a customer criticizes its performance.

Hence, ignorance of the local business customs and culture may reduce the chances of selling products successfully in foreign markets. A detailed discussion of the challenges faced by foreign companies entering domestic markets is beyond the scope of this book as it is generally discussed under the international business or global marketing segment.

STRATEGIC ISSUES FOR INTERNATIONAL SALES AND MARKETING

There has been an unprecedented growth in the number of companies entering overseas markets in the last few decades. Better opportunities, increasing customer requirements, need to achieve economies of scale, and cut-throat competition are some of the driving forces for internationalization of companies. Differences in culture, traditions, the stage of economic development and the business environment in the host nation make entering overseas markets a complex matter for companies. Many strategic issues are to be considered before a company undertakes international sales. The question of whether to adapt the marketing mix to match the host country requirements or standardize the operations on a global scale is one of the most debatable issues facing companies. Another important issue is the mode of entry into the foreign market. Let us discuss these aspects in detail.

Marketing Mix – Adapt or Standardize?

Every company that plans to go international must decide whether to have a different marketing and sales approach for each country in which it plans to set up operations or have an identical approach in the various markets. Companies may choose one of these approaches or a mix of both. The decision depends on a host of factors, such as the corporate objectives, mission, organizational resources, management orientation, and so on.

Companies that are ethnocentric in their approach consider the sales organizations operating in foreign regions similar to company branches in the home country. These divisions have sales forces that replicate the selling approaches used in the home country. They have very little autonomy in decision-making and their needs are set aside to give priority to the decisions of the parent organization. such companies adopt a standardized marketing mix because it enables the parent organization to exercise better control over the overseas operations. Standardization improves operating efficiency and reduces wastage of efforts due to duplication of sales force activities like market research and sales promotion. It also enables the company to respond to new trends quickly and uniformly due to worldwide similarity.

A standardized approach also helps companies create an image of global quality in the customers' minds. Further, it helps them gain economies of scale and quickly move along the experience curve. Many countries have become famous in certain sectors due to the standardized approach taken by the companies having their base there. For example, South Korea has become famous for its television sets and heavy-engineering equipment, Colombia and Hungary for apparel, Western Europe for automatic washing machines, Brazil for automobile components, Singapore for optical equipment, and so on.

The adoption of a standardized approach has helped companies dispel the traditional selling practices in some countries by introducing new ways of selling and distribution. For example, when SmithKline Beecham introduced its decongestant Contac 600 in Japan, it used only 35 wholesalers instead of the 1000 plus normally used by pharmaceutical companies. It also introduced a regular contact program with distributors and key retailers, a practice which had never been followed in Japan till then. However, irrespective of the above-mentioned advantages, the usage of a standard marketing mix will not work at all times due to inherent differences in social traditions, salary structures, management hierarchies, tax structures, labor laws, and so on.

Companies that have a geocentric or non-centric approach exercise minimum control on the overseas sales divisions. There is a full exchange of ideas among divisions and the marketing mix decisions are made independently by the overseas sales divisions to suit local requirements. There is minimal interference from the parent organization. Changing the product, price, promotion and distribution might prove necessary to suit the economic, social, technical and cultural factors prevailing in the host country. The disadvantage of such an approach is that since the marketing mix varies in different markets, the sales force cannot leverage the experience gained in other markets. Learning cycles are repeated and this leads to loss of valuable time in the ever-changing global market.

The decision to adapt the marketing mix or not is generally based on the size of the company's home market and the manner in which it starts its operations in overseas markets. Companies that are successful in the domestic market tend to use the same approach abroad due to the feeling that 'what worked here will work elsewhere.' Moreover, the reluctance of sales managers to diverge from the existing path and look for new ways to sell products is another reason why companies use the same approach in overseas markets. The home country's history in international trading also influences the marketing mix adaptation. Companies operating in smaller nations are indirectly involved in international trade due to the necessity of purchasing raw materials and modern equipment from abroad for domestic operations. Such companies easily adapt their marketing mix to local conditions in other countries when they enter foreign markets.

Exhibit 5.1 describes how Japanese companies have achieved success in the US market by partly standardizing and partly adapting their marketing mix.

Obtaining International Information

A company planning to enter a foreign market needs accurate information about the market and about the political, economic, socio-cultural and technological conditions prevailing in that country. Based on this information, the company can plan its entry strategies and successfully conduct its operations. However, many sales managers begin operations in foreign markets without the required information and without conducting proper market analysis. Most companies obtain information from sources in their home countries and ignore other possible sources of information. This causes difficulties in achieving the desired results. In order to overcome difficulties associated with obtaining relevant information, many companies have set up distinct departments to source and provide real-time information to sales managers. These include the Market Research department and the Competitive Intelligence department. Companies have also been able to streamline their ability to gather information with the help of management information systems.

Exhibit 5.1

Japanese Approach to Marketing

The Japanese are considered champions because of their successful foray into international markets in a host of industries. They have achieved the maximum success in the US markets. The most important reason for their success is their ability to sell products that have very little environmental sensitivity. In other words, the products manufactured by Japanese companies have similar functional utility across different countries. The automobile, calculator, television, steel, camera, watch and shipbuilding industries have contributed most of Japan's success. A unique aspect of Japanese marketing is that these companies have not adapted their products to local tastes but have concentrated on adapting the promotion and distribution aspects of the marketing mix. The Japanese notion of marketing is different from that of the West. They believe in the philosophy that if a high-quality, low-cost product based on consumer tastes is manufactured, it is bound to sell.

Yet another factor that has contributed to the success of Japanese companies is the sensitivity of these companies to local culture. Japanese companies allow local marketers to develop marketing programs to sell their products. The Japanese marketer only decides which markets to enter, the mode of entry, type of products to be manufactured and the basic marketing strategy. The rest of the marketing aspects are handled by the local marketers.

It would be correct to say that the success of Japanese products in America is due to the American style of marketing Japanese products and not because of the Japanese style of marketing. Despite their worldwide success in some sectors, Japanese marketers have not been able to show the same results in case of products that are culturally sensitive, such as cosmetics, food items and fashion clothing. They are relatively weak in the services industry also. Thus, the success of Japanese companies is primarily due to adapting the promotion and distribution aspects of the marketing mix while the product and pricing approaches are more or less standardized.

Adapted from Paul Herbig and Carol Howard, "The Future of Japanese Marketing," <u>Business Forum</u>, Winter/Spring 1999, Volume 24, Issue 1/2, 26-31.

The most common sources of information available to an international sales manager include:

1. Internal company records (if the company has been previously involved in overseas ventures),
2. Information from published sources (newspapers, magazines, trade journals), government statistics, Chambers of Commerce, Universities and research institutions.
3. Primary sources like surveys, observation studies, mail, telephone and personal interviews, consumer opinions, focus groups and market testing.

International marketing research helps a sales manager understand the complex cultural aspects of the host nation and its probable effect on the implementation of sales and marketing policies and consumer behavior. The main challenges a sales manager faces in international marketing research are lack of reliable secondary data, costs involved in collecting primary data, and difficulty in establishing comparable methods of data collection. Coordinating marketing research activities in different countries of operation, language barriers, and lack of knowledge of relevant agencies in the host country also create difficulties for the sales manager in obtaining information.

In most cases, the salesperson is the most vital source of information for the sales manager. Exhibit 5.2 describes the ways in which the sales force can provide information on international markets.

Exhibit 5.2

Sales Force as a Source of Information in International Markets

The sales force of a company can be a very useful source of information. It can provide valuable information during various stages of the company's operation in foreign markets.

At the entry stage, salespersons can help conduct secondary research and collect statistics on markets and government policies. The sales force can also be used to collect useful information on market potential, information about competitors, consumer beliefs and expectations, their awareness about the company and its products as well as information pertaining to socio-economic conditions prevailing in the country, political stability and market volatility.

During the growth stage, when the company expands its product lines and gains market share, the sales force can provide useful inputs about customer satisfaction, service needs and future requirements. They can also help gather competitive intelligence data, reports on the competitor's tactical moves and competitor statistics like sales volumes, to determine expansion plans.

At the maturity stage of operations, the firm has established itself successfully in the host country. At this stage, the sales force can be used to collect information on product substitutability, emerging competition, government policies and ways to improve or modify the marketing mix.

Adapted from Lawrence B. Chonko, John F. Tanner Jr., and Ellen Reid Smith, "Selling and Sales Management in Action: The Sales Force's Role in International Marketing Research and Marketing Information Systems" *Journal of Personal Selling & Sales Management*, *Winter 1991, Volume 11, Issue 1, 69-79.*

Most companies use both formal and informal systems to collect information pertaining to international markets. Due to the growing importance of international sales, many professional sales publications carry articles on international sales management issues, opportunities, local statistics about markets, business conditions, and so on. With the advent of the Internet, numerous information databases providing extensive information on these aspects are available to the international sales manager.

Entering Overseas Markets

Many companies are venturing into overseas markets to sell their products and services. Different companies use different modes of entry into overseas markets. The commonly used modes of entry are exports, licensing, franchising, joint ventures, strategic alliances and wholly-owned subsidiaries. A company can choose a particular mode of entry depending upon the level of control it desires, the extent of risk involved, resources available and flexibility of operations required.

Exporting: Most companies start international selling activities by exporting their products or services. Exporting involves manufacturing the goods in the home country or a third country and transporting them to a host country market. Companies may choose between a direct and an indirect route of export. In the latter, the company can use independent intermediaries such as export houses or trading companies to sell their products. The direct route of exporting involves the use of a company's sales force to sell the products directly to the customer, or the use of agents and distributors.

For the sake of convenience, the other modes of entry into foreign markets – franchising, licensing, turnkey contracts and strategic alliance – can be put together under contractual modes of entry. Companies use these modes when they are unable to leverage their competitive advantage due to resource constraints and long-term arrangements with partners are required.

Licensing: In a licensing agreement, a company usually trades its technical know-how or products in return for a certain sum of money or royalty. The know-how may involve patents, trademarks or other intellectual property rights. License is generally given for a specified time period in a given geographical region. Licensing contracts involve a host of legal aspects and are generally handled by competent personnel. It requires the smallest investment among all contractual modes of entry but it also gives the company the lowest level of control.

Franchising: This is another mode of entry for companies interested in selling abroad. Here the franchisor gives the franchisee the right to use the brand name and operational expertise in return for a fixed amount of money. The operational expertise may consist of a package that includes the franchisor's managerial marketing and technical expertise. The advantage of this entry mode is that the company can enter many international markets in a short period of time without having to make substantial financial investments. It also enables the company to rapidly expand and penetrate new markets that have strict legal formalities or are highly competitive. The disadvantage is the absence of any significant control over administrative functions. Companies like McDonald's of the US and Body Shop of UK have used this mode of entry successfully. As much as 70% of McDonald's operations are through franchisees. Similarly, more than 90% of the 1,000 Body Shop stores in 44 countries are franchised.

Joint ventures: Companies can use this mode of entry when local conditions are restrictive or competitive, but offer significant growth potential. It involves tying up with a local partner to gain market knowledge and experience while reducing risks in the form of political vulnerability and opposition from nationalists who are against the entry of foreign companies. In a joint venture, the partner who is a native of the host country is responsible for the success of the arrangement because of his local connections and expertise in different sales management functions. Joint ventures are the most common mode of entry into the high-potential markets of underdeveloped and developing nations. Most of the companies that entered India after the liberalization of the Indian economy were through joint ventures. Similarly joint ventures have been the most common mode of entry of companies into the eastern European market.

Wholly-owned subsidiaries: These are overseas operations of the parent company. It does not involve contractual arrangements with a local partner. This mode of entry is preferred when cultural, political, economic and business environment are favorable for starting domestic operations. The company has complete control over all the sales management functions but this entry mode requires substantial investments on the part of the company.

The other modes of entry include strategic alliances, mergers and acquisitions, turnkey projects and greenfield ventures. All of them differ in their levels of investment and control.

Based on the corporate objectives, organizational strengths and weaknesses, transferability of business practices or image and country-specific barriers, a company can choose an appropriate mode of entry into foreign markets.

Equity-based joint ventures were the best route to enter the Chinese market due to the prevalence of 'Guanxi'. Guanxi is the network of relationships among various parties that cooperate together and support one another. The inevitable risks, barriers, and set-ups of operating in China will be minimized when one has the right "Guanxi". Similarly franchising, licensing or joint ventures are the best ways to enter the Japanese market. In the extremely competitive Western European markets, most companies make use of acquisitions or direct investments in a local company to enter the market.

INTERNATIONAL SALES TECHNIQUES

Due to variations in economic, socio-cultural and political conditions, selling in international markets requires a great deal of sensitivity to local customer needs, expectations, approach to doing business and personal philosophy.

The various steps in the selling process are similar all over the world. The selling process includes 1) Prospecting for customers 2) Pre-approach stage involving planning for the sales interview 3) Approach stage where the salesperson secures the sales interview 4) Sales presentation, 5) Handling objections and resistance to the sale 6) Negotiating and closing the sale and 7) Follow-up.

Preliminary aspects of selling include publicity, prospecting, generating sales leads, arranging sales interviews and establishing relationships. The advanced stages of selling include sales presentations, negotiations and after-sales service or follow-up. The salesperson must ensure that each of the above aspects take place in accordance with the local business environment.

Preliminary Selling

The salesperson must be able to effectively utilize the marketing information gathered personally or given by the company to identify prospects and generate sales leads. The salesperson can make use of various techniques for prospecting in international markets.

He can identify prospects by 1) Personal observation, 2) Holding telephonic conversations with a select list of people and making customer inquiries through mail or company advertising, 3) Making cold calls, 4) Attending or conducting trade shows, 5) Searching through company records, directories and yellow pages, 6) Soliciting references from earlier prospects, 7) Obtaining sales leads from social contacts and salespeople in related segments.

To plan and set up a sales interview and establish relationships, the salesperson can adopt various approaches or techniques like 1) Introductory approach (where only the name of organization and salesperson is given), 2) Product approach (offering the product with minimal explanation), 3) Benefit approach (in which benefits of the products are explained), 4) Survey approach where the salesperson can offer to undertake a survey for the prospect, 5) Question approach where the salesperson asks probing questions to identify the prospect’s needs, 6) Showmanship approach where the salesperson tries to get the attention of the prospect, and 7) Compliment approach where a simple request is made for a sales interview.

Depending on the country of operation, the salesperson must vary the selling technique used to suit local conditions and culture.

Advanced Selling

At the advanced stage of selling, the salesperson comes into close contact with the prospective customer. A successful interview or presentation can convert a prospect into a firm customer or client. Hence, advanced stages of selling have to be handled very carefully.

Salespersons can use many approaches during the sales presentation. 1) He can use the sales interview to ask questions that clarify the prospect’s level of understanding about the company’s products and his actual requirements. 2) In diverse cultures, the salesperson can use a sales presentation that is flexible enough to be modified for different customers. 3) Product demonstrations, use of visual aids, simple words or the use of a professional translator may also be used to convert the prospect into a client.

The various sales techniques that the salesperson can use in different overseas markets to handle objections and resistance are 1) Direct approach, where an appropriate response is given to a particular question. 2) Highlighting advantages that offset the weaknesses of the product. 3) Case-history method, where the salesperson describes the case of a previous prospect who benefited from the purchase. 4) Boomerang technique, where the objection is converted into the main reason for purchase. 5) Trial offer technique, under which the prospect is allowed to use the product in order to give him a chance to be converted and gain a chance. 6) Comparison technique, in which the product is compared with competing products.

The most crucial step of the selling process is closing the sale. Obtaining the sale is crucial, irrespective of the country in which the salesperson operates. Closing techniques include 1) Direct close, where the salesperson asks for the order. 2) Summary close, where the salesperson briefs the customer on the benefits of the product. 3) Choice approach, where the prospect is given a choice of various offers. 4) Concession approach, under which a discount or special offer is made after the sales presentation to persuade the customer to buy. 5) Assumption close, where the salesperson starts price and delivery negotiations assuming that the prospect is ready to purchase the product. 6) Silence approach, the best in countries like Japan, where the Japanese make group decisions after considerable deliberations and the salesperson cannot expect an immediate response from the client.

Finally, after-sale techniques could include providing customer training, offering maintenance tips, making periodic visits, sending a letter of appreciation or building customer confidence by giving referrals.

Cultural aspects have a great influence on the salesperson's approach to negotiation. The Japanese adopt a very positive approach at the time of negotiations. They are more silent, less aggressive and are ready to give suggestions and make recommendations, though it takes a long time to complete the negotiation. The French are very aggressive and use more threats and warnings during negotiations. They also frequently interrupt sales presentations. Brazilians, on the other hand, are also aggressive and resort to frequent touching of their negotiation partners. Americans and the British are less aggressive and do not interrupt as frequently as the French.

Time and Territory Management

Another important issue in international sales and marketing is time and territory management. Proper routing and scheduling of territories of the sales force increases the performance effectiveness of salespeople. This in turn directly influences organizational effectiveness. A properly designed territory can improve sales force productivity and customer service. Territory management is crucial in international selling, as the salespeople and sales managers may be located at great distances from each other, making the process of coordinating selling activities cumbersome.

An international sales manager must consider local conditions while making decisions about territory design issues like territorial boundaries and sales force allocation. Sales force automation tools now make it easier for sales managers to assign sales personnel in overseas territories. For example, MapInfo's 'MapInfo ProAlign' is an automation tool that helps assign sales personnel to territories in which they will be most effective. 'MapInfo ProAlign' automates territory realignment and formation of new territories in different regions.

STRUCTURES FOR INTERNATIONAL SALES ORGANIZATIONS

Organizations that plan to enter foreign markets can adopt a number of methods of entry. These include long-distance selling, use of manufacturers' representatives, piggybacking arrangements, intermediaries and establishing a direct sales force abroad.

Long-Distance Selling

Companies adopt this mode of selling when a sustained effort to establish sales in overseas markets is unnecessary. Long-distance selling is common in highly specialized industries such as the airlines industry, defense equipment industry etc, where only a few companies operate globally. For example, in the airlines industry, selling is a result of inter-government discussions, leading to the award of contracts. Boeing and Airbus sell their aircraft mostly to governments of foreign countries for use in their domestic and international fleet. Many defense contracts too are a result of this type of selling approach. Such contracts are usually one-time affairs which do not require any continuous presence after the contract is awarded. In long-distance selling, high-level contacts and personal involvement of top executives of the concerned company is a common feature. Long-distance selling requires that companies have a formal presence in the foreign market in the form of a purchasing office.

Manufacturers' Representatives

Manufacturers' representatives or distributors enable companies to gain early market penetration. This approach does not involve high costs, unlike joint ventures and use of a direct sales force. Companies interested in employing sales personnel to regularly sell their products use this type of structure. Manufacturers' representatives are independent sales agents who work for a commission. There is a difference between a manufacturers' representative and a distributor. A distributor is an independent merchant who purchases goods from the manufacturer and resells them to a domestic or foreign buyer. Transfer of ownership of goods takes place. A representative or agent acts as an intermediary between the buyer and exporter and is paid on a commission basis. Generally such people represent different foreign manufacturers of complementary products that do not directly compete against each other and are well established in their respective operational areas.

Companies availing of the services of manufactures' representatives are able to control the selling activities better than those employing other types arrangements. They enter into direct contact with overseas buyers and bear the risk of selling on credit. Before selecting a representative, companies must cross-check his financial status, present clients, facilities, experience and reputation. This will help prevent unforeseen problems and conflicts.

Manufacturers' representatives are responsible for maintaining relationships with all the distributors who sell the company's products. They are more necessary for companies that sell technical products. Downsizing and reduction of the importance of certain departments have forced manufacturers to use the services of independent representatives to train distributors on the technical aspects of their products. The company must take legal aspects into consideration while entering into contracts with independent representatives. This is essential because different countries have different legal implications. For example, the criteria for terminating a distributor or representative vary from country to country. In Germany, poor performance of the distributor cannot be a criterion for terminating a contract unless this condition has been laid down beforehand. In Belgium, a contract is considered to have been renewed unless proper notice is given before the expiry of the contract period. In Latin America, independent representatives are considered employees of the manufacturer and have to be provided social security and disability benefits.

Therefore, companies must select foreign representatives very carefully and provide proper training and support programs. The company must also continuously monitor the performance of the manufactures' representatives.

Piggybacking

Piggybacking is another arrangement that enables a company to make a low cost entry into an overseas market. It involves a rider and a carrier. Piggybacking involves a cooperative arrangement between the rider and the carrier, where the carrier sells the products of the rider by using its distribution facilities. This arrangement is done to gain economies of scale and complement one another's strengths. The rider gains the advantage of he local knowledge, expertise and distribution system of the carrier. In return, the carrier gets an increased product line.

Piggybacking can be used by a company to increase its market or product coverage. The rider can increase market coverage in a single country or in a number of countries. For example, Whirlpool had such an arrangement with Sony in Japan. AT&T took Toshiba's help to enter the Japanese market. Fujitsu used Siemens to enter the western European markets to sell its computer systems. Similarly Kyocera took the help of Philips, which had a worldwide marketing presence in telecommunications equipment, to enter the European market. Sometimes, companies have a reciprocal arrangement, where each company takes the services of the other to enter a particular market. AT&T and Olivetti had this arrangement to cover the US and European markets.

A company can have a piggyback arrangement to increase the coverage of one or a few of its products. This is done when a company has a product or product-line that is completely different from the rest. DuPont, which has a range of chemical products, had an arrangement with Colgate to sell its consumer product, 'Reveal wrap', all over the world.

In piggybacking, the carrier can serve as an agent, receiving a commission on sales or act as an intermediary, earning a profit from reselling the goods of the rider. The potential drawbacks of this arrangement are that it is likely to make the rider dependant, there is no guarantee of the carrier maintaining the desired quality or selling levels and that there might arise a clash of objectives in the future.

Intermediaries

Intermediaries or middlemen, along with manufacturers, make up part of the marketing channel. Middlemen may be merchants, independent agents or facilitating intermediaries. Facilitating intermediaries are indirectly involved in selling a product in the market. They include transporting and warehousing firms and market research or advertising firms. In most countries, the merchants and agents are usually wholesalers and retailers. Retailers include store- and non-store (door-to-door, mail-order) retailers. Wholesalers may be merchant wholesalers or agents like manufacturer's agents, selling agents, brokers, commission agents, resident buyers etc. Organizations that plan to enter overseas markets must make the crucial choice of whether to set up their own distributor/dealer network or give the selling activities on contract to one of these merchants or independent agents/distributors. The former gives the company better control over the distribution of its products to customers and also helps integrate international operations. The choice of using a direct or indirect distribution channel depends on the corporate objectives and conditions that prevail in the market. The selection of the right intermediary can lead to large sales volumes, increased product awareness, reputation, and faster market penetration. Exhibit 5.3 describes the factors that influence the choice of intermediaries in foreign markets.

Establishing Direct Sales Force Abroad

A company usually decides to establish its sales force abroad when it expands its product line, requiring greater commitment and control on selling activities. Establishing a direct sales force abroad is feasible only when a substantial market potential exists for the company's product in the overseas market that will generate enough sales and profits to overcome the costs of setting up the sales force.

Exhibit 5.3

Choice of Intermediaries

The choice of intermediaries by a company entering a foreign market depends on the following factors:

- *Number of intermediaries available:* Independent distributors are preferred when the local competition in distribution is very high, as the cost of replacing independent agents is low. This approach is also used when the country has a very complex distribution network requiring specialists with experience.
- *Stage of products:* The stage of the product life cycle has a bearing on the choice of intermediary. Independent sales agents are preferred by companies having mature products, because the products are well known brands and many distributors have gained experience in selling similar products over the years.
- *Service requirements:* Companies use integrated channel intermediaries rather than independent ones when the service requirements are high. A company's own distributor or dealer network ensures that a consistent service level is maintained for its products.
- *Product differentiation:* The customer's perception of the product influences the choice of intermediaries. If there is a high degree of product substitutability, an independent set-up is better since fierce competition and price wars can easily make integrated an distribution network unprofitable.
- *Legal aspects:* Independent intermediaries are preferred when the government of the host country restricts foreign companies from establishing their own distribution networks.
- *Cultural aspects:* Companies prefer independent intermediaries when there is a significant difference between the culture of the host country and that of the home country. Most American companies take the help of independent intermediaries when entering South-east Asian markets like Japan, China, Thailand, Philippines and Vietnam.
- *Competitive behavior:* If the competitors in the host country have their own distributors, the new entrant must also set up its own network to build credibility among consumers about its commitment to serve the market.
- *Existing intermediaries:* If the company has an existing arrangement with a distributor, it will prefer to introduce a new product into the country under the same arrangement.
- *Product exclusivity*: Products that involve patents, trademarks and trade secret protection are usually sold through direct distribution instead of independent intermediaries.

Adapted from Erin Anderson and Anne T. Coughlan, "International Market Entry and Expansion via Independent or Integrated Channels of Distribution," <u>*Journal of Marketing,*</u> *January 1987, Volume 51, Issue 1, 71-82.*

Differences in infrastructure, education, level of market development, culture, corporate policies and a host of other factors affect the type of sales force structure that a company decides to establish. Most companies, especially American corporations, which are successful in the domestic market, tend to establish the same sales force structure abroad. Use of the same sales force structure is also common in high technology industries across the world.

The sales force abroad can be organized on the basis of product, geographic location, or customer, or it can be a combination of all or some of these. Various factors influence a company's decision regarding the establishment and size of an overseas sales force. Industry differences in terms of channel length (number of intermediaries involved) required and the extent of product complexity commonly influence the sales policies and sales force structures of companies entering foreign markets.

Large market size and high potential, especially in developed nations, prompts organizations to use a large sales force. Companies operating in developing nations with small markets, trouble-prone regions (such as the Middle East), and in culturally diverse markets (India, Indonesia, etc) maintain an independent sales force or a small-sized sales force. On the other hand, availability of cheap labor force can encourage a company to set up an extensive sales force. For example, Sunbeam Corporation in Peru and Philip Morris in Venezuela used an unnecessarily large sales force due to the cheap cost of labor in these countries.

Market similarities may also influence the establishment of sales forces abroad. Multinationals may take advantage of cultural similarities, lesser geographical distances and common language to develop common sales forces across countries. For example, Spanish is commonly spoken in the whole of Latin America except Brazil, Dutch in the Netherlands and the Flemish part of Belgium and so on. Hence, companies setting up operations in such regions can have a common sales force covering the entire region.

Company operations also influence the establishment of overseas sales forces. The size of the company and the width of the product mix exerts an influence on the kind of sales force structure that it decides to have. If the subsidiaries are large, a geographically oriented sales force structure is established. A diverse product portfolio may require the setting up of a product-based sales force structure.

Generally, consumer goods and industrial goods companies prefer an independent sales force when entering a foreign market. Companies manufacturing specialized products like pharmaceuticals prefer to have a company sales force or take the help of the sales force of a local company to sell their products. Most companies establish their sales force structure based on prevailing market conditions. Ingersoll-Rand is one company that uses a sales force structure that is appropriate for a particular national market.

INTERNATIONAL SALES MANAGEMENT PRACTICES

With the globalization of markets, many organizations are setting up overseas ventures in order to increase their customer base, gain economies of scale and diversify into more opportunistic areas with newer products. Due to differences in culture and traditions, most organizations employ local people to sell their products. It is therefore necessary for an international sales force manager to be aware of the appropriate recruitment, selection, training and compensation procedures for a local sales force in order to successfully operate in different regions of the world. Let us discuss each of these aspects in detail.

Recruitment of Sales Personnel

Due to the complexities in language, culture, beliefs and the different approaches required for selling in various countries, most organizations prefer to recruit local people to form the sales force. An international sales manager must avoid the tendency to hire and select sales personnel on the basis of standards established in the home country. The approach used in the home country will not work in the host country due to differences in culture as well as customer expectations. The international sales manager must hire sales personnel keeping in view the customer expectations in the host country. Due to the vast differences in customers, geography, market and products, many organizations utilize the services of local consultancies to avoid mistakes during selection and recruitment of the sales force. Some aspects that must be kept in mind while selecting sales personnel in foreign regions are discussed below:

Selling Approach: The sales manager must keep in mind the type of selling approach that customers in a particular region/country expect from the sales force. For example, customers in Canada do not like sales persons to be aggressive and pressure them into buying a product. Thus, recruiting an aggressive sales person in Canada will fail to yield the results the company desires.

Although there may be two or more countries having a common language or similarity of markets, it does not justify the adoption of a similar selling approach in all of them. For example, though countries in Latin America are geographically close and are predominantly Spanish speaking, the sales approach in these countries cannot be the same. In Mexico, customers expect sales persons to develop personal relationships and discuss non-business matters with them before starting the sales talk.

Origin of sales personnel: The sales manager must decide whether to hire a local person, a person from the home country or a third country national for the sales force. A home country sales person can be recruited if the company sells high-value technical products, due to the extensive product knowledge and superior after-sales service that are required for these products. Further, a home country sales person will be preferred if the organization plans to train its employees or prepare them for future promotions. A home-country sales force gives the organization a direct presence and better control over selling activities in the host country. Effective recruitment and selection procedures enable the sales manager to identify the level of commitment of the individual and reduce the possibility of such people exiting the organization after their return from the overseas assignment.

On the other hand, a company can hire host-country sales personnel if it wants to establish itself quickly in the host market. Hiring sales personnel from the host country makes it easier to understand local conditions, customs, culture and customer-base since these personnel belong to the place and there is no need for them to make any adjustments. Sales personnel from a third country can be recruited when there are many similarities in the markets and when the sales manager has the opportunity to hire people with similar cultural and language abilities and better skills than host-country personnel, at lower costs.

Sources of recruitment: The sales manager must be aware of the best sources for recruiting the sales personnel. In most countries, university graduates are the most common source of recruitment. But in some countries, this is not so. For example, many multinationals in Central and Southern Africa recruit sales personnel from the army because of their administrative skills and discipline. In countries like Saudi Arabia, selling is not a regular course taught in colleges. Therefore, recruiters have to seek potential employees from vocational institutes and trade schools where such courses are conducted.

Selection of Sales Personnel

Selecting sales personnel for foreign markets is much more complicated than selecting people for the local market. Sales managers generally consider criteria such as education level, experience and interpersonal skills while selecting sales personnel. However, in certain countries, some other factors like social class and religion of the sales personnel can also affect the sales of the company. Thus, factors like education, religion, ethnic composition, social stratification and socio-economic development of the region have a profound influence on the recruitment and selection practices of companies operating in overseas markets. For example, in Malaysia, there are cultural differences between Chinese and Malays, religious differences between Muslims and Buddhists and the society is also highly stratified. Hence, a sales manager must be very careful when selecting the sales force in this country because the religion, ethnic culture and social position of the sales person can significantly influence prospects.

Education: The level of education plays a crucial role in the selection of sales personnel. The education system in many developing and underdeveloped nations is not well established, and in such nations, it is very difficult for a recruiter to find candidates with the right educational qualifications. In Europe, which has an elitist education system that focuses on arts and social sciences, it is very difficult to get people with the right technical and business management educational qualifications and experience. Only in countries like the USA, where 45% of the individuals in the 18-21 age group are educated, there is a pool of potential educated recruits available for the sales manager to choose from. A related background or educational qualification is a crucial requirement for sales personnel in some countries. For example, in some countries like Germany, organizations select Ph.D. holders to sell chemical equipment. Companies like Pfizer and Sun Pharma in India select MBBS graduates to promote some of their specialty line products. This approach is used to build credibility among the customers by having sales personnel with educational qualifications similar to those of the potential client.

Religion: The religious aspect must also be considered while selecting sales personnel for foreign operations. This is because in some countries, the religion of the salesperson has a significant influence on the buyer-seller relationship. For example, the Muslim-Buddhist strife in Indonesia and Malaysia, Hindu-Muslim tensions in India and Pakistan, and the Sunni-Shia conflict in the Middle-East can influence the buyer-seller relationships in these countries. Therefore, it is ideal to have a sales person of the same religion as that of the prospective customer in such nations.

Ethnic composition: There are extreme variations in this dimension across different countries. USA and some other countries are relatively homogeneous in culture despite the presence of Afro-Americans, Jews, Hispanics and native Indians in significant numbers. This is not so in countries like India and Zaire, where there are more than 300 dialects and sub-cultures. Belgium too is divided on the basis of Flemish and French origins, while 25 percent of Canadians are French in origin. It is necessary, therefore, for a sales manager to remember these differences in ethnic composition while recruiting and selecting sales personnel.

Social stratification: Social classification is also a crucial factor to be considered during the selection of sales force personnel. Countries like USA have a simple social stratification based on wealth. It is easy for an individual to move up the social strata by accumulating material possessions. This is not so in other nations. The caste system in India, seniority in Japan and ethnic criteria in South America play a role in deciding the individual’s position in society. These aspects also have a substantial effect on individual and group behavior in business affairs and transactions. For example, in Latin America, upper class elite and light-skinned people are respected automatically in comparison to the low-class and dark-skinned people. Hence, the organization must select the sales personnel according to the type of customers it plans to cater to. Similarly, in Germany it is preferable to select native Germans for the sales force than people of Turkish or Yugoslav origin.

Several studies have noted that educational qualification, professional experience and the personal appearance of the candidate, as well as the personal impression of the interviewer are the most common criteria based on which sales managers select sales personnel for overseas markets. The relative importance of these dimensions varies across industries. For example, in the pharmaceutical and information technology industries, educational qualification is given higher priority during sales force selection, since the job necessitates knowledge of technical details. On the other hand, in the FMCG industry, education is not given much importance in sales force selection. Ethnic, religious and cultural factors are given significant importance for selling of industrial products, especially farm equipment, because of the diversity of the customers and suppliers.

Exhibit 5.4

Hiring in the Czech Republic

With many companies expanding their operations in Eastern Europe, the Czech Republic is one of the favorite destinations due to its pro-American attitude and similarity to Western culture. In selecting sales personnel, companies in the Czech Republic make use of aptitude tests that identify the ego drive, aptitude, empathy, leadership and other such qualities in the candidates. Educational qualification and experience are not considered important factors during hiring. The first MBA in the country graduated in 1991 and due to the socialist history of the Republic, there is practically no one who has experience in sales management in the free economy. The Czechs are highly educated in technical aspects but they are very poor in practical knowledge and experience. Due to the socialistic history of the nation, companies have to invest heavily in training and development programs and concentrate on hiring freshers from academic institutions. Even if an individual does not pass the interview, the interviewer cannot reject the candidate outright but has to try to determine the cause of failure. Because the Czechs are unaware of the free market culture and have a socialistic upbringing, the interviewer must double-check the reasons of failure.

Adapted from Weld F. Rroyal and William Keenan Jr., "From Socialist to Sales Rep," Sales & Marketing Management, August 1994, Volume 146, Issue 8, 63.

Socio-economic development: The level of socio-economic development of the host country influences the recruitment and selection of the sales force. In less developed nations, educational qualifications, personal appearance and references are given more importance due to the variations that exist in these societies in terms of personal background and lifestyles. However, in advanced nations like the US, these factors do not play as significant a role as they do in the less developed nations because these societies are low in social diversity and therefore do not display significant socio-economic differences. In these countries, the impression created in the mind of the interviewer plays a more important role during recruitment.

In African and Muslim countries, nepotism, in the form of references or personal contacts is quite prevalent and forms a part of the recruitment and selection process. The extended family culture in these countries makes it obligatory on the part of those who are well-settled to help their less-fortunate relatives secure good jobs. Also, in comparison to companies operating in developed nations, those in developing nations make wider use of psychological tests to select personnel. Many companies make use of tests tailored to American and European attitudes to measure the mechanical aptitude and general abilities of people at the time of selection. However, such tests are not very accurate. Variations in social and cultural factors across countries make it necessary for intelligence and aptitude tests to be tailored - for different countries. Exhibit 5.4 describes how the socio-economic status of the Czech Republic influences the selection process in companies operating in the region.

Training and Development of Sales Personnel

The training and development of sales personnel varies from country to country. Sales personnel who are required to operate in different markets must be trained separately for international sales, irrespective of the extent of domestic experience he has. Translating the training manuals and programs obtained from foreign countries into the native language is not the means of effective sales force training. A training program must ensure that the sales personnel are aware of the prevailing conditions and culture of the nation in which they will have to sell. Trainers must also make use of different training programs, depending on the country of operation and the culture prevalent in that region. For example, countries like Japan give great importance to international training programs. The sessions are conducted in a formal ritualistic atmosphere where the sensitivity of the trainees is kept in mind and they are not overly criticized. Politics, law, time consciousness, technology, values and attitudes of individuals from the home country and the host country must also be thoroughly analyzed during the training programs. Let us consider certain factors to be kept in mind while conducting a sales training program.

Changing role, attitudes and perceptions: The differences in selling approach and business dealings must be identified and communicated to the sales personnel during training. The Europeans do business at a much slower pace than the Americans. Hard-selling and aggressiveness can backfire when dealing with customers in Europe because the Europeans take longer to make a decision. The size and reputation of the distributor is not as important as the buyer-seller relationship in Europe. The buyer-seller relationship is more formal and sales personnel do not meet customers unless specifically invited to do so. Sales personnel in Switzerland and Germany usually use the title and surname to address customers or refer to themselves.

Business lunches have different protocols in different countries. In Switzerland, business is not discussed during lunch. In France, Germany and Italy, a business lunch is used for general business discussion only, without any specific transactions. The customer's perception of the salesman also varies from country to country. Sales personnel are referred to as commercial attaché, marketing representative or consultant in the European countries.

Flexibility in training content and methodology: Training programs have to be modified according to the cultural and regional factors in the country in which the company plans to set up operations, otherwise there is a possibility that trainees will not be able to relate to certain aspects of the program. Much of the content of the training programs in one country will be similar to those in other countries -- the selling process, role-play, group discussion etc, will be more or less the same, -- but minor adjustments need to be made in the language, presentation style and pace of the training modules when conducting the training in certain countries.

An awareness of the cultural aspects is necessary while designing a sales training program. For example, asking Japanese sales trainees to hard-sell the products to customers will fail to obtain the desired results because the Japanese consider this selling approach disrespectful and unethical. The length of the training schedule is also an important factor to be kept in mind. Europeans begin to respond to training only after intensive group discussion and review sessions. The video segments used in behavior modeling sessions must be produced keeping in mind the variations in culture and religion. The trainees should be able to relate to the situation shown in the video. For example, a situation showing a female salesperson discussing business over lunch with a customer will not be effective in the Middle-East where women are not usually involved in business dealings and moving around without a male escort is considered an offense. Another example is the issue of shaking hands. In Germany, it is considered rude to shake hands with another person across the desk whereas in France, it is common to do so. In Saudi Arabia, a woman salesperson must shake hands only when the male customer initiates it.

Conducting sales training programs for sales personnel in different countries is not as simple as it would seem. A company can coordinate global sales strategies and plans in a much better way if it is able to standardize the approach and methodology of its sales training programs to suit the culture in all countries. Doing so will enable the company to develop a uniform sales culture across its various divisions.

Sales Incentives and Compensation

Global competition and global expansion of companies have made it difficult for companies to decide on compensation packages for the sales force operating in international markets. Companies either adopt a uniform compensation plan for the entire organization, without discriminating between local and international sales personnel or set up different compensation plans for local and international sales personnel. The compensation plan can be fixed on the basis of the importance of the product or service offered by the foreign sales organization to the headquarters, the extent to which the foreign sales organization plays a role in achieving the corporate objectives, and the extent to which it varies from the parent organization in terms of culture. Due to the variations that are likely in the roles of foreign sales organizations, it is suggested that it would be appropriate to design compensation plans that are tailor-made for each organization.

It has been observed that sales personnel working in foreign subsidiaries given the responsibility of selling certain products globally, have their pay structures directly linked to organizational performance. Sales personnel in subsidiaries that are of crucial importance to the parent organization take one-third of their compensation in the form of incentives. Further, sales personnel in such organizations are paid more than what their local or domestic counterparts earn on an average. For sales personnel of top-performing foreign sales organizations that culturally differ from the parent organization, the compensation plan is more incentive-based than a straight salary plan. This emphasis on the incentive component is to regulate the behavior of sales personnel in alignment with the corporate objectives.

The type of compensation also influences the motivation and performance of sales personnel. A comparative study of the influence of the type of compensation on the motivation and performance of American and Japanese sales personnel shows that American sales personnel are willing to work for an organization with values that differ from their personal ones if the compensation is sufficiently high, whereas Japanese sales personnel prefer an appropriate work culture to high compensation. Further, American sales personnel prefer financial rewards and incentives whereas Japanese sales personnel are motivated just by being part of a winning team, not by financial incentives. Also, the extent of job satisfaction of American sales personnel is more directly influenced by the level of pay than that of Japanese sales personnel.

In conclusion, a sales manager must modify all aspects of hiring, training, selection, promotion, compensation and motivation when dealing with sales personnel operating in foreign regions in order to align the management practices with the culture and prevailing conditions in a particular host country. The extent of modification required depends on the degree to which conditions vary. The sales manager must experience the conditions first-hand, take the help of consultants and experts, hold discussions with sales personnel operating in those countries and also attend trade exhibitions organized in the host nations in order to determine the number of sales management functions that need to be localized or standardized.

SUMMARY

Globalization has opened up markets and provided hitherto untapped opportunities to companies across the world. With increasing competition, changing customer needs and stagnation of demand in domestic markets, many companies have started looking at international opportunities. International sales management plays an important role in implementing the marketing policies and selling programs of the company in the foreign market at the ground level. The international sales manager plays the crucial role of planning and organizing this effort and ensuring that the desired results are obtained. A thorough understanding of the overall operations of the organization in the global context, an open approach to multi-cultural differences and the ability to implement both the basic and advanced levels of sales management functions is necessary for the sales manager to succeed.

Companies enter foreign markets in search of opportunities. The chances of diversifying the market base, attaining low costs of labor and manufacturing, economies of scale, first-mover advantage and faster growth rate of the economy in comparison to the home market, are some of attractions that woo companies to enter these markets. An awareness of the pitfalls that accompany entry into foreign markets is also necessary to fully reap the benefits. These pitfalls may be in the form of economic, socio-cultural and legal factors.

The decision to enter and operate in international markets is a strategic one. An awareness of various strategic issues is necessary to ensure success in foreign markets. The strategic issues to be considered pertain to the marketing mix, sources of information and mode of entry into the foreign market. The timing, scale and mode of entry are also crucial to the success of a company. The modes of entry include long-distance selling, direct or indirect exporting, franchising, licensing agreements, strategic alliances, turnkey contracts, greenfield investments, joint-ventures and wholly-owned subsidiaries.

Variations in economic, socio-cultural and political conditions in different countries makes selling in international markets a challenging task. It requires a great deal of sensitivity to local customer needs, expectations, business approach and personal philosophy.

Companies can adopt different structures while operating in foreign markets. These include use of long-distance selling, piggybacking with local distributors, using intermediaries or operating independently by establishing a direct sales force.

Finally, due to differences in culture and traditions and associated problems, most organizations employ local people to sell their products. An awareness of the recruitment, selection, training and compensation procedures for the sales force appropriate for the host country is necessary to successfully operate in different regions of the world.

Part II
Planning the Sales Effort

Chapter 6

Sales Planning

In this chapter we will discuss:

- The importance of sales planning
- Sales manager as planner and administrator
- The sales planning process
- Causes of unsuccessful sales planning
- Accuracy of sales planning

To make the future happen one has to be willing to do something new. One has to be willing to ask: What do we really want to see happen that is quite different from today?

Peter F. Drucker, Managing for Results

Present day organizations operate in an environment of uncertainty. They have to be able to anticipate the future and prepare themselves well in advance. Planning is the process that guides the organization from where it is today to where it wants to be tomorrow. It helps to decide the activities to be performed, when to perform them, how to perform them, where they should be performed and who are the people who will perform them. Simply stated, planning helps determine organizational objectives and strategies required to fulfil these objectives. Planning minimizes risks and ensures the efficient utility of organizational resources in a focused manner.

Sales planning helps to establish sales goals and take decisions on types of strategies and action plans required to achieve these goals. It also works to implement set objectives, measure ensuing results against set standards and finally undertake control measures in case of deviation from established objectives. Sales planning derives its basic tenets from the company's overall plan and marketing plan.

The sales plan is an annual document that must be periodically updated according to external environmental changes. A business may have one or more than one sales plan. The sales plan, in tune with the company plan, shapes the role and activities of the sales force.

Planning is an internal activity in the sales organization. Most steps in sales planning are done through internal analysis using information from internal records, market intelligence systems and internal organizational sources. Sales planning is guided by the top management, but should always take into consideration real-time inputs given by sales personnel who have first-hand knowledge of prevailing market conditions.

In this chapter we will discuss the importance of sales planning, the role of a sales manager as a planner and administrator, the various steps involved in the sales planning process, the causes of failure of sales plans and the importance of accuracy in sales planning. Other constituents of planning, that include forecasting, budgeting and territory management, will be discussed in detail in subsequent chapters.

THE IMPORTANCE OF SALES PLANNING

Sales planning is the first step in the sales management process. It guides the organization in achieving its objectives in a systematic manner leading to profitability and success. Planning is a prerequisite not only for achieving business success but also for surviving in the present complex and ever-changing global environment. The importance of planning can be understood in terms of its influence on different managerial functions. It is discussed in the following section.

Better Implementation of Corporate Plans

Planning ensures better coordination and implementation of corporate plans as it influences other management functions like organizational design, selection, training, monitoring and compensation of sales personnel. For example, if the corporate strategy is to build customer relationships in new markets, the sales force compensation plan must emphasize the fixed component of salary. This ensures that sales personnel have a sense of financial security and will allot more time to improving customer relationships. If the corporate strategy is rather to penetrate existing markets, stress should be laid on the variable pay component of the sales force compensation plan.

Provide a Sense of Direction

Proper sales planning helps anticipate future events, but it should not be confused with forecasting and budgeting. Forecasts and budgets give a future projection based on the organization's existing strengths and weaknesses, but does not consider possible changes in these factors, because of changes in the organization in the future. This narrow view can create problems because both the environment and the company undergo dynamic changes over time. Sales planning overcomes this deficiency and formulates a framework for managers to identify problems and evolve solutions accurately. Proper planning helps organizations to cope with the changing environment without facing extreme pressure Otherwise, inability to anticipate changes may make sales organization lose direction.

Focus on Realistic Objectives

Good sales planning helps the management avoid setting unrealistic objectives that lead to unnecessary expenditure on recruitment of excess sales personnel and promotional activities. It also helps minimize responses that are not logical, especially when decisions in response to unexpected conditions have to be taken by sales personnel. For example, excessive or diverse expectations in a sales plan confuse sales personnel and lead to waste of time and resources in pursuit of goals that are not in alignment with organizational objectives.

Improve Coordination

A well-designed sales plan leads to better communication and coordination among sales personnel and the management, reducing conflicts. Effective coordination ensures the subordination of personal goals to organizational goals and to a greater understanding of set objectives by sales personnel. Good inter-functional coordination also helps create a highly motivated sales force, as it enables them to understand their priorities and accept the need for continuous changes in routine activities.

Facilitate Control

Proper sales planning ensures that the organization has greater control over sales volumes and is better geared to face unexpected demands in the future. Planning provides the basis for control. The control function ensures that activities conforming to developed plans are being carried out. Planning leads to the development of an early warning system that allows sales managers to detect possible deviations from the plan. It also provides quantitative data that helps managers compare and evaluate the performance of sales personnel.

Ensure Healthy Interpersonal Relationships

Planning helps in maintaining healthy relationships among sales personnel. This can be achieved by involving them in the planning process. Such participation creates awareness of objectives and proposed strategies. It also leads to transparency in the process of setting quotas, sales force evaluation and compensation systems for them.

Reduce Uncertainty and Risk

An important element in sales planning is to conduct a situational and environmental analysis. This creates alertness among sales personnel about probable situations, enabling formulation of proactive contingency plans. The sales plans will then be flexible enough to be modified according to prevailing conditions, reducing the risk of inability to cope with change.

For more on contingency plans see Exhibit 6.1.

Exhibit 6.1

Contingency Planning

Despite meticulous planning for the future, very few companies formulate a back-up plan to implement in case of unforeseen circumstances. Contingency planning has remained a rarely practiced art in most corporations. Most organizations are not proactive and only react when faced with unforeseen problems. When developing a contingency plan, sales managers have to anticipate events and identify crucial factors (external environmental factors and internal company factors), their probable impact, timing, force and direction. They have to understand the complex relationships between the organization and the environment. Conventional planning considers only action that will be taken in the future under normal forecasts. These plans describe objectives and strategies for sales personnel to implement in day-to-day activities. Contingency plans, on the other hand, need to set down contingencies or 'what if' conditions. After this follows the preparation of action plans for each contingency and evaluation of their feasibility. An internal early warning system must be in place to identify and warn managers as soon as a contingency condition arises. Managers can use some clues for this.

Some conditions that signal a contingency are:

- Internal emergencies like labour problems in the form of strikes, sudden departure of key sales employees from the organization, etc.
- External conditions like change of government, sudden economic instability.
- Competitor actions like reduction in prices or merger with a rival.

A contingency plan, if prepared well, can save a lot of time and costs for an organization in the long run.

Adapted from Cyril O'Donnell, "Planning Objectives," California Management Review, Winter 1963, Volume 6, Issue 2, 3-11 and Friedrich Schiefer, "Planning For the Unexpected," McKinsey Quarterly, Spring 1974, Issue 2, 53-64.

SALES MANAGER AS PLANNER AND ADMINISTRATOR

The role of a sales manager has undergone a sea change over the years. Globalisation, changes in sales force composition and technology development have forced present day managers to equip themselves with a different set of skills. From a job that required aggressive selling skills and the ability to impart these skills to sales personnel, the sales manager's role has been transformed to becoming more of a planner and administrator, with emphasis on conceptual and human skills. Irrespective of this change, very often managers tend to be more directly involved in the routine selling activities of the sales force than in managing the sales force. This is because most organizations promote a star salesperson to a sales manager's position and these managers are confident of selling products but not of managing people. Many organizations try to instil the managerial instinct into sales managers by training them and sending them to management development programmes. The other choice is to directly hire graduates from top management institutes.

The significant difference between selling and managing is - selling involves getting sales results through prospects and customers, while managing means using the power of authority and responsibility vested with managers to get sales results through sales personnel. Managing includes activities like planning, directing and controlling the sales force. Most of these are dealt with exhaustively in subsequent chapters. Let us discuss below the activities that organizations actually expect from sales managers. We will primarily concentrate on the planning and administrative functions of the sales manager.

Sales Manager as Planner

The effectiveness of the selling effort is dependent on the sales manager's ability to get desired results from the sales force. The manager's ability to ensure this significantly impacts sales, profits and the pay-off from the overall marketing programme. As a planner, the sales manager has to plan for all activities that ultimately result in sales through the sales force. These include forecasting, developing objectives and sales programmes, designing the sales organization, formulating policies and budgets, developing evaluation standards and formulating sales force compensation plans.

Sales forecasting

Forecasting involves developing projections for the future. It is usually in the form of expected sales volumes at the end of a specific period, say a year. Sales managers can make precise estimates and projections by collecting information on the effect of changes in strategy, market plans, product innovations and sales forecasts. The manager must redefine operational planning forecasts for field sales into shorter time spans like a monthly or quarterly schedule. An effective forecast helps sales managers make effective decisions for managing the sales force.

Developing objectives

A sales manager's primary objective is to increase sales volumes through sales personnel. This is done by setting sales objectives, developing and implementing sales programmes and policies, that are reflected in the sales quotas given to the sales force. Objectives help sales managers to direct the activities of sales personnel. Deciding on the number of sales calls sales personnel must make in a three- month period is an example of an objective. Managers must quantify objectives to facilitate easy evaluation and control of the sales force. They must keep in mind strategic or operational plans, which focus mainly on expected course of events in the near future and methods to tackle them, and contingencies too.

Developing the sales organization

This is an important planning activity for a sales manager because the successful implementation of sales plans is closely linked to an effective sales organization design. The sales manager has to plan the type of organizational structure, the hierarchy and positions and develop the reporting relationships, duties and responsibilities of the sales force. The manager must devise the sales organization design keeping in view the corporate and marketing plans. We have dealt with these aspects in detail in the preceding chapter.

Formulating policies and procedures

The sales manager has to prepare policies and procedures that guide decision- making and directing sales force actions. Policies are predetermined approaches to tackle routine or recurring situations. Sales managers prepare different policies for the sales force. For example, the sales manager may develop a customer policy that requires sales personnel to spend more time on relationship building and customer service, to increase customer satisfaction. The manager may develop another policy restricting the extent to which sales personnel can utilize the assistance of staff personnel in fulfilling overall sales objectives.

Procedures are elaborate descriptions of specific steps required to carry out a task or action. For example, the sales person has to follow a series of clear-cut steps while refunding the money for a defective product returned by a customer, and complete the transaction without delay.

Exhibit 6.2

Skills for Modern Managers

In the present competitive environment, where there is very little to differentiate organizations in terms of resources and technology, employees are the main competitive advantage for organizations. Among them, it is managers who hold the key. Organizations are interested in retaining only those managers who have the requisite skills, while those with obsolete skills get the pink slip. Nowadays, organizations prefer managers who are generalists to those who are specialists, because they want people capable of seeing the big picture, who will add value to organizational functions. This has led to the need for a new skill-set that includes the ability to have vision, an understanding of ethical implications, awareness of informal organizational relationships and proficiency in soft management skills.

Vision: The modern manager must have a vision of the future and be able to proactively engineer changes in the organization. A long-term vision gives managers the facility to think creatively and seek a new approach to old problems. Companies with visionary managers are always a step ahead of competitors in anticipating changes in the industry and the market.

Communication Skills: The manager must be able to work with individuals and groups within the organization as well as outside. The sales manager has to promote the cause of the sales department to other departments, be it production or finance, within the organization. This calls for effective communication skills. Gathering, analysing and disseminating information, a routine activity for managers, requires effective interpretation skills. It is also a precursor to a manager’s effective decision-making ability. Sales force motivation, training and evaluation also require correct communication of relevant information to sales personnel. Outside, the sales manager represents the image of the organization to customers. Effective communication skills help the manager to develop a positive image for the organization. This has a positive bearing on sales volumes generated from customers.

Ethics: Managers have to cope with increasing demands from top management to perform and get positive results. This means ends often dominate means. Some managers might think of resorting to unethical practices during selling activities to achieve ends. Increasing awareness among stakeholders about ethical practices and the changing mindsets of top management has led to organizations expecting sound ethical practices from their managers in decision-making and dealing with customers.

People skills: Managers need good human relation skills. In the 1980’s, organizations wanted managers with good technical skills. This has changed and organizations today prefer managers with better human and conceptual skills. Managers have to get the work done through the sales force and manage their changing needs. To develop and manage the sales force and accomplish organizational objectives, the ability to develop strong human relationships is imperative.

Empathetic Approach: Organizations have shifted from the earlier traditional approach to a more participative management approach. Managers were earlier aggressive, and task and achievement oriented. Now, the focus is to be team oriented. Managers must be sensitive to the needs of sales personnel. The environment must be nurturing and congenial to enable sales personnel to balance family and work issues and be empowered. Managers are nowadays put through sensitivity training so that they are more empathetic towards the sales force.

Adapted from Patricia Buhler, "A New Breed of Managers," Supervision, January 1994, Volume 55, Issue 1, 17-20.

Preparing the budget

Budget preparation involves planned allocation of resources and efforts for various activities related to the organization’s objectives. The sales budget is usually a mechanism for control of expenditure and is an instrument for regulating sales force activities. It also provides financial standards for evaluating actual results against budgeted figures. Sales managers have to decide on the cost budget for their sales office and convince top management to approve it. The manager must consider that sales personnel must not feel that the plan has been forced on them. This can be avoided by ensuring that sales personnel are involved in the planning process from the beginning.

The sales managers of today need skills completely different from those used by organizations a few decades back. Exhibit 6.2 lists these skills.

Sales Manager as Administrator

As an administrator, the sales manager has to supervise, delegate, coordinate, motivate and counsel the sales force. The sales manager must undertake staffing and training activities and act as a facilitator between the sales force and other employees in the organization like accounts and personnel.

Supervision

The sales manager has the difficult task of supervising the sales force. This is tough on a daily basis because sales personnel operate in the field, away from the office. Supervision includes giving daily instructions to the sales force, guidance to tackle routine problems and coaching to carry out the sales plans effectively, without deviations. For example, supervision may involve solving a problem a salesperson has encountered. At the same time, with the advent of sales force automation and new concepts in sales management like ‘team selling’, the manager’s role has become more of a collaborator and consensus builder than a supervisor.

Delegation

Delegation includes assigning routine tasks to sales personnel. It also comprises assigning authority and responsibility to different members of the sales force. The manager must sit down and review the subordinate’s job in terms of its impact on the organization’s profits. Based on this, a collective decision on activities to be undertaken in the coming months can be taken along with the identification of possible roadblocks.

Coordination

The sales manager has to segregate sales force activities based on the level of importance. All activities must be carried out with minimum conflict. Coordinating a set of objectives is complicated in practice for a sales manager because they might be quite diverse. They may range from rearranging sales territories, recruiting sales personnel, opening new markets, to market research and so on. Putting in efforts simultaneously for everything is very difficult. If the sales manager focuses on each individual objective, it will disturb the planned accomplishment of all other objectives, because some objectives have to be accomplished simultaneously. Focus on a single objective also reduces the priority given to other objectives.

Balancing different sales objectives is tricky because of shifting priorities, changing costs and the dynamic external environment. For example, a manager’s plan to restructure the sales force may have to be advanced by two years owing to unexpected competitive pressures. Such sudden changes can influence the priority given to implementing another objective. This can affect the selling activities of sales personnel. The manager must keep in mind that sales personnel tend to pursue only those objectives in which the manager shows particular interest. They reduce the time that should be devoted to other objectives.

A sales manager selects priorities based on the impact the fulfillment of a sales objective has on the marketing and corporate plan. Utility of time and resources is also considered. For example, in the event of a bandh or strike, it is impractical to make sales calls. Holding a sales meeting is a good alternative.

Motivation

Sales force motivation is a widely discussed concept in sales management. Sales managers have the huge task of maintaining motivation and morale of sales personnel. This is easier said than done because managers can rarely spend time on a one-to-one basis with field sales personnel. The sales force has to face the rejections and dejections of their customers and channel members. This makes it tough for sales personnel to keep up their morale. Similarly, evaluation is hard as the scope of personal supervision is restricted. But, proper evaluation is a must because discrepancies will further reduce sales personnel morale and have a direct and immediate impact on the organization's bottom-line. The sales manager can use rewards in the form of incentives and commissions or sales contests, because the compensation plan is closely tied to sales force motivation. We will discuss motivation in detail in another chapter.

Ethical approach

Managers in organizations today are expected to adopt ethical practices in their daily activities. With the manager desperately keen to improve company revenues, he or she might take a short-term approach while hiring, setting quotas, promoting and evaluating the sales force. This can be disastrous for the organization in the long-term. For example, the manager might not suggest the name of a high-performing executive when a vacancy for a higher position occurs, in order to maintain the sales volumes in his/her territory. In one case, the Prudential Insurance Company of America had to pay $425 million to its customers because its managers did not stop their sales personnel from selling costly new policies to existing customers, to maintain profitability levels.

Routing and scheduling, staffing and training are other administrative functions of a sales manager. Managers should help sales personnel plan and assign sales territories and direct them to cover their territory through a routing and scheduling plan. This helps reduce territory coverage, time and costs. Staffing and training are other administrative activities for sales managers. For example, the manager may give a sales presentation to a prospective client along with the salesperson. This is a type of "on the field training" for the sales person.

The manager is no longer the stereotyped super-sales man. Present day managers have to lead a diverse sales force, who are highly educated and prefer greater challenges and higher rewards. To be a successful manager, one must not only master basic sales management functions but also be proficient in marketing and management skills. This has led sales manager to be more planners and administrators than supervisors or controllers. However, a sales manager must still spend sufficient time in the field with the sales force as it enables effective management of the sales force. The importance of being in the field can be ascertained from Exhibit 6.3.

THE SALES PLANNING PROCESS

Although sales planning is generally a part of the overall marketing planning strategy, it has its own, independent planning process. It can be undertaken either as a top-down approach, where the objectives, strategies and tactics are decided by the top management and the sales force only implements them, or a bottom-up approach where inputs are taken from the sales force to prepare the sales plan.

A company should carry out research before formulating a sales plan. To start with, it should collect past sales data from sales records and organize it into various categories like product, territory and customer groups. The sales manager should then study economic conditions that may influence the company and the industry.

Exhibit 6.3

Sales Managers should be in the Field

A sales manager's primary job is to ensure increase in sales volume by maintaining the productivity of sales personnel at a high level. This is possible only when the sales manager spends more time with sales personnel. Sales managers in many organizations are totally engrossed in administrative work like handling phone calls, paperwork and attending meetings. They should realize that it is advantageous for even experienced sales persons to have their superior alongside while handling major accounts. The sales person will have the opportunity to learn better ways to project product benefits, and will also get hints on making presentations for product lines and managing price issues. Sales personnel tend to feel lonely in the field as they are generally on their own. The sales manager's visit not only relieves boredom but also helps in trading a lot of information. The manager can impart on-the-field training to sales personnel by acting as a role player or teacher.

Even when it is difficult to spend time with the sales force, the manager must make it a point to call up sales personnel at least 3-4 times a week and enquire about their work and whether they need any support from the organization. A sales manager who is willing to be on the field, can support, train, motivate and reinforce the commitment of sales personnel towards the organization. This is because most sales managers have experienced life on the field themselves and can relate their experiences to the sales force.

Adapted from Carl Swartz, "Sales Managers Need To Get On The Road Again," American Salesman, November 1998, Volume 43, Issue 11, 16-19.

Once the manager has adequate data relating to past sales and the economic situation, he or she should take operational decisions on the development of the sales plan. Decisions relate to the timing of the year when the plan would be developed, place of the meeting and members who would participate.

The sales planning process consists of the following basic steps.

- Setting objectives
- Determining operations to meet objectives
- Organizing action
- Implementation
- Measuring results against standards
- Re-evaluating and control

A sales plan influences organizational design, selection, training, monitoring, evaluation and compensation of sales personnel. Hence, the sales manager must ensure that the sales plan is developed properly. Let us discuss each step of the sales planning process.

Setting Objectives

The first step of the planning process is to decide and formulate sales objectives for the sales force. The sales manager requires accurate information to set sales objectives. A situational analysis followed by an environmental audit provides the information necessary to determine sales objectives.

Internal situational analysis

An internal situational analysis with the addition of a SWOT analysis gives a clear picture of the organization's present condition - its internal strengths and weaknesses and external opportunities and threats. An objective approach is needed while undertaking situation analysis. The sales manager should discuss and debate questions like – Who will sell the company's products? What are the various selling methods to be adopted? What are the types of sales tools to be used? (this includes presentations, mailers and brochures). At this stage, an analysis on the alignment of existing sales methods and tools with the organization's image and an analysis of current customer levels must be done. Such analysis will lead to knowledge of factors that can be controlled internally and the sales force's strengths and weaknesses. For example, the experience of the sales force might be the strength of the organization. Its weakness might be that the sales force is aging and cannot adapt to the vigour of present day competitive selling. Generally, the internal strengths and weaknesses can be obtained from the company's sales records, market share, nature of products sold, target markets and so on. A structured approach (like looking into product life cycle positions) is necessary for an effective situational analysis. Finally, the results of the analysis must be clearly communicated to other sales organization members.

External environment audit

After internal situational analysis, external environmental audit must be undertaken and the findings discussed with sales personnel. The factors analysed during external audit are largely external and uncontrollable and can have a significant impact on the organization's functioning. They include competition, market, political, economic and social conditions. Generally, a PEST (Political, Economic, Social and Technological) analysis is conducted to identify the direction, intensity, extent and time of impact of relevant external variables that can significantly affect an organization.

Sales objectives are clearly defined only after conducting internal and external audits. The sales manager must remember that specific sales force objectives must be derived from broader marketing and corporate objectives mentioned in the marketing or corporate plan. Sales objectives must align with corporate vision. Depending on the spread of sales operations, a sales manager has to set sales objectives at various levels. The objectives might start at a macro level (country or geographic region) and trickle down to a micro level (a key account). For example, sales objectives can be set for countries, markets, territories, key accounts and so on. Objectives provide the direction for the activities to be undertaken by the organization. They help canalise resources towards essential activities and prevent dissipation of effort. The objectives also help performance evaluation and controls as results can be compared with objectives.

Objectives may be long-term or short-term. The former contribute to the organization's mission and should not be in conflict with it. The latter contribute to the attainment of objectives set in the marketing plan. The selection of these should be based on priorities related to long-term objectives. Generally, the objectives will be more specific in the first year of a sales plan than its fifth year, i.e. the accuracy reduces over longer periods. This can be avoided by preparing the first year objective so that it provides the foundation for the objectives in succeeding years. This is possible only when short-term plans are part of long-term plans.

Next, objectives must be output oriented and measurable and not just activity-oriented. For example, an objective of increasing sales is of no consequence as it is vague. The goal must be quantified. Increasing sales by 10 % is an output- oriented sales objective. Other measurable objectives could be as follows –'x' number of days of training per year for sales personnel or 'y' number of average monthly sales calls per representative. Sometimes, objectives cannot be quantified. For example, objectives like increasing sales force morale and improving company image are difficult to quantify. However, they can be measured through indirect quantification. Absenteeism is closely related to low morale among sales personnel. Thus, reducing absenteeism by 50% gives an indirect quantified objective of improving sales force morale.

Exhibit 6.4

Planning by Objectives.

Before switching to sales planning by objectives, General Electric (GE) planned its strategies by asking sales personnel to prepare their plans in the form of action programmes. The reactions of customers to their plans was assumed. This method did not yield expected results because it is difficult to assess customers' reaction patterns beforehand. Owing to this deficiency in the planning approach, newly recruited sales personnel in General Electric's service division had greater difficulty in planning compared to new sales personnel in other product divisions. The reason was that the service division was involved in industrial maintenance and repair, requiring sales personnel to react quickly when there was failure of equipment in the customer's plant. Sales personnel were unable to identify beforehand customers, whose equipment might fail. Due to this, though GE was prompt in reacting to equipment failure, it was unable to gain customers' confidence by identifying and preventing failures. This led to loss of revenue and accounts. GE then implemented planning by objectives. Sales personnel were able to identify and keep track of probable service problems and service contracts lost to competitors from major accounts. They could also undertake and review major account planning on a monthly or bi-monthly basis and approach these accounts with clear-cut objectives.

Adapted from Robert A. Else, "Sales Planning by Objectives at General Electric," Management Review, August 1973, Volume 62, Issue 8, 47-50.

Sales planning through objectives has been implemented by many large organizations. Exhibit 6.4 explains this concept as implemented by GE Corporation.

Determining Operations to Meet Objectives

After objectives are decided, sales strategies to achieve objectives have to be formulated. Sales strategies are operations, which organize and direct sales activities that help achieve objectives. A strategy must be prepared to accomplish each objective formulated. Strategies must be defined in terms of logic, feasibility and practicality. All the strategies are defined and combined to form a master plan, which makes for easy review by sales manager as well as by top management. The sales manager must develop sales strategies in relation with overall corporate or marketing strategy. The importance of linking both these strategies can be better understood by comparing possible variations in a sales strategy with respect to corporate strategy. An organization typically adopts a 'build', 'hold', 'harvest' or 'divest' corporate strategy.

If the organizational strategy is a 'build' marketing strategy, which focuses on increasing sales volumes, the sales manager must then design a sales strategy that focuses sales force activities on current and new accounts to increase sales of various products. The sales force has to adopt a relationship marketing approach and collect market information as a source of competitive intelligence.

If the organization is going for a 'hold' marketing strategy, which focuses on maintaining current sales volumes, then the sales force strategy must focus on consolidating relationships with current accounts to improve the organization's position among existing customers.

If a 'harvest' marketing strategy. which focuses on reducing overall operations costs, is being selected, then the sales force must be directed towards their most profitable customers. This approach will help sales personnel to improve the sales to expenses ratio. A major account strategy or a customer-based sales force is preferable in such circumstances.

If the organization is going for a 'divest' marketing strategy, which focuses on minimizing operations costs totally and clearing inventory and overheads at the earliest, then the sales force strategy should be based on selling products without specific focus on profits. The major objective of the sales team here is to clear piled-up inventory at the earliest.

The sales manager must break down the above set of objectives and the corresponding strategies into individual sales objectives for the entire sales force. This can be accomplished by communicating objectives and coaching sales personnel to implement planned sales strategies. For example, if the objective is to gain new accounts, the strategy should support this by ensuring that more recruitments are made to cover new territories and that the existing sales force is given training.

Some organizations assign a group of quantifiable objectives to each individual sales person, based on the sales activities they are supposed to perform. The sales person must develop specific strategies for each objective and implement them in selling activities. The problem with this approach is that sales personnel prepare their strategies for reaching set objectives by assuming the customer's reaction patterns in advance. In practice, it is very difficult to predict customer reactions. Organizations encouraging this kind of planning create conditions where it is the sales force that supports the organization by preparing strategies and not the organization that supports the field force.

Different competitive strategies require varied sales management strategies. The same strategies will not prove effective in all situations. The sales manager must ensure that the adopted strategies aid and support the organizations competitive strategy.

Organizing for Action

Once sales objectives are identified with the help of sales strategies, the sales manager must devise ways to organize the objectives into tactics. Development of tactics involves identifying steps and taking decisions on operational aspects. It includes answering questions like,

Which customers to target?

Which products to highlight among the entire product range?

What are the apparent market trends?

What is the sales department's present condition?

Is the present compensation plan suitable?

What is the compensation average in the industry?

What are the different ways to introduce a new product into the market?

The sales manager should communicate the importance of planning to all sales personnel, gain the support of top management, arrange for training programmes or workshops for all personnel and finally garner sufficient resources to implement the action programmes. Decisions on quota setting and budget compilation aspects are also taken in this stage of the planning process.

Tactics are used as short-term action plans depending on the current need of the organization. Increasing profits through a skimming strategy or focusing on sales promotion while introducing a new product are examples of short-term tactics.

Implementing

The role of sales manager in implementation is two-fold – first, it includes developing strategies and delegating responsibilities to sales personnel and second, it involves coaching each individual to develop similar plans for his or her territory.

Table 6.1: Relation between Performance Measures and Performance Standards

Performance Measures	Criteria for comparing sales plan performance		Current Plan Objectives
	Industry averages	Past performance	
Sales volume	Trade publications	Internal records	Sales forecast
Selling costs	Trade publications	Internal records	Cost budget
Market share	Annual company reports	Marketing department	Forecasts
Profit margins	Trade publications	Sales force expenses, product returns, number of service calls.	Sales force expenses.

Developing strategies

In this step, the sales manager has to decide on responsibilities to be assigned and the ways to support each salesperson. They must complement the sales plan and the corporate objectives. Dividing tasks to be accomplished in a time sequence format ensures timely implementation of plans. Also, a periodic review schedule for each sales person has to be established to ensure that sales plans are implemented accordingly.

Coaching

The sales manager must break down objectives and corresponding strategies into individual sales objectives for the entire sales force. This can be done by communicating objectives and coaching sales personnel to implement planned sales strategies. Sales meetings and presentations are used to communicate the plan, because if sales personnel are not clear about responsibilities and expectations, the sales plan cannot be successfully implemented.

Before implementation, it is necessary to check the feasibility and affordability of objectives and strategies. It is also essential that sales managers remain alert to unexpected changes in the external environment during the implementation stage. It must be remembered that it is people who make systems work. Implementation should take into account the culture, tradition and values of the organization along with the attitudes, personality, values and beliefs of sales personnel.

Measuring Results against Standards

The basic process of control involves three steps: (1) Establishing standards (2) Measuring performance against these standards and (3) Re-evaluating and correcting variations from standards. For the sake of convenience, we have discussed steps 1 & 2 in this section. Step 3 is discussed in the subsequent section.

Sales managers need performance standards to measure results obtained from implementing the sales plan. Different performance measures can be taken and related to set performance standards to assess the effectiveness of the sales plan. Sales volumes, selling costs, market share, profit margins and rate of sales force attrition are some frequently used performance measures. Usually, industry averages, past sales force performance or present managerial expectations are used as standards to evaluate results. Objectives set by sales managers are considered the best performance standards as they are based on corporate objectives, current forecasts and budgetary support. The relation between performance measures and performance standards can be clearly understood from Table 6.1.

Performance measures formulated earlier can be measured using forecasting methods like sales and market analysis, return on investment, contribution to profits, return on assets managed by the sales force, sales to cost ratio and market share analysis. These methods are discussed in the Chapter - Sales and Cost Analysis.

Re-evaluating and Control

The process of re-evaluation can begin midway during implementation of the sales plan or at the end of the process. All programmes have to be monitored constantly and consistently over varying periods of time for effective control and to ensure that overall organizational objectives are met at the end of the year. For example, if the company objective is to increase sales by Rs. 10 crores, then one must monitor and ensure that at least Rs. 2.5 crores in sales volumes is achieved every quarter.

Adjustment in sales objectives or strategies or tactical changes are undertaken in this stage of the planning process. A thorough reanalysis of planning assumptions and the practicality of the planning approach is also done at this stage. Sales control will be more effective with the aid of a sales audit. Evaluation and control are covered extensively in subsequent chapters.

CAUSES OF UNSUCCESSFUL SALES PLANNING

Sales plans become unsuccessful when manager have a penchant to benchmark sales plans using top plan models adopted by successful companies. A sales plan must add value and must be able to achieve set goals that are unique to a company. One must never make the mistake of trying to create new processes in the organization by copying successful plan models. The aim should be to better existing standards with sales plans that are specific to a company. Another reason why sales plans fail is because managers try to duplicate the general steps in the planning process without thinking of specific requirements of the organization. Some other reasons that lead to failure of sales plans are discussed below:

Lack of Awareness or Understanding of Important Aspects

Sometimes, sales managers prepare sales plans without being aware of corporate or strategic plans formulated by top management. This leads to sales force objectives clashing with corporate objectives. For example, top management might decide to reduce operating costs, while the sales management may decide to go for sales force automation, needing substantial investments. Hence, it is necessary to be aware of the link between corporate plans, marketing plans and sales plans.

Sales managers sometimes formulate plans with no reference to the abilities and views of colleagues and subordinates. This leads to confusion and lack of interest on the part of sales personnel while implementing plans.

Lack of awareness of changes in social values and systems and their likely impact on business is another reason for failure of plans. Having contacts outside traditional business circles with sociologists and economists will enable one to get first hand information about these trends, which should be kept in mind during planning.

Insufficient understanding of the organization’s present business interests and factors affecting success like external environmental influences, competitor moves and customer dynamics, cause plans to falter. For example, the sales manager may decide to increase profits by adopting hard-selling methods and aggressive pricing, at a time when a new competitor is planning to enter the industry with a new range of products at lower prices.

The organization’s strengths and weaknesses have to be kept in mind while preparing the plan. For example, a plan to increase market coverage might require recruitment of more sales personnel. This, in turn, calls for increase in budgets to compensate the extra sales force. If the organization is not able to afford this, the plan will fail.

Absence of Proper Planning

Many ‘so called sales plans’ fail miserably due to the misconception that planning only requires sales managers to set profit targets and that sales personnel will somehow manage to fulfil these objectives without support from the company management. Sales managers prefer to focus efforts on areas they are comfortable with and do not think of alternate ways to improve neglected areas. They make no attempt to apply out-of-the-box thinking. The plan’s efficacy is lost when alternate strategies have to be implemented in contingency conditions requiring an alternative approach to overcome problems.

Sales managers sometimes develop sales plans that are nothing more than a list of numbers which do not focus on key organizational issues, clarify the company’s position in the market or explain opportunities in quantitative terms. For example, a sales plan having an objective to increase market share to become the number one player is not sufficient as details on the ways and means to achieve the objective (time period, strategy changes and sales force structure) is not elaborated.

Another reason for plan failure is contradiction in objectives. The sales plan objective may be mainly profit oriented and to achieve this, sales targets are sometimes inflated beyond what can be logically achieved. On the other hand, sales budgets are reduced, instead of being proportionately increased by sales managers. This leads to de-motivation among the sales force as they feel that the organization only wants to use them as a medium for profits.

Sales managers fail to identify objectives in the sales plan that complement the organization’s core competence with customer needs. Sales objectives have to be well defined to think of sales strategies and alternatives that are to be formulated to achieve them.

A narrowly defined sales plan focuses on overall increase in sales and the minimum rate of return, without considering other aspects like product life cycle implications, market and industry growth rates and so on. This approach will obviously lead to failures, as both internal and external variables have to be considered during planning.

Lack of Systematic Communication

Insufficient communication and reporting relationships in the sales plan creates difficulties in integrating individual goals with organizational goals. Due to communication breakdown, sales personnel tend to pursue the wrong goals and waste their efforts. For example, a salesperson may try to exceed given targets by compromising on the selling approach, in order to win a foreign trip, whereas the organizational goal might stress ethical selling.

Sales plans that are full of jargon and complicated terminology are difficult to comprehend for sales personnel and result in lack of clarity.

Absence of Sales Force Involvement

Not getting sales personnel involved in the initial steps of planning can lead to their being disinterested. A sales manager has to take sales personnel into confidence and arrange for planning sessions with them during the sales plan preparation. Decisions on actions to be taken during selling, results that can be expected from sales personnel, probable changes in the external environment and hurdles to be overcome will all lead to more commitment from the sales force and help effective performance control measures.

The presence of an external sales planner (consultant) also reduces sales force involvement in the planning process. This person may develop sales plans without taking inputs from sales personnel. The planner may not be conversant with ground realities and issues faced by sales personnel. He or she may also not be aware of existing structures and processes in the organization. This may lead to a plan that is not feasible at the ground level due to lack of integration between the sales planning, marketing planning and overall corporate planning system. However, if an external sales planner is efficient, willing to study ground realities and knows the job, the advice rendered might be invaluable.

ACCURACY OF SALES PLANNING

Accuracy in sales planning is of utmost importance to any organization. Forecasting, budgeting and territory management are the different sub-sets of sales planning. An error in any one will lead to an error in the overall sales plan. The accuracy of planning depends on the plan's time- frame. A systematically prepared sales plan that gives sufficient time and scope for evaluation continuously, will lead to greater accuracy of sales forecasts. Accuracy can be gauged from the difference between forecasts and actual results.

Organizational plans are more accurate when the gap between the plan and its implementation is shorter. Hence, short-term plans are more accurate than long-term plans. This difference arises due to the difficulty in forecasting the occurrence of unplanned events like a company merger or inflation. Inflation in the economy also makes long-term plans look more impractical than short-term plans. This is because the former are prepared based on price levels prevalent at that time while results are measured based on current price levels. In such conditions, price-adjusted figures are a good measure of the plan's accuracy.

Many factors impact the accuracy of the sales plan. They include growth rate of profits, organizational size, involvement of top management, the planning process, sales force participation in the planning process, communication of planning elements and formulation of specific objectives.

Organizations that have higher rate of profits tend to have less sales plan accuracy because they are more optimistic in forecasting profit rates, based on current profit growth rates.

Large organizations are more accurate than small ones in sales planning because they often have a formal planning department or a planning board that comprises teams of sales managers and supervisors from different regions. In small organizations, the planning function is usually vested with a few key managers.

Sales plans are more accurate if objectives are set by the top management and are supported by sales managers. The greater the involvement of top management, the higher the sales plan's accuracy.

A bottom-up approach is more accurate than a top-down sales planning approach. This is because when sales personnel are asked to set their own quotas or selling objectives, they have a greater responsibility to achieve them than when objectives are defined for them by sales managers. Planning accuracy is also proportionate to the extent to which the plan is tied to the budget. If the plan proceeds strictly with reference to the budget fixed, without variations, the accuracy will be greater. The budget is the framework that keeps planning activities on track.

The extent of communication of planning elements also influences accuracy. Many organizations withhold information about strategies and objectives devised by top management for various market segments from their sales force. This approach prevents sales personnel from getting to know organizational strategies and how they will fit into the scheme of things. Attention must be given to regular communication of company goals and clear and specific objectives provided to sales personnel on their responsibilities. Otherwise, sales force actions may not complement organizational expectations and this will lead to sales plans not achieving expected results. For example, at IBM, account planning sessions are held for three to five days involving around 50 sales personnel. The objective is to discuss decision-making processes and purchasing capabilities of IBM's major accounts. This helps to update all applications, maintenance and installation issues of sales personnel with the help of superiors. Such continuous communication will keep sales force activities on expected lines and help maintain the accuracy of the plan.

SUMMARY

Most organizations find themselves operating in highly competitive markets with varying customer needs and expectations. This has made them redefine the importance of meticulous planning to be successful in the globalised environment. An understanding of the sales planning process is essential to effectively manage the sales management function. It provides a framework and direction to all actions involved in sales management. It also helps sales personnel understand where the organization is headed, how it will reach the desired position and what activities must be undertaken to fulfil the organization's mission.

Sales planning is very important to an organization because it helps in better implementation of plans, provides a sense of direction, improves coordination and control and reduces uncertainty and risk. The sales manager's role has gradually shifted over the years to that of a planner and administrator. As a planner, the sales manager has to forecast, develop objectives, design the sales organization, formulate policies, procedures and standards and prepare sales budgets. As an administrator, the sales manager has to supervise, coordinate, delegate and motivate the sales force. Managers must also ensure that ethical standards are followed by the sales force during selling.

The planning process involves – setting objectives, determining operations to meet these objectives, organizing action, implementing the sales plan, measuring results against standards, re-evaluating, and control of the sales force performance. Most plans fail due to a host of reasons. The primary reason is the habit of sales managers to duplicate the successful plans of other organizations without trying to understand the specific requirements of their organization. Lack of awareness of important aspects, absence of proper planning, absence of sales force participation and lack of effective communication of planning elements also lead to failure of sales plans.

The accuracy of the sales plan is dependent on the time- frame. Plans are generally accurate for shorter time spans than for longer periods. The rate of profits, size of the organization, involvement of top management, communication and sales force participation affect the accuracy of the sales plan.

Chapter 7

Sales Budgets

In this chapter we will discuss:

- Purpose of sales budgets
- Benefits of budgeting
- Principles of budgeting
- Types of budgets
- Methods of budgeting for sales force
- Requirements for successful budgeting
- Developing a sales budget
- Precautions in preparing sales budgets

The budgeting process was first used by companies like General Motors, DuPont and Siemens during the 1920s to manage their expenditure and cash flows. By the 60s and 70s, this was transformed into a process of controlling and planning a firm's activities. Since then, budgeting is being used as a tool for improving employee performance and organizational capabilities in functional areas.

The budgeting process helps represent the organization's objectives and strategies in numerical terms. It is important for managers to recognize that budgets are the most important planning aspect of the organization. A well- prepared budget facilitates smooth functioning. Developing the sales budget is an important activity for a sales manager and the sales department plays a significant role in planning and developing sales budgets. In this chapter, we will discuss the different dimensions of sales budgets including their purpose, benefits and types. The chapter concludes with a discussion on the development of a sales budget and the precautions that should be taken while preparing budgets.

PURPOSE OF SALES BUDGETS

A sales budget serves two purposes – it is a mechanism of control and an instrument of planning. For any budgeting process to be successful, an organization has to know where it is going and where it has to head. Budgets clearly define the resources required for performing activities that help an organization achieve its goals and act as an effective tool for controlling a firm's performance.

Budgets should be developed by those responsible for achieving the stated objectives and should be communicated to top management for approval. Budgeting helps managements identify the financial difficulties they might face in the budgeted period and prompt them to prepare strategies to deal with them.

Generally, an organization's budgeting process depends on the revenues it has been getting. For instance, the budgeting procedure for an organization generating revenues in hundreds of crores of rupees will be very different from that for an organization whose revenues are in lakhs.

Mechanism of Control

Controlling and planning are inter-linked and one is useless without the other. Budgeting in itself is a control process. Controlling is a process of making a disciplined effort to follow an established plan of action and identify any deviations that occur. Deviations cause friction between the employee responsible for the deviations and the manager. The emphasis to control deviations forms the central point of control and an explanation about the reasons for deviations is warranted. Most often, this results in arguments, leading to frustration and the entire budgeting process is questioned.

It is therefore important for the management to impart sufficient training to employees about the best utilization of budgeted resources. This will ensure that deviations are avoided. Installing a budgetary control system in an organization, as discussed in Exhibit 7.1, is very useful for an organization.

Instrument of Planning

Planning is the process of determining a future course of action for helping employees to tread a particular path. Forecasting sales, scheduling the production process and most important, budgeting the expenditure for the organization, are part of planning. Budgeting will be an effective planning tool if it is done for the entire organization, rather than for individual departments or functions. Budgeting will be successful only when every employee of the organization starting from the top executive to the shop floor worker follows it diligently. Budgeting as a planning tool will help the organization anticipate all its future financial needs and allocate sufficient financial resources for these needs so that the firm attains maximum profitability.

Exhibit 7.1

Installing a Budgetary Control System

Installing a proper budgetary control system in an organization needs a manager to find answers to certain questions like,

- What may happen in the future that warrants control?
- What can be done to achieve objectives?
- What are the possible hurdles, and what needs to be done to overcome them?

Once, answers are found, the process of installing the budgetary control system can begin.

The first step is setting up a concrete organization plan by preparing a budget manual that specifies the powers, duties, responsibilities and areas of operation of all personnel involved. The budget manual, apart from detailing these issues, should contain,

- The process of obtaining necessary approval for the budget.
- A detailed timetable for all stages of budgeting.
- Details about all reports, statements and other records that need to be maintained.

Apart from having a budget manual, the organization must appoint a budget controller, who will be responsible for all budgeting activities of the organization and will report to the chief executive. These are the activities involved in the installation of a budgetary control system in an organization.

Adapted from <http://www.laynetworks.com/Accounting%20and%20Finance%20on%20Computers.htm> 09 October 2004.

For budgets to act as an effective planning tool, they must be developed very carefully by following certain steps -- assessing the previous year's financial performance, connecting the current year's expenditure and programs with long-term strategies, developing short-term activities to achieve long-term objectives and finally communicating plans clearly to all those concerned. Budgeting becomes an effective planning tool when the sales manager lists the goals and objectives that the sales department has to achieve in the coming year. The next step is to identify the best ways to achieve these goals and assess the expenditure that will be so incurred. Most organizations follow zero- based budgeting, where they calculate the expenditure of each activity starting from zero. Another method is to evaluate the previous year's spending patterns and based on that, the current year's budget is developed by making alterations to suit the current year's activities. The sales manager can have an idea about the budget needed if he or she has prior knowledge of the expenditure the staff may incur.

BENEFITS OF BUDGETING

The budgeting process has several benefits. It helps improve planning, better communication and coordination, evaluate the performance of all involved and avoid uncontrolled expenditure.

Improved Planning

Budgeting enhances the quality of planning as it describes the actions to be taken in quantitative terms. For example, the firm's sales forecast usually provides a specific potential revenue figure, while the operating budget specifies the likely expenditure of the sales department for earning revenues. The top management can use these figures while preparing corporate plans. Although it is true that the budgeting process can only guide the firm to follow a path that will lead to profits, it definitely helps improve planning.

Better Communication and Coordination

Budgeting improves the efficiency of communication and coordination among an organization's different departments. As a budget gives the future course of action in quantitative terms for functions like sales, production, personnel, etc. it forms the basis for coordination within the organization. For instance, if the budget allocates more resources for improving sales, production and other departments have to gear up to meet the expected demand for products and services. This will result in constant interaction between departments and in turn lead to better coordination.

Control and Performance Evaluation

As budgeting establishes the objectives and responsibilities of all departments and employees, it facilitates performance evaluation and control. Any deviation from the plan can be easily identified by conducting periodic reviews. This will help the management to take necessary steps to rectify the situation. For example, an expense budget gives the amount that can be spent by the sales department. If any slippage in identified, the manager should find the cause and take measures to control it. The slippage may occur either due to indiscriminate spending by sales personnel or because the allotted resources are insufficient to achieve sales targets. Thus, budgets can be used to control expenses and monitor performance of various departments.

Psychological Benefits

Budgets instil a sense of profit consciousness in employees. Budgetary controls remain in the minds of sales personnel and encourage them to achieve sales targets with the least possible expenses. If the budget does not act as a tool for controlling expenditure, it becomes very difficult for the firm to achieve profitable sales. The budgeting process thus helps the firm's management to curb uncontrolled expenditure.

PRINCIPLES OF BUDGETING

A firm can derive several benefits of budgeting if it follows five basic principles. These are:

- All employees must be involved in the process
- It should be practical and gain acceptance in the organization
- Outputs must be linked with inputs
- It should be flexible to adapt to environmental factors
- The management should continuously learn

The first and the foremost principle is that all employees must be involved in the process of budgeting. Every employee of a firm must be clearly told about the tasks he or she has to perform. Communication is the key and any gap in this process will jeopardize the entire budgeting process. People at all levels of the organization should be involved and each department given the responsibility of achieving results. Mass involvement means that everyone will naturally feel responsible towards the set budget and contribute to the firm's profitability.

The second principle of budgeting is that it should be practical enough to gain wide acceptance in the organization. Superior officers can improve the performance of subordinates by setting budgets, which are practical. For instance, a salesperson may accept his or her individual budget to be fixed at Rs. 1 lakh per annum in the confidence that Rs.2 lakh worth sales can be achieved. If the budget is increased to Rs 1.5 lakh, the salesperson might put in extra effort to improve his performance. But, if the budget is raised still higher to Rs 2 lakhs, the salesperson might feel dejected as he or she is aware of the extent to which he or she can improve his or her performance and may begin to feel it as an impractical and impossible target to achieve. A manager can achieve a significant performance output from subordinates with the help of budgeting.

The third principle of budgeting is that outputs must be linked with inputs. Outputs that have been achieved, like the number of units produced in a production firm, or the number of customers who have opened an account in a bank, are important factors. Inputs that are required to achieve those outputs are usually the costs involved, apart from other aspects like infrastructure. With the aid of budgeting, the management can avoid costs that do not contribute to production or whatever the activity concerned may be.

The fourth principle of budgeting is that it should be flexible enough to be able to adapt to environmental factors, which will affect the firm anytime during the budget period.

Finally, the fifth principle is that the management should continuously learn from the process and from any mistakes committed. This will ensure that the process of budgeting is constantly improved and utilized in the best possible manner for achieving goals.

TYPES OF BUDGETS

A sales manager is responsible for developing budgets for the sales department. In general, sales managers prepare three types of budgets. They are

- Sales budgets
- Selling-expense budgets
- Sales department administrative budgets

Sales Budget

A sales budget is a detailed plan showing the expected sales for a future period. It is developed based on expected revenues (as given by the sales forecast) from sales. In general, a sales budget gives the sales that would be generated from a geographical location, product or service offering, salespeople and customers.

This is the most crucial budget as it is the first part of the master budget and forms the basis for other operational budgets like finance and production budgets. Sales forecasts should be prepared for each product division rather than for customer or territory. This is because the production and finance departments should know the number of units required rather than the number of customers the salespeople would like to target.

Selling-Expense Budget

A selling-expense budget is a plan that gives expenses that would be incurred by the sales department to achieve the planned sales. These expenses could be commissions or salaries paid to salespersons. Travelling and entertainment expenditure is also part of the selling expense budget. Allocating a percentage of sales, as commission or a fixed salary, will form a major part in developing selling expense budgets. The costs incurred on training salespersons when a new product line is added should also be included in the selling expense budget. Finally, this must be closely linked with the sales budget, as the selling expense budget is determined by the number of products supposed to be sold in a given period.

Administrative Budget & Profit Budget

The administrative budget comprises the budget allocation for general administrative expenses such as rent, electricity, office furniture, stationery and other costs incurred by the sales department. Generally, the sales and selling-expense budgets are prepared separately, but sometimes both are combined to develop profit budgets. In profit budgets, the gross profits are calculated by deducting the sales expenses from the revenues generated by the sales department.

METHODS OF BUDGETING FOR SALES FORCE

Different methods are used for developing budgets for the sales force's various activities. While developing the budget for the sales force, the involvement of the sales manager is important, since he or she will be personally held responsible for expenses incurred by the department. Several methods such as the affordability method, percentage-of-sales method, competitive parity method, objective-and-task method and return-oriented method are used for budgeting sales force costs.

Affordability Method

The affordability method is a process where the management develops the sales budget depending on its ability to spend on sales functions. Here, a firm develops the budget based on whether it can afford to spend a certain amount for selling its goods. The funds allocation will be arbitrary as this figure may fall short or exceed the exact requirements of the sales department. In practice, most budgets prepared using this method fall short of the sales department's requirements.

Percentage-of-Sales Method

Percentage of sales method is also used for developing budgeting for marketing efforts. The budget is developed by multiplying sales revenues by a given percentage. The sales revenues used may be a past sales revenue figure or a forecasted figure. Sometimes, even a weighted average of the two is used. This is one of the easier ways of developing budgets. A serious shortfall is that it is based on the amount of sales revenues that have been or will be generated. It has to be remembered that sales revenues are dependent on the efforts of salespersons.

Competitive Parity Method

In this method, the sales manager sets the budget based on the budgeted figures of competitors or the industry average. Firms adopt this method because they feel that the collective wisdom of the industry is superior to the wisdom of the firm. The budget is based on a comparable (in size and revenues) competitor's budget so that the firm does not lose market share to the competitor.

Objective-and-Task Method

The objective and task method overcomes a fundamental shortcomings in all the above methods i.e., developing budgets without considering the organization's objectives. In this method, the management develops the budget based on the objectives to be attained. The objective task method involves four steps. The first step is the identification of objectives of the sales department after arriving at a consensus

Exhibit 7.2

Tips for Successful Budgeting

Companies need to bridge the gap between financial planning and tactical planning. Predicting future trends should be done based on past performance. Having an external vision about what is happening in the industry will significantly help the company in budgeting and in setting up external benchmarks. A rolling forecast is a credible and useful technique in sales forecasting, which helps the company in preparing flexible budgets and adapting to the environmental changes.

Although it is important to carefully prepare the budget by paying attention to detail, the information so gathered should not overload the planner. A major problem during the budgeting phase is called "sandbagging". This is a process of calculating budgeted requirements by intentionally inflating figures, so that they can be easily met. However, the management can identify such "sandbaggers" by adopting advance software tools like MPC (Management Planning and Control). MPC suppliers include Comshare, Hyperion and Cognos. Improved capital budgeting is vital aspect to an organization's budgeting process. Proper strategic direction regarding investment in capital is essential from top management at this stage. Software applications help a company to analyze business uncertainties with the help of "what-if" scenarios. Advanced IT solutions can certainly be useful in preparing a near-perfect sales budget.

Adapted from "Ten Latest Techniques to Improve Budgeting and Planning," Non Profit Business Advisor, August 2002, Volume 5, Issue 155, 11-4.

among sales department employees. Next, the tasks to be performed for achieving the objectives are specified. The third step involves determining the expenditure required for these tasks. The fourth step involves adding all the above expenses to arrive at a final figure for the purpose of budgeting.

Return Oriented Method

These days, budgeting is being increasingly done with the help of return- oriented methods. These methods like return on investment (ROI), return on assets (ROA), return on total assets (ROTA), return on assets managed (ROAM) are some tools that help managers to develop a sales budget. ROAM will help the sales manager to analyse the financial picture of budgeting decisions. ROI will help sales managers analyse the impact of a particular sales cost allocation on revenues and profits generated by sales.

REQUIREMENTS FOR SUCCESSFUL BUDGETING

There are certain criteria that a successful budget should meet. Otherwise, it will become a burden for those involved in terms of imposed sales targets. For proper implementation, budgeting should be developed with the involvement and support of top management and should be flexible. Exhibit 7.2 describes some requirements for successful budgeting.

Involvement & Support of Top Management

In the budgeting process, top management involvement is essential. This group has to clearly understand the budgeting procedure and its role as a planning and control tool. Unless and until top managers understand fully, they cannot appreciate its importance. Apart from understanding it, a top manager also has to ensure that every employee too understands and appreciates the budgeting process. Top managers should also see that budgeting controllers report deviations from the planned budget and do not demand explanations from employees on their own. For successfully budgeting the different functions and activities of the organization, the top management should support the activity and ensure all round participation.

It is advantageous if the top management encourages responsible people in the organization to develop budgets by themselves, as they are the best persons to judge their performance levels and resources needed. However expert advice can be sought.

The staff should not perceive the budget as a pressure device that forces them to perform. They should rather view it as an effective tool, which will help them perform better. The management should also ensure that the budget is firmly implanted in the company's planning function. It must also identify performance levels required for each department and convert them into rupee terms for developing budgets.

The control aspects to be built into a budget are equally vital. The top management should initially define what controlling is and what it means to the organization as a whole. In addition, a clearly defined organizational structure is necessary for proper implementation of the budgetary process. Finally, the top management should ensure that controllers, who develop the budget, have a clear understanding of the tasks that they need to perform. These controllers should be responsible for the budgets they develop.

Flexibility in Budgeting

Companies these days operate in an intense competitive situation, where environmental changes take place rapidly. In such situation companies rarely achieve the planned performance using the developed budget. Budgets should be flexible so that sales activities can be adjusted to fast changing environmental conditions. A flexible budget can minimize the negative effects of variations between the planned and actual performance. Flexibility in developing budgets is particularly important for manufacturing and distribution firms, that operate in a highly volatile environment.

DEVELOPING A SALES BUDGET

To develop an efficient sales budget an organization has to follow certain steps. These are review and analysis of situations, identifying specific market opportunities and problems, sales forecasting, communicating sales goals and objectives, preliminary allocation of resources, preparing the budget and getting approval for the budget.

Review and Analysis of the Situation

The first step in developing a sales budget involves collection of past data pertaining to the company's budgets for previous years and identifying any variations between planned and actual performances. Here, the sales manager's job is to search for discrepancies and analyze why they occurred. This will help in taking necessary precautions in developing the current sales budget.

Identifying Specific Market Opportunities and Problems

Opportunities and problems that confront the sales management can be assessed from situation analysis. A careful look at problems and opportunities will estimate the impact they may have on a company's operations.

Sales Forecasting

At this stage, a sales manager can conduct sales forecasting using different procedures. Forecasting has to be done product- wise, client- wise and territory- wise. Sales forecasting can be done by obtaining information from individual sales persons and from the MIS department. Forecasting is done for both unit- wise sales and rupee-wise sales, so that any deviation can be easily identified by comparing them with the number of units and amount of sales, respectively. Exhibit 7.3 discusses some useful tips for sales forecasting.

Exhibit 7.3

Sales Forecasting Tips

Sales forecasting plays a major role in preparing sales budgets. Irving Sherman, a popular sales consultant, has described some important issues regarding sales forecasts.

- Sales forecasting must be done with the help of information collected by giving attention to every detail of an organization's operation process.
- Sales forecasting should be done for individual products in product lines. This should be for number of units that would be sold, rather than for amount of sales, as there might be price fluctuations in the future. Forecasting should be done based on territories, accounts and time periods.
- While forecasting sales, some intangible factors should be incorporated. These include, long-range market trends, seasonal patterns, cyclical trends, planned fluctuations like advertising and promotional campaigns and unplanned fluctuations like strikes, wars etc.
- Sales forecasting is useful in analyzing sales patterns for a number of years.
- The tough part of sales forecasting is to predict the general business environment in a given period. To accomplish this, the manager has to collect all possible information relevant to making such a forecast.
- A salesperson's estimates about future sales are useful in forecasting sales. However these figures should be compared with past experiences and trends.

Adapted from Joseph Arkin, "Contracting Insights: Proper Use of a Sales Budget and Forecast,"Air Conditioning Heating & Refrigeration News, 12 September 1994, Volume 193, Issue 2.

Communicate Sales Goals and Objectives

After sales forecasting, the next step for sales manager is to communicate the goals and the objectives of the sales department to sales people. When developing these aims, the involvement of sales people is essential. By encouraging them to participate in the development, a sales manager can obtain mutual agreement on them. Once objectives are developed, they have to be sequenced based on importance. In other words, they should be prioritized and necessary resources identified.

Preliminary Allocation of Resources

The next step in the sales budget development process is to allocate resources for specific tasks that have to be performed for achieving objectives. Resource allocation starts from selecting salespeople, assigning tasks to them, giving salespeople sufficient tools such as laptops and palm tops, and most important, enough financial resources to cover their expenses.

Preparing the Budget

Sales budgets have to be prepared by striking a balance between the potential of the sales force and the true nature of market opportunities. The sales budget should be flexible, as stated earlier. The sales manager at this stage may ask for substantial resources to be allocated in the budget for the department. It is up to the top management to decide the amount of budget to be allocated.

Getting Approval for the Budget

In the final step, the sales department seeks approval of the budget prepared, relating to sales expenses that it may incur in the subsequent planning period. Once the budget has been approved, it may need modifications owing to environmental changes. The sales manager has to apply for the modified budgeted figures to the top management as and when a deviation occurs in the sales budget.

PRECAUTIONS IN PREPARING SALES BUDGETS

The budgeting process has certain drawbacks too. These are -- inability to project the course of future events, inability to gain acceptance, involvement of time, repudiation of the long term. We will now discuss each drawback and the necessary precautions that should be taken to reap the benefits of budgeting.

Inability to Project Course of Future Events

Forecasting and predicting the future course of events is a very tough task. Some companies have tried to overcome this with the help of rolling forecasts. These forecasts are developed every three months and are constantly revised to suit market conditions. This way, the budgeted figures become flexible and will not be outdated. Volvo is one company that does rolling forecasts. Its managers prepare a forecast for a three- month period every month, and constantly keep vigil on market conditions. They then determine what strategies have to be adopted from time to time.

Inability to Gain Acceptance

Generally, those in the organization not involved in developing budgets are likely to resent the entire budgeting process and call it either a waste of time or too restrictive. People in the organization often will not work towards achieving budget objectives until top management intervenes. Therefore, management should ensure that adequate care is taken to involve sales personnel in the budgeting process, so that they will cooperate at the time of implementation.

Involvement of Time

The budgeting process in an organization consumes a lot of time. A typical budgeting process takes up about 30 per cent of the management's time. This is even more for companies with subsidiaries or businesses. But, this time is worth it as it facilitates better planning, communication and coordination.

Repudiation of the Long Term

Sales managers sometimes have to incur expenditure towards activities that may not show results in the present budgetary period. This may deter them from taking up such activities when there is a cash crunch. In other words, they may repudiate or ignore long term needs. For instance, certain costs related to recruiting and training salespeople may be higher than budgeted returns for the current period. Such expenses may exceed the allotted budget. Therefore, management should take adequate care to allocate adequate resources for activities that are necessary to meet the organization’s future requirements.

Apart from addressing these concerns, managers should take adequate precautions to avoid the misuse of budgetary controls that would disrupt harmony. Exhibit 7.4 illustrates the human relations problems that might arise due to improper development and implementation of budgets.

Exhibit 7.4

Human Relations Problems in Budgeting

The aim of budgeting in an organization is to control expenditure. Every person in the organization is exposed to the budgeting procedure in some way or the other and will be rewarded or punished for either meeting budgetary requirements or failing to meet them. Certain human relations problems arise from budgets. The first relates to superior officers using the budget as a pressure point. Managers feel that budgets can be effectively used as a pressure device for improving performance and achieving goals. Lower level employees feel that top management considers them lazy and unless sufficient pressure is applied, they will not work as required. Such assumptions, though proved true to a certain extent in research, create a negative image about the top management among employees.

Long- term application of pressure in the form of budgetary constraints will lead to tension, anger, fear and mistrust among employees. Pressure can be handled by an individual only to a certain limit and beyond that it becomes intolerable. These people then form groups to vent their anxiety. These groups may later on become so strong that they will launch a defensive against the top management.

Another human relations problem arises when an individual's failure to meet budgetary requirements is highlighted. Pointing out discrepancies to the individual and asking for better performance will not cause damage. But, if everyone comes to know, the under-performing employee will lose interest in work, resulting in low efficiency and low confidence in himself.

Adapted from Chris Argyris, "Human Problems With Budgets," Harvard Business Review, January/February 1953, Volume 31, Issue 1, 97-14.

SUMMARY

A budget is a plan expressed usually in monetary terms. It is a process of allocating a portion of an organization's resources for its various activities for a specified period of time. It helps in planning and coordination of the organization's activities. Sales budgets are developed for the smooth functioning of the sales function. Developing sales budgets serve two purposes - as a mechanism of control and an instrument of planning. There are several benefits an organization derives from budgeting. They are -- improved planning, better communication and coordination, performance evaluation, psychological benefits and avoiding uncontrolled expenditure.

In practice, sales managers prepare three types of budgets - sales budgets, selling expense budget and administrative budget. A sales budget gives a plan showing the expected sales for a specified period in the future. Selling expense budgets details the schedule of expenses that may be incurred by the sales department to achieve planned sales. Administrative budget specifies the budgetary allocations for general administrative expenses that would be incurred by the sales department. The different methods for budgeting include the affordability method, percentage-of-sales method, competitive parity method, objective-and-task method and return-oriented method.

The success or effectiveness of each of these depends on the involvement and support received from the top management and the flexibility built into the budgets. To develop an efficient sales budget a manager has to follow certain steps like review and analysis of the situation, identifying specific market opportunities and problems, sales forecasting, communicating sales goals and objectives, preliminary allocation of resources, preparing the budget and getting approval for it. A meticulously developed sales budget provides many benefits to an organization. But, like any other management concept, budgeting has its share of limitations. They include inability to project the course of future events, inability to gain acceptance by all people in the organization, consumption of significant amount of managerial time and avoidance of expenditures that will bear fruit only in the long run. Once adequate care is taken to overcome the limitations of budgeting, it will act as a tool to enhance the profitability of the organization.

Chapter 8

Estimating Market Potential and Forecasting Sales

In this chapter we will discuss:

- Importance of assessing market potential
- Need to determine market potential
- Analyzing market potential
- Sources of data
- Importance and uses of sales forecasts
- Sales forecasting methods
- Selecting a forecasting method
- Criteria for effective forecasting
- Difficulties associated with forecasting

As a result of the great strides in telecommunication, transportation and other areas of applied technology over the last two decades, physical and geographic distances between nations have narrowed in many ways. This has enabled businesses to identify new avenues for growth and new markets. Organizations are reaching out to new markets across national boundaries with great ease. Even so, an organization has to estimate the market potential of the new market as realistically as possible before it enters a new market. The estimation of market potential helps marketers develop effective marketing strategies. But it is not enough to base a business decision at this level on a hunch or a guess. Therefore, managers seek a rational methodology to help them estimate the potential of a new market.

Expanding the operations of a company globally without careful assessment of various markets is a dangerous move. In fact, several companies have had to withdraw from some of their foreign operations because of poor market assessment.

Today, organizations have vast capacity to store data and analyze it scientifically. Therefore, companies have moved towards fact-based forecasting. However, it is obviously very important to collect the appropriate information in order to develop an effective forecasting system.

In this chapter, we study the ways in which marketers can estimate market potential. We also discuss the importance of sales forecasting and the various forecasting techniques that are widely adopted by companies to forecast their sales volumes.

IMPORTANCE OF ASSESSING MARKET POTENTIAL

Assessing market potential is the first step for companies planning to enter new markets. Without this step, the company could make irrecoverable losses. In the last few years, many dotcom companies failed because they could not assess the potential of the market properly. However, companies such as Amazon and eBay succeeded because they were innovative and were able to identify the right market with huge market potential. Companies that could not do so, lost the battle for market share and were squeezed out.

Though certain products have the potential to satisfy consumers, it may still take time to convince customers to buy them. For instance, it took about ten years for the VCRs to become a successful product in the US market. However, it took less than two years for Hotmail to become one of the most successful and sought-after websites for e-mail users. Reportedly more than 1 crore users signed up for an e-mail account in Hotmail within the first 18 months of its launch.

Sometimes, despite their market potential, certain products fail miserably in the market due to poor timing of their entry into the market. Hence, the time of entry is also vital for a firm to exploit market potential. Even before it looks at potential of a market, a company should try to assess its own abilities and resolve certain critical issues, which it is likely to face. The critical issues include the ability of the company to face tough technical obstacles, whether the market can be won by developing complementary products or services, whether the customers need to learn new skills or processes in order to use the products effectively, how intense the competition is, and so on.

NEED TO DETERMINE MARKET POTENTIAL

When companies enter new markets, they are often over-optimistic with regard to the prospects for growth. For instance, many automobile firms from the West invested heavily in China, assuming that the country’s huge population would soak up their products and give them high profits. But many of them failed miserably and left the country. In another instance, Unilever and Nestle entered Saudi Arabia to market their ice-creams, confident that the hot climate of the country and the large proportion of youth would provide a ready market for this line of products. But both the companies could not attract customers and retreated from the market, chiefly on account of the cultural barriers, which they had ignored. These large established global companies failed because they ventured into these markets on the basis of a broad analysis of market factors such as population and the climate of the country, but failed to study the market specific factors such as cultural factors and distributional inefficiencies. In fact, many multinational companies entered countries like China, India and Russia, only on the basis of their huge populations, but failed to sustain and hold market share. Therefore, market potential should be determined taking all factors, whether broad or specific, into account. Selection of the right markets and the timing of entry are the two vital decisions that firms need to take when considering entering new markets.

ANALYZING MARKET POTENTIAL

There are two ways of analyzing market potential. The first is a top-down approach, while the other is a bottom-up approach. In the top-down approach, the top management assesses a particular market on the basis of macro environmental factors such as overall demographic data, GDP and disposable income. Information on macro environmental factors can be easily accessed by the top management as the data is published in various magazines, government publications, etc. In the bottom-up approach, the micro environmental factors of the market in terms of customer and product-specific data, such as the customers' ability to buy the product and the product's acceptance are analyzed usually by lower level management. The customers' ability and willingness to buy the product are ultimately of key importance, and we will look at these two factors now.

Ability to Buy

The customers' ability to buy the products of a company in a specific market is fundamental in determining market potential. If customers are interested in the product but cannot afford it, we can conclude that the market does not have potential for the producer.

Willingness to Buy

However, even if customers can afford the product, if they are not interested in it or willing to buy it, the market does not hold potential. In fact, the ability to buy a product should be backed up by willingness to buy. For an analysis of the customers' willingness to buy a company's products, macro-level data or demographic data are not of much help.

In order to assess market potential in all its aspects, the manager has to access various sources of data, as explained in the next section.

SOURCES OF DATA

Data can be collected from two sources – primary sources and secondary sources. Which sources are used depends on the availability of data, time, costs, affordability, etc.

Secondary Sources

If a company is planning to enter new markets, especially overseas markets, market data is available in the form of country level economic and demographic data from secondary sources. The sources include government reports, and reports from various international institutions such as United Nations or the World Bank. Such data can also be gathered from private agencies that develop economic intelligence and risk assessment of different markets. While data at the macro level is useful for investment in a country, selling products and services in a particular market requires more detailed information. Information regarding customer attitudes, product usage, customer tastes and preferences and a host of such related data is vital for an organization wishing to assess a market for sales potential. Therefore, we also need to gather primary information through market research.

Primary Sources

The primary data regarding customer spending patterns, their preferences, their product usage and product purchase information can be obtained through market research. Conducting market research in a new market is extremely difficult because customers usually do not have adequate knowledge about the product. Therefore, it is difficult for them to comment on the products, their quality, ease of use, etc. In such situations, companies can obtain information about the market in general from market research consultants, to begin with. Information regarding pricing patterns, the extent of distribution required, customer tastes and preferences and a host of other details can be gathered in this manner.

Primary data has to be gathered from respondents on the basis of key indicators. The questions put to the respondents reflect the indicators and are tailor-made to get the required information for the firm.

We now move to the importance of sales forecasts in markets where the company has already established its presence.

IMPORTANCE AND USES OF SALES FORECASTS

The importance of sales forecasting has been increasing over the years. This is because of the constantly changing market environment and customers' attitudes. Constant change means that organizations are forced to modify their plans and strategies from time to time in order to stay in the business.

Conventionally, sales forecasting was based on the intuition of the management. But today, sales forecasting has become much more systematic. This systematic approach is warranted, since mistakes can be easily detected if a systematic approach is followed. The forecasting process of the firm has also changed. People from different departments collaborate with each other and take collective decisions to reach a consensus on the sales forecasts. For collective decisions on forecasting, techniques such as Vendor Managed Inventory Program (VMI), and Collaborative Planning, Forecasting and Replenishment (CPFR) have been developed.

Earlier forecasting was undertaken mainly to predict how changes in the economy would affect a firm's performance and to extrapolate from prevailing business trends in a country (Refer Exhibit 8.1). But now, forecasts can be made not just at a general level, but even for specific areas of concern such as for demand measurement, logistics movement, cash flow of the organization, etc. Forecasting can be divided into long-term forecasting and short-term forecasting. Short-term forecasting or operational forecasting helps an organization in taking decisions regarding day-to-day operations like production processes, logistics management, raw material procurement, sales management, marketing management, advertising management, etc.

Exhibit 8.1

Retail Sales Forecasts in India

During 2003-07, retail sales in India are forecasted to grow at around 6 per cent per annum. At present, retailing in India is largely in the unorganized sector, and organized retailing is still a new and developing concept in the country. It is estimated that organized retailing is poised to grow substantially due to the rising income levels of consumers, industry deregulation and increased global influences. Forecasters have suggested that retailers maintain prices at Indian levels (low).

Analysts believe that the growing trend of consumer financing is one of the major factors influencing retail sales growth. Retailers of refrigerators, televisions, washing machines, computers and other household appliances are collaborating with banks and financial institutions to provide loans at lower interest rates to their customers in order to increase their sales. It is felt that the customization of products according to local tastes will also play a major factor in sales growth. Retailing of food and groceries has good sales prospects. According to the estimates of CII (Confederation of Indian Industry), 50 percent of the retail sales in India take place through supermarkets.

Adapted from "Retail Sales Forecast Looking Up." Economist Intelligence Unit, Business India Intelligence, 14 May 2003.

We take a look at one area of forecasting, namely sales forecasting in this chapter. Sales forecasts help an organization to determine accurately the market demand for products, and customer tastes and usage patterns. The data from customers and markets are the primary sources of data for sales forecasting. Forecasts developed using such data are often highly accurate and help the organization in achieving both short-term and long-term sales objectives. Field sales staff plays a vital role in attaining first hand information about the markets and customers. Therefore, the top management of a company has to motivate its sales force and work closely with them to obtain crucial information. Exhibit 8.2 gives some insights and tips that can help develop close coordination between managers and field sales staff.

SALES FORECASTING METHODS

There are different methods one can use to forecast the sales of a product or service. Some of the important methods that are used for sales forecasting are discussed in the following sections.

Forecasting methods are classified into qualitative methods and quantitative methods. The expectations of customers, the sales force, executives and experts about the future trends in sales are used in qualitative methods, whereas forecasting through the use of mathematical models come under quantitative methods.

Qualitative Methods

Among the methods of qualitative forecasting, we have forecasting based user expectations, sales force composite, jury of executive opinion, the Delphi technique and market test.

User expectations

Forecasting based on user expectations is normally carried out for industrial products, where the number of customers is less and the products are well-defined. In this method, the customers requirements are found out directly by meeting them. The information from customers can be gathered using different methods ranging from simple questionnaires to complex probability analysis. Although this method has the advantage of establishing direct contact with the customers, this also gives rise to certain drawbacks. Customers sometimes overestimate their product requirements, while in other cases, they may not stick to their plans due to changes in the business environment.

Exhibit 8.2

Collaboration between Forecasters and Field Sales Staff

There are many areas where a successful partnership between the field sales force and those responsible for forecasting can be developed. Crucial information regarding markets and customers can be tapped from the field staff for better and more accurate forecasting.

1. Developing a regular interaction schedule with the field sales person. Meeting the sales person once a week will develop a formal communication process. Both the sales person and the forecaster can watch the market changes that will help the forecaster in forecasting the sales effectively. Over a period of time, the forecaster as well as the sales person will be able to understand each other's duties and activities, which will help in a better communication process required for effective sales forecasting.
2. Accessing customers' websites provides an unbiased and exact information resource for sales forecasts. These websites often provide information regarding their inventory requirements over a period of time, which helps the company in developing a sales forecast. The sales forecaster can discuss such information with the sales person and develop efficient forecasting.
3. Field sales persons do not normally analyze the information they acquire with regard to sales. In such situations, if the forecaster analyzes and shares the related information with the field staff, they see the advantages to be derived and become more cooperative.
4. Information related to production, procurement processes and logistical support issues can be shared with the sales persons by the forecaster. Such information is crucial for the salesperson, since he needs to provide information related to the delivery time of products to his customers. When the forecaster shares such vital information with the field sales staff, an environment of trust is created. The joint efforts of the sales person and the forecaster will result in an efficient sales forecast.
5. Monitoring the sales orders from time to time helps the forecaster to determine future sales. Sharing information on expected future sales results in better cooperation between the forecaster and the sales force.
6. The sales forecaster can provide valuable information to the company and to the sales force regarding the market potential of new product by assessing past data. If such data is not available, then the forecaster and the salesmen can collaborate and develop a sales forecast by agreeing on some common presumptions.
7. The sales forecasters can help the sales team in preparing sales planning schedules and sales budgets as most of the sales-related information is later analyzed by forecasters.
8. The sales forecasters can also request the participation of the field sales staff while analyzing the final sales forecasts in order to identify mistakes in the prepared sales forecast. This instills a sense of belongingness among the field sales staff and contributes to building a positive attitude.
9. Information regarding sales forecasts of top products purchased by the major customers of the firm can be shared with the salespersons. Transparency is maintained when forecasters involve the sales persons in analyzing the product wise sales forecasts for each customer group.
10. Finally the forecasters should strive to achieve an organizational level acceptance of the sales forecasts developed by them.

Adapted from Tony Alhadeff, "Engaging the Sales Organization for a Better Forecast," The Journal of Business Forecasting, Spring 2004, Volume 23, Issue 4, 7-4.

Sales force composite

The sales force composite is derived by taking an estimate of expected sales in the forecast period from each salesperson of the company. Thus, in this method, the sales forecast is based on the expectations and experience of the salespersons. The data from each salesperson is then combined to form the overall company's sales forecast. This method is considered a reasonable method of forecasting, since it is based on the expectations of those who are actually involved in the sales activity. However, this process too has some shortcomings as salespersons are not always the best judges of sales possibilities. They normally tend to underestimate or overestimate their performance with regard to meeting the target. Salespeople may also lack a broader perspective on the environment in which the firm is operating and therefore sometimes lose sight of overall picture while forecasting sales.

Jury of executive opinion

This is one of the simpler methods of sales forecasting. This method is based on the opinions of executives at the top level of management. These people give their opinions based on their experience and intuition. The opinions of all the executives are combined and an average forecast is prepared. Another way of doing this is to convene a meeting of all the executives. After exchanging ideas, they are asked to reach a common forecast figure with regard to sales. This method too has certain disadvantages. It lacks scientific validity as it is based on the intuition and opinions of top level executives. A great deal of time is wasted on deliberations in order to arrive at a common figure and usually the top most executives’ opinion prevails over the opinions of those people who have more detailed knowledge about the product and the markets. This brings inaccuracies into the process of forecasting sales.

Delphi technique

The Delphi technique is similar to the jury of executive opinion, in this technique experts are asked to forecast the sales of an organization. The experts involved are usually from universities, government institutions, industry and so on. In this method, the opinion of the experts is sought independently. The participants are kept apart so that group pressure can be avoided. Once the experts give their opinion, it is compiled together and an average figure is given to each of them. The experts are kept informed about the general opinion of the group, so that they can modify their own positions, if they wish. This continues until a consensus is reached. This method requires that the coordinator be very efficient in compiling the opinions and presenting them accurately to the others. He/she should also be able to decide when a consensus has been reached to ensure effective forecasting.

Market test

This is a method that has wide acceptance for sales forecasting. In this method, the product is tested in a limited area to find out about consumer acceptance of the product. Based on the sales of the product in that particular market, future sales are forecasted. Companies usually choose cities and towns that reflect the behavior of the country as a whole and are representative of the entire country. The biggest advantage of this method is that companies do not need to spend lakhs of rupees for launching the product nationally. The consumers’ reaction in the particular market where the product is launched is taken as a base for the forecasts of overall sales of the product or service in the country as a whole.

Quantitative Methods

The methods used in quantitative forecasting are: time series analysis, moving averages, exponential smoothing, regression and correlation analysis, and multiple regression model.

Time series analysis

Time series analysis is a method of estimation of future trends based on the past performance of the organization. The past sales performance forms the basis of future sales for the company. Many companies including Coca-Cola use this method for forecasting sales. This method is normally used for long-term forecasts usually for a period of ten years and above. Four elements of sales variations are considered for forecasting sales. They are long-term variations denoted by T, cyclical variations are denoted by C, seasonal changes denoted by S and finally irregular or unexpected changes in the environment is denoted by I. The analysis is dependent on the assumption that these elements are combined as shown below.

Sales = $T \times C \times S \times I$

These elements are then projected by extrapolating the trend with adjustments for the seasonal and cyclical factors. The irregular factors are considered but are not forecasted separately.

Moving average

An extension of the time series analysis is the moving average model. In this method, sales are forecasted based on the sales of the previous period. This is done on the assumption that the environmental factors prevailing in the previous periods will also be present in the future period. Since one period may not be an accurate representation, the average of several sales periods is considered. This average of sales for several periods is used for projecting future sales. Future sales are calculated by using the formula:

$$Sales_{t+1} = \frac{(sales_t + sales_{t-1} + sales_{t-2} + \ldots\ldots + sales_{t-n})}{n}$$

Where sales t+1is forecasted sales, sales t is sales in the current period, sales t-1 was the sales in the immediate past period and so on. The sales of all the periods that have been considered are added and are divided by the number of periods to arrive at an average, which is the forecasted sales figure. When calculating the forecast for the next period, the oldest period's sales are dropped from the average and the latest sales are added for calculations. Hence it is called the moving average method.

Exponential smoothing

Exponential smoothing is a further refinement of the moving average method for sales forecasting. In the moving average method, all the past periods considered have the same impact on the projection of future sales. But in exponential smoothing, greater weightage is attached to sales in recent periods compared to sales in earlier periods. This method is best suited to short-term forecasting when the market is relatively stable. It is usually of great help when updating quarterly forecasts. This method also has the advantage of being easier to use than more sophisticated mathematical models.

Regression and correlation analysis

Regression and correlation analysis are used for forecasting the sales of a firm. Regression analysis is used to identify the factors that influence sales. If there is only one single independent variable then it is called simple regression analysis. When the number of variables is two or more, it is called multiple regression analysis.

Simple regression analysis is determined by the least-squares method. The formula is:

$Y = a + bX$

Where, Y = the dependent variable (sales)

a = the Y-intercept value (the value of Y when X=0)

b = the average increment of sales change (the slope of the equation)

X = the independent variable (gross state product)

This formula can be used to determine the average increment of change in Y (sales, which is the dependent variable) resulting from one increment of change in X (gross state product, which is the independent variable).

Correlation analysis is carried out to measure the degree of relationship between the sales and other variables. This method helps identify a coefficient of correlation (r). The value of coefficient ranges from -1.0 to +1.0 (-1.0 represents perfect negative correlation and +1.0 represents perfect positive correlation). A correlation coefficient (r) of +1.0 would indicate that for each one unit change in the independent variable, there would be a equal change in sales in the same direction in the dependent variable. Similarly, a correlation coefficient (r) of -1.0 would indicate that for each unit change in an independent variable, a proportionate change in the dependent variable takes place but in the opposite direction. It means that if the independent variable goes up by one unit then the dependent variable goes down by one unit.

Multiple regression model

Forecasting methods normally include several independent variables. Multiple regression analysis will help a forecaster to identify the relationship between sales and several independent variables. The equation is given by:

$Yf = a+b_1 X_1 + b_2 X_2 = b_3 F_3 + b_n X_n$

Where X_1 ...... X_n denote different independent variables.

SELECTING A FORECASTING METHOD

The appropriate sales forecasting method for a particular purpose can be selected depending on factors and requirements like accuracy, costs, type of data available, requirements of the software, and experience of the company.

Accuracy

Accuracy of a forecasting method is an important aspect to consider when selecting the method to be used. The accuracy of quantitative methods is often found to be higher than in qualitative methods since qualitative methods use an informal approach. Each of the individual quantitative forecasting methods is accurate. However, the different methods are appropriate to different time periods over which one is making the forecast. For instance, for short-term forecasts, exponential methods give the desired level of accuracy. For forecasts that exceed six months, exponential smoothing and moving averages methods are appropriate. Regression analysis is accurate for longer time periods of more than one year.

Costs

The cost of the technique is a consideration for its choice. The setting up costs are important at the initial stages when it is being developed and installed. But once the setup is established, the additional costs of generating updated forecasts are usually quite low.

Type of Data Available

Prior to the selection of the technique to be used, the forecaster must consider the elaborateness, validity, relevance and accuracy of the available data. The level of extensiveness of the data determines the accuracy of the data. Detailed and extensive data are a prerequisite for certain types of forecasting; if such data cannot be collected, a less complex forecasting method may be selected.

Exhibit 8.3

A New Forecasting Approach

The validity of forecasting – particularly long range forecasting – has long been questioned. Some managers doubt the credibility of forecasts as predicting the future seems too open to error. On the other hand, forecasters opine that the future is not certain, but needs to be looked at seriously.

The ultimate aim of forecasting for the management of a company should be to develop in themselves the capacity to make well-informed decisions regarding future aspects of sales by assessing certain probabilities. On these lines of thinking, Lockheed Aircraft Corporation has developed a new technique of forecasting. This technique can be used effectively by firms which have a small number of customers who purchase in large quantities (as in the airline industry).

In this method, the top management of a company sets up a committee of experts from different functions of the organization such as marketing, marketing research, finance, engineering, personnel and so on. Once this committee is formed, the management asks them to assume the role of the management of a customer firm, which is contemplating purchasing the company's product. Once they assume this role, they have to analyze products of the organization and its competitors before making purchase decisions. The managers are provided with all the necessary information relating to the customer firm they are assumed to be managing. This method results in a sales estimate derived from the consumers' point of view.

Adapted from Gerald A. Busch. "Prudent Manager Forecasting." Harvard Business Review, May/June 1961, Volume 39, Issue 3, 57-8.

Requirements of the Software

Today, sophisticated mathematical models and software applications are used for forecasting. The format in which the data is required in the application should be borne in mind when selecting the method of forecasting. Advanced computing tools also make possible more complex analysis and forecasting with a high degree of accuracy, according to the needs of the researcher.

Experience of the Company

The company's own experience in forecasting sales also helps it select an appropriate sales forecasting method. Past experience gives the manager an awareness of the constraints and pitfalls of forecasting methods that may be peculiar to a particular industry or product market. Several large companies have developed their own techniques of forecasting, as in the case of the Lockheed Aircraft Corporation (See Exhibit 8.3).

CRITERIA FOR EFFECTIVE FORECASTING

The effectiveness of forecasting depends on factors like accuracy, plausibility, durability, flexibility, organizational participation and the key factors influencing the growth of the industry.

Accuracy

Forecasting is effective in use only if it is reasonably accurate. Inaccurate sales forecasting may result in higher stocks of inventory, increased customer order lead-times and longer delivery periods. This will result in companies losing revenues and customers being dissatisfied. Therefore, it is very important for firms to forecast their sales accurately. Accuracy in forecasting can be obtained by integrating past sales data through the use of statistical models, coupled with moves to gain extensive knowledge about customers and their preferences. To get insights about their customers, forecasters should work together with field sales managers. The management should encourage the sales people of the organization to share their customer feedback with the forecasting staff in a way that is mutually beneficial. By moving closer to the field sales staff, forecasters indirectly get closer to the customers, and obtain vital information about the customers which will improve the accuracy of the forecast.

Plausibility

Forecasting and especially sales forecasting has to be done with determination and sincerity, and there should be no manipulation of figures under influence or pressure. First of all, forecasting has to be reliable and the people of the organization should be able to believe it. A forecaster may manipulate figures to avoid displeasing his higher-ups. He may suppress negative sales forecasts and project acceptable figures to the top management. Sales forecasts can also be manipulated by the usage of specific forecasting methods which produce the desired results. The top management has to indicate its openness and willingness to face accurate sales estimations, even if the projections are not very rosy.

Durability

The durability of the forecasts can be improved by following certain principles, such as combining the techniques utilized for forecasting, by simulating a series of inputs and by using quantitative forecasting approaches rather than relying largely on intuition. By combining forecasting techniques rather than applying a single technique, a company can ensure that the sales forecast is more durable. Using a combination of techniques may help reduce errors, as one forecast is used to modify another derived through a different technique. Using advanced software tools that provide the facility of alternative scenarios (what-if analysis), the forecaster vary the inputs and determine which forecasting method will increase the durability of the outcome.

Flexibility

The forecasting technique will be more effective if it is flexibly applied by the management. In today's volatile business environment, there are sudden changes in both the micro and macro level environment of a firm. In such a situation, a rigid sales forecast which cannot be changed according to changes in the market, will be of little use to the management. Therefore, flexibility in forecasting is essential. However, the management should also remember that this flexibility should not render forecasting a meaningless exercise.

Availability of Statistical Indexes

It has been discussed earlier in this chapter that quantitative forecasting methods are more appropriate for the firm than qualitative methods that are based on intuition. For sales forecasting to be developed using quantitative methods, availability of required statistical indexes and related data is highly essential for an efficient forecast. However, it is very difficult to apply statistical techniques in high technology industries that are extremely vulnerable to market changes.

Organizational Participation

Organizational participation is essential for developing a successful sales forecast. Lack of proper coordination or cooperation from the top management acts as a constraint on forecasters in collecting useful and relevant information for the forecasts. The participation of the top management in providing the necessary and timely data is of utmost importance.

The forecasting function is most efficient if it is part of the sales department. The top management has to communicate the importance of forecasting to the entire organization and insist on the participation of every member of the organization in the forecasting process, thus contributing to the development of an effective forecast.

Demand Patterns in the Market for the Product

The demand patterns in the market for the product are important in determining the effectiveness of the sales forecast. Here, demand primarily means the quantity of the product demanded by the end user of the supply chain. The end user could be an individual consumer or an industrial consumer who determines the demand for the product. Three types of demand patterns play a major role in sales forecasting. They are independent demand, derived demand and dependent demand.

Independent demand is the quantity of the product demanded by the end user of the supply chain. Derived demand is the demand resulting from the actions of the companies that are at the upper level of the supply chain to meet the demands of their immediate customers. Dependent demand is the demand for the components that go into a product.

With better understanding of the demand patterns, forecasting can be made more effective.

DIFFICULTIES ASSOCIATED WITH FORECASTING

There are many difficulties associated with forecasting, which are discussed below.

Lack of Adequate Sales History

Although forecasting is extremely beneficial to the organization, it does have certain shortcomings. These shortcomings arise less because of the statistical methods or the software tools, and more on account of lack of proper sales data that can be utilized for developing a proper forecast. In the case of absence of sufficient and relevant data, managers have to depend on their intuition and experience for forecasting and this could be a substantial risk for the organization.

Lack of Time, Money and Qualified Personnel

Forecasting sales consumes more time for certain products than for others. Further, the availability of money for forecasting plays a vital role. Forecasting for new products is very difficult when similar products do not exist in the market. Lack of qualified personnel for forecasting sales is another problem faced by organizations.

Changing Customer Attitudes

Constantly changing customer attitudes and preferences limit the effects of forecasting for a company. The data gathered from customers often leads to a forecasting failure because, though customers say that they will buy the goods, their future plans and activities are unstable. Moreover, there is always a distinction between the desires of customers and the reality. Sometimes customers may not part with crucial information as they consider it confidential. Introduction of new and enhanced products may completely alter the customer demand and they may buy these instead of those that they have been purchasing. Rapid technological advancement is another reason for changing customer attitudes.

Fashions and Fads

Fashions and fads tend to throw forecast figures out of gear. A sudden change in the market due to a new fashion or fad will completely alter the demand for products. Therefore, companies should be very careful while forecasting sales, especially those products that are highly influenced by fashions and fads. Companies have to determine the indicators that are likely to alter forecasting results due to fashions and fads, and make allowances for them.

SUMMARY

Estimating the potential of a market is very important for a company planning to enter a new market. This is a process where an organization estimates the attractiveness of the market for selling its products or services. Before venturing into a market and investing huge sums of money, it is very important to asses it in order to avoid irrecoverable losses. Besides studying the broad market factors such as the size of the population, GDP and the spending capacity of the market, firms should also analyze market specific factors such as customers' tastes and preferences, the cultural factors prevailing, their willingness to buy the products and so on. Data regarding customer and market specific factors can be obtained through primary and secondary sources.

Estimating the future sales of the company in a given market is called sales forecasting. Over the years, the importance of sales forecasting has been on the rise across the world. Apart from the mathematical models developed earlier, many new software tools have emerged for forecasting sales in a better fashion. Forecasting can be classified into qualitative forecasting and quantitative forecasting. The methods used in qualitative forecasting are user expectations, sales force composite, jury of executive opinion, Delphi technique and market test. The methods used in quantitative forecasting are time series analysis, moving averages, exponential smoothing, regression and correlation analysis, and multiple regression models. Selecting the appropriate forecasting method is of great importance for a firm.

The method of sales forecasting is selected on the basis of factors such as accuracy, available time, costs, pattern of data, experience of the company and requirements of the software. For effective forecasting, certain criteria in terms of accuracy, plausibility, durability, flexibility, availability of statistical indexes, organizational participation and demand patterns, should be met.

Sales forecasting faces several difficulties such as lack of adequate sales history, lack of time, money and qualified personnel. The changing customer attitudes, and changing fashions and fads also act as hurdles to effective forecasting.

Chapter 9

Sales Quotas

In this chapter we will discuss:

- Purpose of sales quotas
- Importance of sales quotas
- Types of sales quotas
- Characteristics of a good sales quota
- Methods of setting sales quotas
- Administering sales quotas
- Limitations of sales quotas

Quotas are quantitative sales goals assigned to salespeople. Quotas are a part of daily duties for sales managers and sales personnel in any industry. They are used as a standard of measurement of performance in a sales organization. Sales quotas are the most common tools used to improve and influence the performance of sales personnel in an organization.

The concept of quotas originated in the goal-setting theory propounded in 1968 by Edwin Locke, an organizational behaviorist. The theory states that when goals are set for individuals, it motivates them to make an extra effort to achieve them, changing their attitude and behavior.

Sales quotas serve as a challenge that helps motivate the sales force. They can be set not only for individual sales persons but also for a sales team, a territory or a region. Properly set sales quotas go a long way in ensuring the satisfaction of the sales force. Sales quotas have a significant relationship with the success of an organization in terms of increase or decrease in sales productivity. Although sales quotas are usually established for a year, they can be altered during the course of the year in keeping with current circumstances.

PURPOSE OF SALES QUOTAS

The purpose of assigning sales quotas is to achieve organizational objectives and provide a direction to sales activities. Sales quotas help sales managers set targets for sales personnel. Quotas play a critical role in sales management because various selling activities are performed with quotas as the focal point. By setting a sales figure for various product lines or for certain classes of customers, sales managers can direct the activities of the sales force towards reaching these targets. Sales quotas also act as a standard to evaluate sales personnel and are widely used as a basis for compensating them. They help develop a system to control selling activities of sales people. Successful achievement of quotas indicates that sales activities are moving forward in the right direction.

IMPORTANCE OF SALES QUOTAS

Quotas have an effect on the entire organization as they are closely linked to sales force productivity and organizational growth. Quotas lay down performance standards, which help sales managers adopt a uniform approach to assess and compare sales force performance. Quotas serve as targets that help sales personnel orient their activities to achieve these targets and also serve as a means for sales managers to direct the activities of the sales force. Sales managers too can give the proper directions. In other words, sales quotas motivate and control the sales force.

Setting sales quotas are important for a sales organization due to many reasons. Some of these are discussed below:

Provide Performance Targets

Quotas provide sales personnel with fixed goals to be achieved within a certain time period. They help sales managers guide and direct the activities of sales personnel by setting goals for them. To attain these goals, sales personnel have to focus their efforts in a way that complements the company’s overall objectives. Assigning challenging goals prompts sales personnel to work harder and perform better. Managers should communicate the importance of attaining quotas to the sales force. The target should be increased each year so that sales persons can devise new ways to achieve them. It will also serve as encouragement for them. At the same time, managers have to be extremely careful while setting quotas because unrealistic quotas will have a negative impact on sales force performance.

Exhibit 9.1

In Line with Targets during the Summer

In a country like India, maintaining the selling tempo in the hot summer days is a big hurdle that sales personnel have to overcome to achieve the quotas set for them for the year. Some of the underlying problems are the intense heat, the unavailability of key decision-makers in both the sales organizations and the client organization as it is the season when people go on holiday. This leads to delays in purchase decisions, resulting in difficulties in meeting planned sales volumes for that period. Absence of decision makers means that special discounts or credit cannot be given. Often, many companies resort to announcing sales and special discounts during the summer – a practice, which used to be restricted to festival seasons in the past – and it becomes a virtual race for firms to outdo one another. The possibility of new competitors entering the fray too cannot be ruled out.

There are ways to overcome these problems. Here are some:

- **Attempt to close large deals before the summer begins:** This is necessary since deals require multiple approvals from various decision-makers. Therefore, the sales person must try to get necessary approvals at the earliest, even if it requires him or her to spend extra time and effort.
- **Focus on additional products:** The sales person must focus on additional products available in the product line that are usually not purchased by the customer. Summer is a good time to introduce such products as it creates a possibility of orders in the future.
- **Focus on relationship building:** Though the possibility of selling is less in summer, one can engage in improving customer relationships and learning more about the client organization and its employees. This will certainly help in the long run. The summer months can also be spent in renewing formal relationships (rate contracts, credit periods, service contracts) with existing customers. It is always easier to sell to existing customers than bring in new customers.
- **Prospect for new customers:** Summer is a good time for salespeople to add new customers to their existing list, as competitors are also caught in the summer syndrome and tend to slow down their sales activities. So, salespersons should try and win new customers. The possibility of getting good business opportunities from new prospects should never be discounted.

Adapted from Dean.A. Goettsch, "Hit Your Sales Goals during the Summer Slump," Sell!ing, May 2004, 3.

Achieving quotas requires sales persons to adopt effective means of conducting sales activities. This aspect gains more importance, especially in the summer season in India, when achieving targets becomes increasingly difficult. Exhibit 9.1 describes some methods that sales personnel can adopt to remain on target during the summer season.

Provide Standards

Sales quotas are excellent tools to measure the performance of sales personnel. They represent a standard for measuring actual sales results and a uniform basis for comparing the performances of sales personnel throughout the organization, irrespective of differences in territories, products sold, etc. Table 9.1 depicts how the performance index of individual sales persons can be arrived at from sales quota figures set for them.

From the Table, it is clear that Ram is the best performer among the four sales persons. John is the only one who has failed to achieve the set quota. Thus, the utility of setting quotas is that irrespective of differences in assigned quotas, the performances of individual sales persons can be ranked. Quotas thus act as a performance standard in organizations.

Table 9.1: Comparison of Salespersons' Performance Based on Annual Sales Volume Quota

Sales person	Quota (in lakh rupees)	Actual Sales (in lakh rupees)	Difference (in lakh rupees)	Performance Index (in %)
Ram	20	20.5	+0.5	102.5
Harry	15	15.1	+0.1	100.66
John	18	17.8	-0.2	98.88
Issac	22	22.1	+0.1	100.45

Provide Control

Quotas serve as a very good source of control as they facilitate evaluation of sales force performance. The failure of sales persons to achieve quotas set for them provides the sales manager an easy index to spot deviation in performance. Consider a situation in which the expense reports filed by a salesperson consistently exceed the expense quota set for that person. Expense quotas are the amount of money allocated to each salesperson to utilize for increasing sales in an assigned territory. Setting expense quotas helps sales managers analyze the reasons for excess expenditure and take remedial measures such as reorienting selling activities, to enable target achievement within expense quota limits.

Provide Change of Direction

Sales quotas also aid sales managers to direct the efforts of sales personnel in the desired course to achieve organizational goals. Sometimes, for certain products or product lines, sales managers set quotas that are challenging, attaining which brings significant rewards to the sales person. This makes sales persons spend more time on selling these products. By setting difficult and challenging targets, sales managers can encourage sales persons and indirectly contribute to achieving manufacturing efficiency and the organization's long-term goals.

Tool for Motivating Salespeople

Quotas are a tool for motivating the sales force to enhance their efforts and performance. Locke's goal setting theory suggests that individuals are more motivated in their efforts when they have a goal to achieve. Based on this theory, it can be concluded that sales personnel will perform better if they have a target to achieve than when they have no targets to meet. Sales quotas also help sales persons to compete among themselves, leading to improved performance and sales volumes.

Several studies have been conducted to determine the impact of quotas on motivation. One such study presents the relationship between the level of self-efficacy of sales personnel and the achievement of sales quotas. Self-efficacy refers to an individual's perception or level of self- confidence on the ability to accomplish a certain task. It has been observed that sales persons respond differently, in terms of motivation, at high quota levels, while the response is very similar at low quota levels. When quotas are set high, different salespersons respond differently, whereas when the quotas are set low, the response of almost all salespersons is similar. This has an important lesson for sales managers. They can assign higher quotas to salespersons with higher self-efficacy as they will respond positively. Those with lower self-efficacy will react the opposite. So, it helps sales managers to allocate higher quotas to specific sales personnel and ensure a higher probability of success in terms of fulfilment of quotas.

Exhibit 9.2

Scrapping Sales Quotas

Changes in the economy, labor policies and rising demands from customers have forced organizations to go for radical changes in their compensation systems, even to the extent of scrapping quotas linked to the compensation system. Organizations have begun to use a number of other criteria to rate sales personnel. Customer satisfaction, profitability from sales and extent of repeat purchases from customers are some frequently used criteria nowadays. Sales personnel are no longer rated purely based on their ability to meet annual targets. With increasing competition and customer expectations, companies are giving more importance to customer satisfaction as an index to measure the effectiveness of sales personnel and the organization. A customer satisfaction index keeps the organization customer-centric by ensuring that sales personnel gain a better understanding of customer requirements. This helps the development of organizational processes that primarily focus on fulfilling customer requirements. A customer satisfaction index, unlike sales quotas, also enables the organization to evaluate the extent of product and customer knowledge of sales personnel.

Adapted from Betsy Cummings and Erin Strout, "Quota Busters," Sales & Marketing Management, July 2001, Volume153, Issue7, 67 and Eilene Zimmermann, "Quota Busters," Sales & Marketing Management, January 2001, Volume 153, Issue 1, 58-62.

Vroom's expectancy theory (1968) also relates salesperson's motivation to expectancy and the valence of reward obtained. Expectancy refers to the probability that a certain level of effort expended by an individual will lead to a certain performance level. Valence refers to the value that an individual assigns to the rewards obtained. According to this theory, if quotas are set too high, it leads to low expectancy. On the contrary, if the rewards are too low, sales personnel will not feel it worthwhile to pursue the set quotas. They experience a low reward valence.

Let us move in a different direction now. We have seen that quotas are useful in many ways. However, many sales managers are increasingly of the strong opinion that sales quotas are no longer an effective measure to compensate sales personnel. Exhibit 9.2 explains this view.

The expectations of sales personnel too have changed. They are no more satisfied with compensation, but desire acknowledgment and appreciation for their work. They seek avenues for personal development too. Companies like JD Edwards and eBay have moved away from the traditional quota system and have started using non-traditional measures for compensation. Nearly 20 to 40% of the salesperson's earnings are dependent on customer satisfaction surveys conducted twice a year by the company. This kind of compensation plan has improved the salespersons' motivation levels and enabled companies to attract and retain salespeople. It has also ensured a wider distribution of bonuses. Under the new compensation plans, salespeople are able to earn between 25 to 300% in bonus form. In traditional quota plans, payments were rigid and bonuses ranged between 90 and 110%. The new system has also enabled companies to ensure the profitability of the business by rejecting customers who are not viable in terms of strategy alignment or profitability. This was not possible in the traditional quota system.

In the near future, there is a major possibility that many more organizations might shift from the traditional sales quota system of compensating salespeople to compensation based on fulfilment of various other criteria.

TYPES OF SALES QUOTAS

After this interesting discussion on scrapping sales quota and newer types of compensation, let us now move back to the subject on hand. Let us elaborate the different types of sales quota.

The various types of quotas used to measure salespersons' performance include those based on sales volume, net profit for the company, expenses and activities of the salesperson.

Sales Volume Quotas

In many organizations, sales quotas are based on sales volumes. Sales volumes refer to the quantity or value of products sold by sales personnel. Industrial manufacturers set quotas based on the number of units to be sold. For example, Maruti Udyog Limited may set an annual quota to sell 400,000 thousand units in India in a particular year. Companies selling consumer goods, especially fast moving consumer goods (FMCGs), also have quotas based on sales volumes, say 20 lakhs per month. Once the annual quota is set, it is broken down into monthly, quarterly or half-yearly targets/quotas. The quota by sales volume can be set as a total for all products handled by the salesperson or for each separate product.

Sometimes sales managers set quotas at levels above what can be normally achieved, with the aim of directing the salesperson's efforts towards certain products the manager wants to push. The drawback here is that there is a possibility of sales personnel spending more selling time on these products and less on other products.

Setting sales volume quotas makes it easy for sales managers to evaluate and compare the performance of sales personnel. For example, in Table 9.1 all the sales personnel except John achieved their respective sales quotas. In terms of sales performance, Ram is the best (102.5 %).The sales manager should take into consideration factors like territory size and potential, concentration of business activity and product features while setting quotas.

Profit Quotas

Sales managers generally assume that an increase in sales will lead to a rise in profits. Managers tend to prefer activities that maximize sales volumes unless clear evidence against this approach is available. Organizations have gradually shifted their focus from quotas based on sales volume to quotas based on profitability. Ultimately, profit is the single most important criterion for an organization to survive in the market. Profit quotas have gained prominence thanks to the advent of advanced data processing systems, which help to calculate the profitability of sales calls for the entire sales period.

The profit quota for a sales person is fixed based on the gross margin or net profit aimed at. The gross profit margin is obtained by deducting the cost of goods sold from the total sales volume achieved by a sales person. Net profit is obtained when cost of goods sold plus expenditure incurred by the sales person during the quota achievement period is deducted from the total sales volume. This can be illustrated:

Sales volume achieved : 20 lakhs

Cost price of goods : 15 lakhs

Gross margin achieved : 20-15 lakhs = 5 lakhs.

Assuming that the expenses incurred by the sales person to achieve 20 lakhs are 2 lakhs (salary, allowances, gifts)

Net profit = Sales Volume – [Cost of Goods Sold + Expenditure]

= 20 – [15+2]

= 3 lakhs

Organizations can fix a gross margin quota or a net profit quota for the sales force. The advantage of net profit quotas is that it gives an accurate picture of profits generated, which cannot be clearly gauged from sales volume quotas. For example, a salesperson may achieve a sales volume quota of 20 lakhs but the net profit margin may be in the negative because of higher expenses. Hence, profit quotas are effective when profitability varies with the type of products, class of customers and differences in territories. For example, Nabisco Foods, the American food conglomerate, has a quota system that rewards sales personnel for selling more high-margin products.

Another advantage of profit quotas is that commission paid to salespersons is more accurate when calculated based on gross margin than other methods. Profit quotas also help sales managers to use profitability analysis for measuring the effectiveness of the entire organization. Here, profit potential instead of sales potential is adopted as the basis for deciding pricing policies, advertising expenses, territory design and product mix. The disadvantage of this type of quota is that there is a possibility of sales personnel selling only those products that bring maximum profits, i.e., products which fetch them a high margin on selling and expenses incurred is minimum.

Expense Quotas

Many organizations are going in for this type of sales quota to ensure that their costs are controlled. Here, a limit is set for the sales person's expenditure on food, boarding and entertainment of prospective customers. The expense limit may be a percentage of the sales volume that the sales person has to generate or may be a fixed amount. For example, if the sales volume expected is say, Rs 20 lakhs, the expense quota may be fixed at 10% of the sales volume, i.e. the maximum expenditure permitted to the salesperson would be Rs 2 lakhs.

Setting expense quotas helps sales managers reduce the expenditure by salespersons so that net profit or gross margins can be attained. Sales managers can also align the sales force activities to the sales budget established during planning.

Activity Quotas

This type of quota is useful when the sales manager wants to direct the activities of the sales personnel towards certain aspects not directly related to selling but will nevertheless increase the probability of achieving sales objectives. Setting activity quotas makes sales personnel perform non-selling activities like maintaining customer relations, providing after sales service to customers, helping retailers display company products on their shelves, etc. These activities might not otherwise be given much importance by salespersons. For example, if a sales manager wants sales personnel to focus on account relationship management to develop long-term relationships with customers, an activity quota can be set that makes it mandatory for sales personnel to make a certain number of calls each day. Apart from customers, this fixing can be done for retailers, dealers, conducting product demonstrations and so on. These are the activities that tend to be neglected by salespersons in their efforts to achieve sales targets.

CHARACTERISTICS OF A GOOD SALES QUOTA

Sales managers must exercise a lot of care while determining sales quotas of sales persons. A well-estimated sales quota goes a long way in ensuring that the organization achieves its goals and objectives without much difficulty. Sales quotas should be:

- Fair
- Challenging
- Flexible
- Easily understandable
- Help managerial coordination

Let us describe each of these aspects.

Fair: While setting quotas, sales managers must take into account factors like competition, territory potential and economic conditions. They should also maintain uniformity in the method of setting quotas. This will make quotas realistic and fair. If sales quotas are not realistic, conflict will arise between the sales manager and sales personnel. This will lead to a decrease in their commitment and job satisfaction, which might eventually make sales persons leave the organization. Quotas have to be set keeping in mind average performers and not high achievers.

Challenging: At the same time, according to the goal setting theory, if sales quotas are challenging, they motivate sales personnel to perform better. In the process of setting challenging quotas, sales managers should not set quotas that are out of reach. If this happens, the sales person's expectation of achieving the quota diminishes and their motivation levels go down correspondingly. This will have a negative impact on organizational growth.

Flexible: Quotas have to be flexible so that sales managers can modify them when required, without causing drastic changes to the activities of sales personnel. This has to be kept in mind when setting activity or expense quotas. It is crucial for companies with seasonal products or selling schedules to have flexible quotas. Flexibility permits quota modifications without disturbing other aspects like sales budget or sales forecast. To sum up, flexibility allows sales managers to adopt contingency or reactive measures at short notice.

Easily understandable: Quotas have to be easy to understand and interpret. Otherwise, sales personnel will not be able to direct their activities towards achieving them. Sales managers must ensure that sales personnel have clearly understood what is expected of them. Clarity about quotas helps improve sales force morale and commitment to the organization. Sales managers must set quotas after mutual discussion with sales personnel to avoid confusion. Periodical meetings with sales personnel and putting them through coaching sessions will ensure clear communication.

Help managerial coordination: Quotas must help sales managers to streamline sales force activities. Salespeople operate away from the sales office and it is difficult for managers to directly supervise them. Quotas can help managers exercise control from a distance and provide direction towards organizational goals. This reduces the need for supervision and enables manager to effectively coordinate the activities of the entire sales force with ease.

METHODS OF SETTING SALES QUOTAS

Sales managers' ability to set reasonable and clearly defined sales quotas is influenced by the industry the company operates in, the type and size of the sales organization and the product or service being offered. There are different methods to set quotas, but the basic criteria include company profitability, past sales performance, present method of setting quotas, present and future plans for maintaining market share, increasing the sales force size and new product introduction. Exhibit 9.3 describes these in detail.

Exhibit 9.3

Basic Criteria for Effective Sales Quotas

Irrespective of differences in industry, products and sales organization, there are certain criteria that have to be taken into consideration to effectively set sales quotas. These are:

Company profitability: It is essential to keep the company's expected revenues in mind while setting quotas. Usually, the total sum of the sales force quota should be more or less on par with expected company sales in a given year. A sales manager can make use of expected revenue figures to determine sales quotas. It is necessary to take into view the profitability of the company and the extent to which it influences the quota-setting process.

Past sales force performance: Past sales performance is yet another factor that must be considered while establishing sales quotas for individuals as well as teams. Analysis of past performance in terms of total sales volumes, individual products, selling activities and expenses, helps sales managers gain a clear understanding of the sales force's performance. It also enables the identification of the effects of territory potential, customer profile, product portfolio, competition and experience of sales personnel on sales performance. This information aids sales managers to set reasonable and equitable sales quotas and to accurately forecast future sales. If queried, they can justify the method adopted to set quotas.

Present quota setting method: An analysis of results from the present method of quota setting enables sales managers to distinguish the advantages and shortcomings. This helps them establish quotas by correcting problems or trying out a new method altogether.

Size of sales force and territories: The size of the sales force and the territories also has a significant bearing on the nature and effectiveness of quotas set for the sales force. The manager has to realign sales territories and recruit new sales personnel from time to time according to the overall company plan. Territory realignment leads to simultaneous changes in sales quotas. Revised quotas have to be set for new people operating in a given territory. These quotas will generally be lower than potential because the personnel are new and will take time to adapt to local conditions.

New product introduction: While setting sales quotas, the sales manager should be aware of the timing of introduction of new products. According to this, the type and size of quotas will vary. During new product introduction, the emphasis will shift to activity or profit quotas instead of sales volumes. If the sales manager continues to stress on volumes, sales personnel, to achieve this, will concentrate on selling the fastest moving products. They will pay less attention to promoting the newly introduced products in the market. In this situation, the purpose of establishing quotas to direct sales personnel to implement sales goals will be lost.

In high-tech industries like telecommunication, biotechnology and pharmaceuticals, market share and product life cycle stage also significantly influence the effectiveness of quota setting.

Adapted from David Berger, "A Manager's Guide to Establishing Sales Quotas – Part 1 & 2," www.nfib.com, 22 March 2002 <http://www.nfib.com/object/2886072.html> and David J. Good and Robert.W. Stone, "Selling and Sales Management in Action: Attitudes and Applications of Quotas by Sales Executives and Sales Managers," Journal of Personal Selling & Sales Management, Summer 1991, Volume 11, Issue 3, 57-60.

Quota Setting Processes

Most organizations emphasize streamlining production and distribution activities through continuous research. However, the same importance is not given to quota setting processes. Quotas are often set through crude methods like extrapolation or personal hunches. As quotas are invaluable tools for organizations to achieve profits and evaluate sales force performance, the need for accuracy in quota setting methods is absolute. Quotas can be set on a monthly, quarterly or on an annual basis. A quarterly sales quota is generally used by industrial goods and machinery producers, while manufacturers of consumer goods prefer monthly quotas. It is relatively easier to set quotas for industrial products than for consumer products because industrial customers are fixed and relatively small in number, with demands that are easy to determine. This is not so for consumer products.

Organizations can set sales quotas based on

- Sales forecasts and market potential
- Sales forecasts alone
- Past experience
- Executive judgment
- Sales force compensation, or
- Quotas may be set by the sales people themselves.

Quotas based on Sales Forecasts and Market Potential

This is the most common method of setting sales quotas and is used in organizations across the world. This method uses sales forecasts as well as territory or market potential to determine appropriate quotas. Disposable income, population growth, employment, consumer preferences and a host of other demographic and geographic factors are considered while developing sales forecasts. Factors like concentration of business activity, territory size, competitor presence and so on are taken into account while estimating the territory or market potential.

The problem here is to identify and list factors that have a direct impact on the sales of the company's product or territory potential. The factors identified are calculated on a percentage basis for the entire country or region. Let us assume that a region's market potential is dependent on the population. The forecaster will then calculate the population of the sales territory as a percentage of the total population of the state or country. This percentage will help arrive at the sales quota for that territory. For example, Andhra Pradesh (A.P.) has 10 % of the total population of India. Suppose, a company's total product sales across the country is Rs. 100 crores. Then, in terms of percentage, the assumed sales for A.P will be Rs. 10 crores. If the company has a market share of 25% for a particular product, then the sales estimate would be Rs. 2.5 crores for A.P. This figure is taken as the sales quota for the sales person covering the state. If A.P is divided into smaller territories, the quota too is commensurately divided among the sales force. This is just a simple example. The actual steps involved and methods used to make accurate sales forecasts and measure territory or market potential are covered extensively in the Chapter 8 – Estimating Market Potential and Forecasting Sales.

Quotas based on Sales Forecasts Alone

This method is used only when the organization lacks the required data, capital, software or personnel to estimate the territory or market potential. As a result, sales quota is set only on the basis of sales forecasts or total market estimates. It does not consider sales potential of the given region. For example, if a region had generated 20% of total company sales last year, it is expected to generate 20% of proposed total sales this year too. Disposable income, population growth, employment, consumer preferences and other demographic and geographic factors will be considered while developing sales forecasts. For example, a company manufacturing tyres, say MRF, will have to study the following factors while making its sales forecasts – the number of new vehicle registrations, total volume of tyres sold by dealers in a year, volume sold by competitors in a given year, tyre features preferred by consumers and so on. The quotas for sales personnel will be based on these forecasts.

Quotas based on Past Experience

This method is based on past sales records. The sales manager sets the quota based on the previous year's sales of the organization and increases it on an arbitrary or fixed basis every year. The quota is then divided among territories and product lines according to past sales of the respective territory or product. Some organizations set quotas by averaging the sales figure for several years. This provides the advantage of eliminating variations in sales volumes and provides a logical average of probable future sales. This method is very simple and preferred when the organization does not have any sales forecast or market potential data. The disadvantage is that it does not consider changes in market potential or customer profile. It is difficult to gain the commitment of sales personnel to achieve quotas set by this method because the equitability of the quota cannot be justified. For example, new competitors may have entered a territory. It is then illogical to expect the sales person to achieve for the present year, a sales volume proportionate to the previous year's. Another disadvantage is that it is not seen whether the sales person's performance is proportionate to the actual territory potential. Even if the sales person's performance falls below actual potential, the sales manager will not be aware of it and may set quotas based on the previous year's sales volume. This will lead to misalignment.

Quotas based on Executive Judgment

In this method, quotas are set based on the sales manager's opinion. This method is generally used when no information is available to set the quota. It is common in small organizations that lack the resources and personnel to collect information on markets, competitors and other relevant factors. Some organizations use a jury of executive opinion where personnel from various departments sit together and share views on what products should be offered to the market. This process obtains the views held by various specialists, lacking in the methods described above. The drawback is that it is impractical for a new product launch or when the company is planning to enter a new territory, because in such cases, the personal experience of managers is not sufficient to accurately determine sales quotas.

Quotas based on Sales Force Compensation

Quotas are set keeping sales force compensation in mind. Sales manager can set quotas so that sales personnel can get higher benefits on achieving them. Compensation in the form of incentives and commissions are given, starting from 50% on attainment of the quota to 150% on exceeding it. By maximizing compensation benefits through quotas, the sales manager can motivate sales personnel and direct their activities to achieve organizational objectives. Based on whether a straight salary, straight commission or combination plan is used, quotas can be set to benefit sales personnel maximally. If a substantial bonus is being given, then a higher than average quota can be set to motivate the sales personnel to push harder. If the compensation plan is based on regular commissions, the sales manager can set quotas based on net profit or activity-based quotas as these types are set to focus sales personnel on certain products. For example, if a company's strategy is to develop and enhance customer relations, the activity quota may involve making a certain number of calls to certain customers. This is tied to a different level of commissions. So, compensation plans influence the method by which quotas are set by sales managers.

Quotas Set by Sales People Themselves

This method is also called the sales force composite method. The sales force of an organization is one of the best sources of information about market conditions and competitors. These are the people in the field. Many companies capitalize on this

Exhibit 9.4

Organizational Factors and Sales Force Participation in Quota Setting

A study conducted to investigate the possibility and degree of error committed by salespeople in making sales quota estimates found that the probability of salespeople setting their own quotas is linked to certain organizational factors. These are described below:

- **Forecasting and Quota Setting:** Organizations with a formal policy of allowing sales personnel to participate in sales forecasts are more likely to involve them in individual quota setting.
- **Type of Compensation Plan and Quota Setting:** Sales personnel who receive compensation in the form of a straight salary or commission have a greater tendency to set their own quotas than sales personnel having a commission-based or combination type compensation plan. This is because the former category is aware that their pay is not linked to achievement of quotas and hence do not hesitate to set their own quotas, even if they are on the higher side.
- **Organizational policy and Quota Setting:** Organizations that have a formal policy for all sales personnel to set their quotas have a greater chance of obtaining accurate forecasts from sales personnel, who also attain the set quotas. Similarly, sales personnel in organizations that do not have such a policy often fail to attain their quotas.

Adapted from Thomas R. Wotruba and Michael.L, Thurlow, "Sales Force Participation in Quota Setting and Sales Forecasting," Journal of Marketing, April 1976, Volume 40, Issue 2, 11-16.

information in their sales forecasting methods to conduct market research and formulate future strategies. In this method, sales personnel are asked to give their estimates of likely sales, either in prescribed forms or at meetings where the sales manager holds discussions with the salespersons on sales opportunities in their respective territories. Mutually agreed upon quotas are then set. The advantage is that it gives sales personnel an opportunity to make projections confidently and helps increase their commitment as they are participants in the process. However, few organizations prefer this method. The reluctance might be due to the inability of sales personnel to project relevant information and their lack of awareness of top management plans and strategies, or the possibility that salespersons might underplay territory potential to avoid the setting of higher targets. Yet another factor that prevents sales personnel participation is the relationship between sales force compensation and quota attainment. As bonuses and commissions are tied to exceeding quota limits, sales managers might fear that sales personnel might set a simple quota to ensure winning these benefits.

Based on several studies over the years, it has been found that the probability of salespersons setting quotas in an organization is linked to factors like the involvement of salespeople in making sales forecasts, the type of compensation received by them, etc. Exhibit 9.4 describes the relationship that exists between these factors and the probability of quota setting by salespersons.

In addition to the above methods of setting quotas, companies are adopting new and innovative practices. Many companies, to avoid the cost and time involved in manually setting accurate and equitable quotas, are using software that automates the quota-setting process. For example, the quota module of Ockham Technology's Sales-Razor 3.0 software performs the task of setting quotas by considering new product launches, trends in buying behaviour and patterns in different regions and segments of the industry in which the company operates. The software enables sales managers to set quotas that do not allow sales personnel operating in high potential regions to derive undue advantage from this. It also helps sales managers to keep compensation costs under control by keeping track of sales personnel who meet or exceed sales quotas. By linking the software to a point-of-sale system, which is connected to the company's database, sales managers get to know immediately when a product is sold by a sales representative. Sales personnel also need not spend time preparing spreadsheets and other information documents, as the data can be fed on to the web page of the software program. Oracle Corporation too offers a tool, the Oracle Incentive Compensation, which when coupled with the Oracle Sales Online tool, facilitates sales managers to obtain real-time forecasts of global sales targets

ADMINISTERING SALES QUOTAS

It is not enough for a sales manager to set quotas for the sales force. This should be followed by steps to ensure that sales personnel are making efforts to achieve the quota. If sales manager do not make these efforts, the entire exercise of setting a quota is negated. Sales managers have to involve themselves and spend quality time in administering the sales quotas. This involves the following:

Minimizing Acceptance Problems

The sales manager has to be very careful in setting quotas because maintaining equity is essential for the quotas to be acceptable to salespersons. The equity can be in terms of job equity, occupational equity or corporate equity. The perception of job equity or inequity results from how sales persons look at themselves with respect to their colleagues in the same sales force. The criteria adopted by a sales manager to set quotas have to be uniform for all salespersons if there has to be job equity. Sales quotas may also give rise to occupational equity or inequity. This refers to the feeling of satisfaction or dissatisfaction when a company salesperson compares himself or herself to a salesperson in another organization. To ensure occupational equity, sales managers should take care that methods used to set quotas are similar to those used in other organizations.

Last, quotas give rise to corporate equity or inequity. This means the feeling of satisfaction or dissatisfaction that arises when salespersons draw comparisons between their equity ratio and that of the firm. Dissatisfaction results when they feel that the organization is not giving them their due.

Sales managers must also remember that for quotas to be acceptable to salespersons, the targets set should be similar in terms of challenge and achievability to those set for employees in other departments of the organization like production, R&D and marketing.

Acceptance problems can be minimized if the importance and objectives of the quota are clearly explained to sales personnel. This can be achieved by:

Briefing: The sales manager should conduct briefing sessions to explain to the sales personnel, especially new recruits, the system and process of setting quotas including benefits to the sales person and to the company. At the end of the briefing session, the manager can ask sales personnel to define their objectives for the coming year, which can be subsequently discussed in a conference.

Conference: The sales manager can also organize a conference for salespeople to discuss various aspects of sales activities like territorial management, account management, call-management and self-management in alignment with quotas assigned to them. The conference can also serve as a forum to clearly define and discuss the annual objectives of salespeople.

Periodical Meetings: The sales manager must also arrange for regular monthly or quarterly meetings to review progress and redirect the efforts of sales personnel towards achieving quotas.

Managing and Controlling People through Quotas

In addition to budgets, sales quotas serve as a tool for sales managers to manage and control the sales force. They provide a benchmark against which the actual performance of sales personnel can be evaluated. A sales manager can effectively manage the sales force by focusing on coaching and using non-monetary incentives.

- **Coaching:** The sales managers must sit down with sales personnel and try to find ways and means that would enable the latter to sell more. The manager should analyze the daily activities of sales personnel to know how much time they spend on non-selling activities (travelling, waiting, etc) and selling activities (prospecting, sales presentations, etc). Based on this, managers can suggest ways to reduce time spent on non-selling activities. This helps salespersons stay focused and on course to achieve quotas.
- **Non-monetary incentives:** Sometimes monetary incentives alone may not motivate sales person to direct efforts towards achieving quotas. Non-monetary incentives sometimes helps improve sales force morale and redirects efforts towards productive selling. For example, providing furnished accommodation or a foreign trip as an incentive for achieving quotas are methods which managers can adopt to motivate the sales force.

Exhibit 9.5

Costs Incurred in Administering Sales Quotas

Sales organizations incur variable and fixed costs while administering quotas. A sales manager has to keep in mind that costs involved in administering quotas do not exceed the benefits from achieving the quotas, in the form of sales volume. If costs incurred are more than the profits earned on achievement of quotas, the whole exercise of setting quotas will be a waste of time and money.

The fixed costs incurred by an organization over the quota period are:

1) Cost of support systems used for administering the quota. These may be in the form of software development, engaging clerical staff and so on.
2) The time spent by managers to explain the plan to sales personnel so that they have clarity of thought and action.
3) Cost of collecting and processing data for deciding on quotas and rewards to be given on achieving them.
4) The time spent by managers in formulating the structure of the sales quota-reward plan. This includes hours spent deciding about commissions or fixed bonuses to be given on quota achievement.

The variable costs incurred by organizations while administering the quota are primarily dependant on the size of the sales force. They include:

1) Time spent by sales personnel in collecting and providing necessary data for planning quotas, which could otherwise have been utilized for selling activities.
2) Time spent by sales personnel in attending training programs or sales meetings to understand and gain clarity on the quotas and management expectations.
3) Administrative costs and time involved in providing feedback to sales personnel and revising quota plans from time to time, to maintain control over sales force activities.
4) Long-term costs incurred when sales personnel, to achieve quotas and maintain their sales volume, avoid taking risks during selling by avoiding new customers and holding on to established accounts.

Adapted from Rene Y. Darmon, "Optimal Salesforce Quota Plans Under Salesperson Job Equity Constraints," Canadian Journal of Administrative Sciences, June 2001, Volume 18, Issue 2, 87-100.

Sales managers in some organizations set quotas that are low enough to enable a majority of sales personnel to achieve them. The objective is to maintain control over sales force activities rather than to increase sales volume. This is a common way of maintaining control through quotas.

Organizations usually focus on the advantages of sales quotas, but while evaluating their effectiveness, forget to consider the costs incurred for administering the quotas. Exhibit 9.5 describes the costs incurred by an organization while setting quotas.

LIMITATIONS OF SALES QUOTAS

Although quotas serve a host of functions in sales management, they have certain limitations. Some are:

- In the case of profit quotas, sales personnel have no control over prices and manufacturing costs. Profit quotas (that are based on the gross margin) lack uniformity. Any increase in manufacturing costs will lead to a proportionate increase in sales quotas and decrease in profit margins, irrespective of factors like concentration of buyers, size and potential of the sales territory, etc.
- Small organizations can set quotas based on forecasts only. They cannot depend on experience or market potential as they lack the necessary information, data, money and personnel to determine sales potentials for individual territories for their sales personnel.
- Quotas based on past experience may not always be accurate. For example, let us consider two sales territories with equal potential. The salesperson operating in one territory achieves the full quota of 100%, but the salesperson operating in the other achieves only 80% of the set quota. While setting quotas based on past experience, the sales manager will increase the quota by the same percentage for both territories in the next year. This means the underachieving salesperson will have a lower quota than the achieving salesperson, though both territories have the same potential.
- Quotas based on sales forecast or total market estimates cannot always be accurate. For example, if these criteria are used, a region which generated 20% of a company’s total sales the preceding year will have to sell the same percentage of the increased target in the current year. That is, if in the previous year, a territory sold 10 lakhs of a total company sales of 50 lakhs, and if the company’s target in the current year is 60 lakhs, the sales quota for the territory will be 12 lakhs. This is not equitable as it does not consider the region’s current sales potential.
- Quotas can influence the decision-making and risk taking capacity of sales personnel by making them risk averse. For example, if a sales person close to achieving the quota, has to decide between spending time on a customer who can give a larger sale but there is less chance of immediate success and a customer who can give a smaller sale but there is more chance of success, the salesperson might prefer the latter. This is because there is greater possibility of getting the sale and fulfilling the sales quota. In doing so, the salesperson overlooks the benefit to the company in pursuing the larger account.
- If failure to achieve quotas is not followed by consequences like warnings, increase in probation period or dismissal, there is a possibility of quotas losing their efficacy as a control mechanism for the sales force.

In addition to the above limitations, another significant aspect that has come into the limelight from several research studies on sales force behavior is that of ethical issues involved in achieving sales quotas. Exhibit 9.6 discusses these ethical issues.

Exhibit 9.6

Sales Quota and Ethical Issues

Sales quotas can have a significant impact on the behavior of sales personnel during selling activities. In the present day globalised market with cut throat competition, maintaining sales volumes has become very difficult. With organizations pressurizing sales personnel to achieve set quotas or face dismissal, there is an increasing tendency among sales personnel to resort to unethical means to achieve targets. Sales personnel prepare false reports, focus only on dumping products on customers without concern for their utility to the customer and neglect after- sales service. They also resort to bribing purchase personnel in organizations to give preference to their products though it may not suit the needs of the end consumer. Sales personnel also sell only those products that have customer demand, without making efforts to promote low-demand products, in order to achieve their quota. In such instances, the majority of sales will be from one product only and the low sales of other products can cause production and inventory problems to the company.

Adapted from David.J. Good and Charles H. Schwepker Jr., "Sales Quotas: Critical Interpretations and Implications," Review of Business, Spring/Summer 2001, Volume 22, Issue 1/2, 32-36 and Anil Gaba and Ajay Kabra, "Risk Behavior in Response to Quotas and Contests," Marketing Science, 1999, Volume 18, Issue 3, 417-434.

SUMMARY

Sales quotas are a way of life for the sales force. All activities of the sales force revolve around the fulfilment of sales quotas. Sales quotas are targets assigned to sales personnel. They signify the performance expected from them by the organization. Sales quotas help in directing, evaluating and controlling the sales force. They form an indispensable tool for sales managers to carry out sales management activities. Sales quotas are prepared on the basis of sales forecasts and budgets. Sales quotas serve various purposes in organizations. They provide targets for sales personnel to achieve, act as standards to measure sales force performance and help motivate the sales force.

Compensation plans are invariably linked to quotas. The commission and bonuses given to sales persons are based on their meeting quotas set for them. The four categories of sales quotas widely used are -- sales volume quotas, expense quotas, activity quotas and profit quotas.

A sales quota should be fair, challenging yet attainable, rewarding, easy to understand, flexible and must satisfy management objectives. It must also help in the coordination of sales force activities. Setting motivating and easy to understand quotas is essential to obtain the cooperation of the sales force. Various methods are used to set sales quotas, among which, quotas based on sales forecasts and market potential are the most common.

Skilful administration by sales managers is required for effective implementation of quotas. Convincing salespeople about the fairness and accuracy of quotas helps the sales management to successfully implement quotas.

Sales quotas have certain limitations such as being time consuming, difficulty in comprehending if complicated statistical calculations have been used and focusing on attaining sales volumes at the cost of ignoring important non-selling activities. Quotas may reduce risk-taking among sales personnel and may influence them to adopt unethical selling practices.

With changes in the competitive environment and variations in customer expectations, many companies have started developing compensation plans that are increasingly based on non-traditional aspects, thereby reducing dependency on quotas.

Chapter 10

Sales and Cost Analysis

In this chapter we will discuss:

- Sales manager's responsibility to ensure profits
- Nature of sales control
- Sales analysis
- Sales audit
- Marketing cost analysis
- Marketing audit
- Profitability analysis
- Principles of analysis

In every business, performance is closely associated with cost. In fact, in most companies, performance and cost run hand in hand. Companies focus on ensuring that performance exceeds the cost incurred. Even the most profitable companies cannot cut out costs altogether. In fact, many companies that appear to be profitable may have actually incurred extremely high costs. Conversely, the costs may have been low, but the performance may not be of the level expected. Thus, it is essential for companies to know what costs they are incurring in obtaining the desired performance from their employees.

This chapter on *Sales and Cost Analysis* discusses in detail the various aspects associated with the sales and cost control functions of sales management. The chapter begins with a brief description of a sales manager's responsibility to ensure profits followed by a discussion on the nature of sales control. Thereafter, the chapter discusses sales analysis and sales audit. In the latter half of the chapter, we examine various aspects of cost analysis. Beginning with a discussion on marketing cost analysis, we proceed to discuss marketing audit and profitability analysis. The chapter ends with a description of the principles involved in sales and cost analysis.

SALES MANAGER'S RESPONSIBILITY TO ENSURE PROFITS

The sales manager's role includes planning, organizing, directing, controlling and leading the sales force personnel of the firm. Controlling the sales efforts of the sales force forms a critical part of managerial tasks. The sales manager's control function involves evaluating the performance of the sales force and identifying weaknesses, if any, in their sales efforts before these weaknesses become liabilities.

Sales control is one of the primary responsibilities of a sales manager. The sales control function involves sales and cost analysis of the company. This function has undergone a lot of changes over the past. Traditionally, the responsibility of a sales manager was to ensure that the sales team achieved its sales targets. Gradually, companies realized that achieving high sales volumes did not by itself, assure the firm of high profitability. Sometimes, high sales volumes brought in undesired results for the business, such as unprofitable operation, customer dissatisfaction, etc. The methods that some of the companies adopted to increase their sales volume also attracted a lot of criticism. Many companies expanded their plant capacities and achieved high sales volume through forceful selling. In doing so, they incurred huge overhead costs on selling, which adversely affected their profitability despite the large sales volume.

The term 'profitless prosperity' began to be used to describe businesses which had large sales volumes that did not, however, add much to their profitability. Despite the high sales volume achieved, the profitability of these firms didn't increase due to high operating costs and high cost of sales.

Therefore, there was a growing need felt that sales managers should take profitability of the business into consideration while setting the sales volume. The emphasis on profitability made the sales manager focus on the sales control and analysis process as well, apart from his usual focus on other marketing activities like managing the distribution structure, market research, price emphasis, etc.

A sales and cost analysis helps a company to analyze its past performance and also to utilize its resources better. The results of the analysis form the basis for sales management decision-making. Sales analysis involves studying the company's sales results and it helps the company in better sales forecasting. Cost analysis involves establishing the cost of selling to ascertain the profitability of sales transactions.

NATURE OF SALES CONTROL

Sales control involves the statistical and accounting analyses that help a sales manager to determine the profitability of the company based on product lines, customers, etc. The concept of sales control has caught the attention of the sales management over the years and efforts are being made to make sales control a more efficient and powerful tool for analyses.

The following section discusses the objectives of sales control, the sales control process, and the difficulties faced in sales control.

Objectives of Sales Control

The sales control function ensures that the company's sales efforts are in tune with its sales plan by taking necessary measures in case of deviations. The objectives of sales control include: Measuring sales force performance, identifying sales problems, and identifying market opportunities before the competitors do.

Performance measurement

The first step in effective sales control is measuring the performance of the sales force. The objective evaluation of sales efforts is critical in ensuring that the company's growth is progressing as planned. An objective evaluation helps the company to identify the difference between actual and desired performance and enables sales managers to take corrective action before irrevocable damage takes place.

Managers have started laying more emphasis on performance ratios than the traditional period-to-period increase in sales, to measure sales performance. The ratios used to evaluate sales force performance include Sales/Quota ratio; Sales/Budget ratio; Sales this period/Sales in the prior period ratio; and Closes/Calls ratio.

Problem identification

Sales control helps managers to identify problems in sales before they become liabilities to the firm. In most businesses, sales problems are difficult to fix because they relate to sales effectiveness, and improving sales effectiveness requires ensuring the right mix of skills, supervision, strategy, and systems. Some of the common sales related problems that organizations face today are: the inability of sales personnel to bring in adequate business, inaccurate sales forecasts, difficulty in increasing profit margins, and the inability of the sales management to capitalize on revenues from existing customers.

Constant feedback can help identify problems at the budding stage itself. Regular reports from sales personnel allow sales managers to monitor the functioning of the existing system and to take necessary action to get the system in line if deviations are observed. Continuous feedback from field sales personnel allows sales managers to identify the problems, both with the system as well those pertaining to the resources (man, machine, material, and capital) involved in the selling process.

Identifying opportunities

Identifying sales opportunities before the competitors do and thus helping the firm gain a competitive advantage is another objective of sales control. This objective comprises the most dynamic activity of sales efforts and involves a thorough and careful analysis of the market and the competitors.

The sales control system thus helps a sales manager to diagnose problems in their early stages and initiate necessary action.

Exhibit 10.1

Sales Planning by Objectives at GE

Most sales plans tend to overlook sales objectives. At GE, however, sales objectives form an important component of the sales plan. The salespersons formulate a sequence of steps that will help them achieve the objectives they set for themselves.

Suppose, a sales man's objective is to obtain $5000 from a certain company for mechanical repair work. The salesman will design a sequence of steps, with each step serving as a subordinate goal. The fulfillment of one step will take him to the next. The sequence of steps for achieving the salesman's objectives would involve:

1. Identifying the key persons involved in decision-making at the company.
2. Studying the repair work being currently done at the company.
3. Identifying the competition.
4. Making a presentation to the decision-makers at the company describing GE's way of undertaking the repair work and the benefits involved.
5. Getting the contract from the company for the mechanical repair work.

The salesmen do this kind of planning and submit it to the sales managers, along with the dates by which they expect to accomplish the objectives. This procedure has helped the GE salesmen to become more effective at their job.

Adapted from Robert A. Else, "Sales Planning by Objectives at General Electric," Management Review, August 1973, Volume 62, Issue 8, 47-49.

The Sales Control Process

The sales control process essentially involves three steps – setting goals, comparing actuals with targets, and taking corrective action whenever necessary.

Setting goals

Setting goals is the primary task of any sales manager. Sales managers direct the sales force by setting goals and framing objectives. They design the courses of action by which the sales force can achieve these objectives and they measure the sales force's performance against the goals set. Goals are set as a part of the sales planning and sales budgeting processes. Thus, sales planning and sales budgeting are forms of sales control in an organization.

Planning is an important function of a manager. Companies that survived recession were those that had a plan and adhered to it. These companies thus demonstrated how essential it is for the survival and success of an organization to have a plan and adhere to it. Sales planning guides the sales force in their performance and gives them a direction along which to work. It sets targets in the form of sales quotas. Thus it forms a critical component of the sales control function. For a sales strategy to be successful, there should be careful and efficient sales planning. Sales planning involves functions such as staffing, recruiting, training, evaluation, and control. It provides the necessary framework for all sales activities. The strengths and weaknesses of the sales team and individual salespersons have to be taken into consideration when sales planning is done so that training requirements can be suggested to improve the sales team's performance. This will, in turn, facilitate the fulfillment of the sales objectives. Exhibit 10.1 describes the sales planning at General Electric.

Sales budgets set targets for the costs associated with various sales activities. They help compare actual spending with the budgeted allowance and enable firms to confine their spending to the limited resources available to them.

Comparing actuals with targets

The next step in the sales control process involves comparing the actuals with the set goals. Large deviations from targets call for investigation into the causes for the deviations.

The performance of the sales force is usually measured by means of sales quotas. Sales managers use the sales quotas as a tool to influence and improve the performance of the sales personnel. Several factors related to the territory, such as territory size, concentration of business, and growth of business activity in the region, play an important role in the assignment of quotas.

The costs incurred on sales related activities are compared with the budgeted allowances set during the sales budgeting process. An analysis of the deviations between actuals and budgeted costs helps the sales management take corrective action if actual spending exceeds the budgeted costs significantly. An analysis of the deviations indicates either an inaccuracy in setting goals or a need to improve performance and efficiency in order to meet the targets. Inaccuracy in setting goals is evident if the sales achieved exceeds the targeted sales at a substantially low cost. And the need to improve performance and efficiency arises when there is an underachievement of sales accompanied by heavy expenditure.

Taking necessary measures

Once the causes for the gaps between the actuals and the budgeted values are established, there is a need to take corrective action. This can be done by modifying the sales plan and budget. If the major cause for the deviation is under-performance of the sales force, the reasons for the under-performance have to be analyzed and remedial measures taken to improve the sales productivity.

Difficulties in Sales Control

There are certain difficulties that come in the way of effective sales control.

External factors, such as the regulatory, legal, political, and economic environment, play an important role in the process of sales control. However, sales managers and the sales personnel have no control over these factors.

The sales control process is further complicated by the inability of sales managers to obtain information about which variable in the marketing mix (product features, promotional activities or pricing) has contributed to the increase or decrease in sales.

Yet another problem that sales managers encounter pertains to the type of information that can be obtained. Though there are several information systems that cater to the their needs by providing vital information pertaining to sales activities, information pertaining to buyers' purchase plans and purchase intentions cannot be captured.

SALES ANALYSIS

Sales analysis involves gathering, classifying, comparing, and studying the sales data of a company. It is one of the means by which a company can analyze its performance and it helps sales managers to plan and direct the sales efforts. Sales analysis classifies and presents the sales data that the company has gathered in an organized manner and thereby reveals market and competitive changes to the sales management. It produces a wide variety of information that sales managers can use to improve the efficiency of the sales function.

As mentioned earlier, sales analysis converts raw data collected from different sources into information that managers can use. The process of conversion involves editing, structuring, and organizing the data by breaking it down into a format that can be used for comparisons at various stages. The process of sales analysis concludes with the interpretation of the information.

In addition to directing and controlling the selling efforts of the sales force, sales analysis also helps the management in many other ways. It helps identify the strengths and weaknesses of the company, thereby allowing the management to formulate suitable marketing strategies for it. Sales analysis also helps the management in production planning, cash management, inventory management, and other non-marketing functions. Most important of all, it helps in the overall management of a company by assisting the management in providing the company with an orientation and a direction in which to focus its competitive efforts.

Elements of Sales Analysis

A typical sales analysis involves comparing the sales of the company at two different time periods or comparing the sales with external data to exercise better control over the performance of the sales function. The key elements that constitute the sales analysis process are described below.

Purpose of evaluation

A sales manager should decide on the purpose of the evaluation before starting the analysis. A simple sales analysis only lists the current sales variables and their values, whereas a comparative analysis is required when sales performances from various territories or pertaining to different time periods have to be compared.

In addition to identifying the purpose of the sales analysis, the sales manager has to take various other decisions such as determining the information needed from the analysis, identifying the sales variables that have to be analyzed like the total sales volume, sales by territory, sales by product line, performance of sales personnel etc. Determining the information needs before a sales analysis can be tedious because the strengths and weaknesses in the sales function are not known unless an analysis of the sales activities is carried out. Another reason for determining information needs is that there are varying information requirements at different organizational levels and it is up to the sales manager to decide on the sources of data and the type of reports that need to be generated.

Comparison standards

A simple sales analysis simply states facts whereas a comparative sales analysis compares the sales figures with some standards. Standards are the yardsticks to evaluate the effectiveness of a system. There are different standards that sales managers can use to determine the efficiency of the sales function in the organization.

The performance or effectiveness of the sales function can be measured in an absolute or relative sense. An absolute measure is an expected or an ideal measure. An example of an absolute measure is a sales quota or target. The performance of the sales function can also be measured in relative terms. The average sales volume is an example of an average or relative standard of measurement.

Reporting and control system

Most companies use sales information systems to store and process data to generate reports. A sales information system uses mathematical and statistical procedures to generate reports that depict trends, seasonal patterns, regression analysis, etc. Managers use these reports both for evaluation of the sales force as well as for sales forecasts.

A key concern of sales managers is the type of reports that need to be generated and the information that should be contained in these reports. If sales managers generate all types of reports, that is, reports that present the sales performance of individual sales personnel, branches, regions, products, etc., they will be left with a huge amount of information, not all of which is useful or necessary. So, it would be useful for them if the reports focus on exceptions in the form of significantly high or low sales figures.

The sales managers should also decide on the type of source inputs necessary for report generation and the way in which the inputs need to be processed. The most commonly used source for sales information is the sales invoice. Other sources include cash register receipts, salesperson’s call reports and expense reports, financial records, warranties, etc.

Another critical decision in sales analysis is the aggregation of sales variables. Without the aggregation, sales managers would be required to analyze individual transactions or focus on aggregate sales, neither of which serves the purpose of sales analysis. So, it is a common practice among sales managers to group the sales data on the basis of geography, territory, products, customers, markets etc. The categorization again depends on the purpose and focus of the sales analysis.

Hierarchical sales analysis

Hierarchical sales analysis involves studying the sales performance at a micro level by investigating and analyzing its components. This helps sales managers to pinpoint any weakness and the causes for it. For example, an analysis of the sales of individual states in a region helps to identify the reasons for low sales in that region. The sales managers get to know if sales are low across all the states of the region or only in a particular state. A state can be further split up into different districts or areas and these compared to know if any one particular area has contributed to the low sales in the state. Sales can be further analyzed on the basis of sales representatives. This will help identify if there are any fundamental reasons adversely affecting the performance of sales personnel in a particular area, such as poor economic conditions, high unemployment, fierce competition, low sales force morale, etc. This analysis can be further broken down to product-wise sales of individual sales representatives. This helps to identify if any single product is contributing to the poor sales.

Steps in Sales Analysis

Having decided on the purpose of sales analysis and the information that is needed from it, a sales manager can perform a sales analysis by:

1. Determining the sources of sales information

The most critical element in sales analysis is sales information. There are many sources of sales information that include data from the marketing information system, company records, customers, sales personnel, field visits, and insights of the manager, as well as external sources such as newspaper and magazine reports, trade journals, etc.

2. Collection of sales data

The sales data is collected from sales invoices, historical records of sales volume, customer complaints, bills of sale, cash registers, etc. The sales invoice identifies the amount and type of products that customers have bought. This source document should capture the data in a format that can be easily read and processed.

3. Processing of sales data

Most firms use an information system to capture, store, and process the sales data. Typical sales information systems provide more functionality than just supporting sales analysis. Sales managers can also use the information system to help them in other sales activities like sales planning, forecasting, etc.

4. Studying the results

Sales analysis only indicates what additional investigation is required; it does not offer a solution. The result of sales analysis should be carefully studied to identify the facts and acquire a lead for further analysis. It does not indicate the reasons for good or bad performance.

Variations of Sales Analysis

Sales are classified and grouped into a number of categories that the management can use for analysis. Sales are usually categorized on the basis of geography, customer groups, products, time periods, etc. The basis of classification depends on the information needed by the management and its relevance. The analysis might involve breaking down the data to the levels at which the problems and their causes can be clearly identified.

Sales analysis involves analyzing the sales volume, that is, the total sales of the company. It is the identification of the company's sales in the market and refers to the total sales of a company, region, product, etc. The total sales volume figure can be compared with historical data to know the trend being displayed. Total sales volume can be used to compare the current sales of the company with the industry sales to identify the company's competitive performance. The total sales volume can also be used to identify the trend in the company's market share. However, as the aggregate sales values are like icebergs, with only the tip being visible, a further analysis has to be undertaken by sales managers to identify any problems and to get a clearer picture of the causes for the problems. The total sales volume can be broken down on the basis of regions and territories, sales representatives, customers, product line, distribution channels and units sold to identify the concern areas.

Sales analysis by region

In the regional breakdown of sales volume, regional sales are compared with performance standards like the Buying Power Index (BPI) or the retail sales index1.

Buying Power Index indicates the percentage of total retail sales occurring in a specific geographic area. It is used to forecast demand for new stores and to evaluate the performance of existing stores. BPI is also defined as a weighted index that converts three basic elements – population, effective buying income, and retail sales – into a measurement of the market's ability to buy. The actual sales in each region are then compared with the established sales quotas and deviations are analyzed and measures taken to overcome the problems, if any.

Let us look at an analysis of a retail outlet. The retail outlet has branches in five states in the U.S and is facing a drop in sales volume in the current quarter as compared to the previous quarter. The sales manager of the company performed a sales analysis to identify the actual cause for the decline in sales. Table 10.1 presents the sales analysis of the company's sales by region. It can be seen that though the other states have been doing reasonably well, the sales recorded in Philadelphia are not satisfying.

Table 10.1: Sales Analysis by Region of a Retail Outlet

State	Buying Power Index of the U.S	Sales Quota ($ millions)	Sales ($ millions)	Difference ($millions) (Sales Quota –Sales)	Performance Index (sales/sales quota ×100)
Chicago	3.2015	10.25	10.2	-0.05	99.51
New York	3.1243	10	10.02	0.02	100.2
Los Angeles - Long Beach	3.1195	9.75	9.73	-0.02	99.79

[1] A retail sales index is a relative measure of the dollar volume of retail sales that normally occur in each respective district and is a key indicator of the progress of the economy. It is used to calculate quarterly consumer spending on retail goods and the output of the retail sector that is used in calculation of national accounts.

State	Buying Power Index of the U.S	Sales Quota ($ millions)	Sales ($ millions)	Difference ($millions) (Sales Quota –Sales)	Performance Index (sales/sales quota ×100)
Washington	2.0558	9.25	9.1	-0.15	98.37
Philadelphia	2.0492	8.75	7.01	-1.74	80.11

Sales analysis by sales representatives

The regional sales data of a company can be further broken down on the basis of sales representatives. The performance of individual sales representatives can be analyzed to determine if the problems are common to all of them or specific to a few. If the problems are specific to a few sales representatives, a further breakdown would help the sales manager to identify the causes. If poor sales performance is the cause, then the sales manager could perhaps perform an analysis of the external environment in which the firm operates. Acquiring information about the economic conditions, employment rate, etc., will help the manager understand the factors responsible for the poor performance of the sales representatives.

To identify the problems that contributed to low sales volume in Philadelphia, the sales manager carried out an analysis of sales by different sales representatives. Table 10.2 presents an analysis of sales by sales representatives.

From the table, it is evident that none of the sales representatives had met their quota. It was also observed that Maria Anderson’s performance was well below the mark. While the fact that none of the salespersons had met their quota suggests that there is a fundamental problem in the state, the causes for Maria Anderson’s dismal performance can be identified through further analysis on the basis of product and customers.

Table 10.2: Analysis of Sales by Representative in Philadelphia

Sales representative	**Sales Quota ($000)**	**Sales ($000)**	**Difference ($000) (Sales quota-Sales)**	**Performance Index (Sales/Quota ×100)**
John Taylor	500.5	475.5	-25	95
Mary Seles	452.3	405.3	-47	89.6
Peter Hopps	425.75	400.75	-25	94.12
Cynthia Jones	300.5	290.5	-10	96.67
Maria Anderson	500.25	150.25	-350	30.03

Sales analysis by product line

Sales categorization by product line can be useful when a salesperson’s performance needs to be analyzed to identify the factors contributing to low sales. It helps a sales manager to identify whether the problem pertains to the lack of sales of a single product or the entire product line. If there is a problem with a single product, the sales manager has to find out the cause for it and check if the problem exists in all the other regions, a fact that might have been obscured by the company’s overall high sales volume owing to good sales of other products.

Table 10.3 depicts the product-wise sales figures achieved by Maria Anderson. From the table, it is evident that the sales of none of the products is satisfactory. This may be an indication of her low motivational levels and calls for immediate remedial action to be taken by the sales manager. Without a sales analysis, it would have been difficult to trace the exact cause of the problem.

Table 10.3: Sales Analysis by Products

Product	Quota (in dollars)	Actual (in dollars)	Difference
Electrical Appliances	300.00	180.00	120
Foods & Beverages	400.00	240	160
Health Care	180	140	40
Cosmetics	500	220	280

Sales analysis by customers

Sales managers can also take customers as a basis for classification of sales. For example, the sales of air conditioners can be classified according to individual customers, apartments, public services, educational institutions, etc.

Sales analysis by distribution channels

Sales can also be categorized on the basis of the distribution channels through which the products were sold. This data can help the management in making elimination decisions regarding the channels and also to focus on promising channels.

Sales analysis by units sold

The sales volume can also be broken down on the basis of the number of units sold. This kind of a break-up is useful during times of inflation and massive price changes. During inflationary periods, the sales figures expressed in currency may be high because of the rise in prices, though there might not be any significant rise in the sales volume. For example, a firm’s currency sales might have gone up by 25% over the previous year though the units sold have actually declined by 12%. In such cases, categorization by unit sales would provide a clearer picture of sales.

Problems in Sales Analysis

The sales analysis is dependent on accounting records for the gross sales and sales returns. So, if there are flaws in the accounting system, the sales analysis is affected and it might not give a true picture of the strengths and weaknesses of the salesmen’s selling efforts.

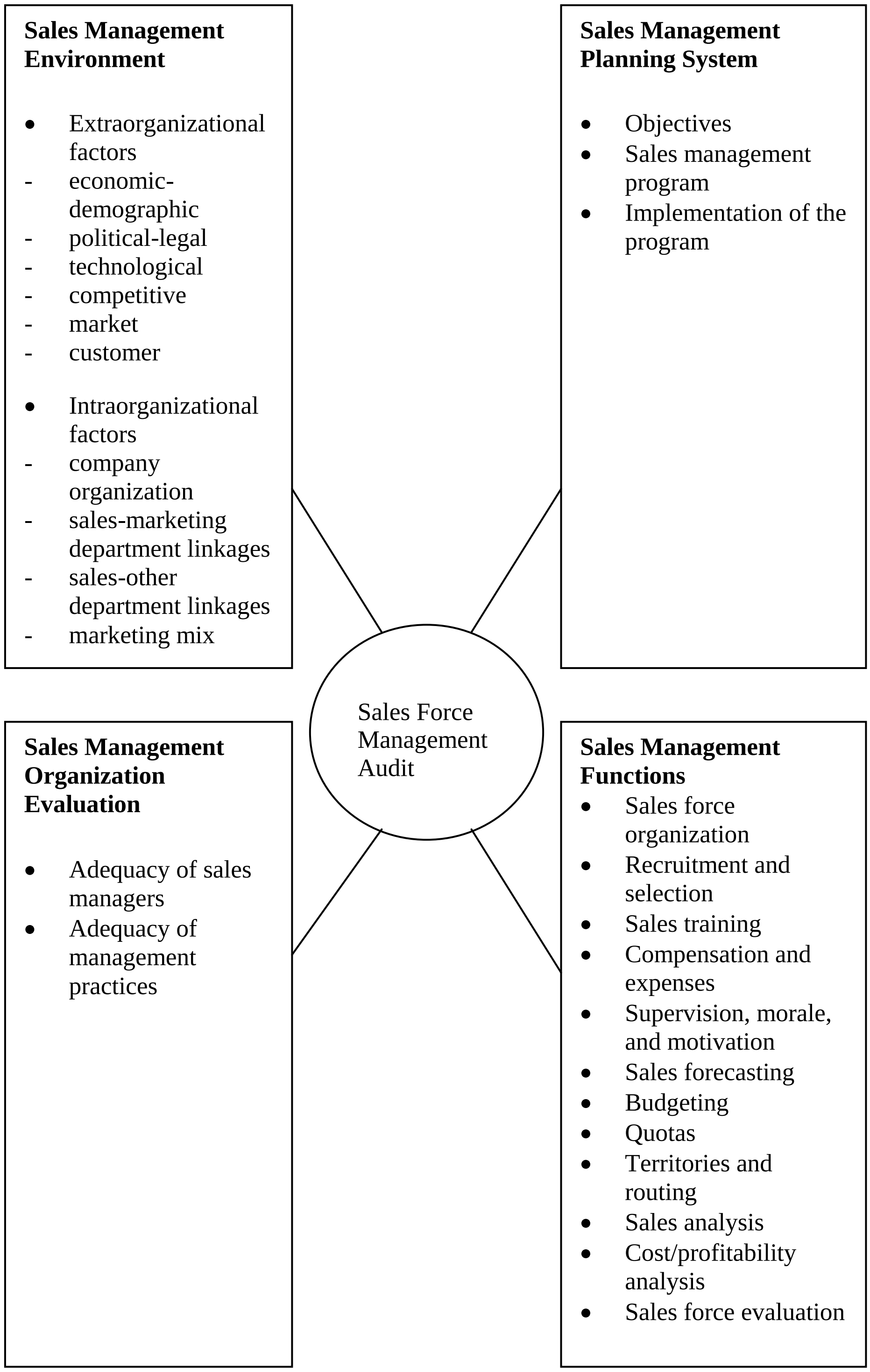
Though a sales analysis identifies the problems and its causes, it does not really reflect the performance of the company in relation to the industry or its competitors. It also does not emphasize on sales profitability. A sales analysis only talks about sales volume and does not give any indication whether the sales were profitable for the company. To analyze the profitability of sales, a distribution or marketing cost analysis has to be done.

SALES AUDIT

An audit is a periodic review of a business activity. An audit lets the auditor identify problems and concern areas, if any. Audits were earlier identified with the finance department of a company. With the increasing importance of other functional areas, auditing has also been extended to the areas of human resources, production, marketing, etc.

A sales audit, also known as sales force management audit, is a cross-functional exercise that evaluates the entire selling operation in a company. A sales force management audit covers the sales management environment, sales management organization evaluation, sales management planning system, and sales management functions. Figure 10.1 presents a diagrammatic representation of a sales force management audit.

Figure 10.1: Elements of Sales Force Management Audit



Adapted from Alan J Dubinsky and Richard W Hansen, "The Sales Force Management Audit," California Management Review, Winter 1981, Volume 24, Number 2, 86-95

Exhibit 10.2

A Case on Sales Audit

SBC Communications Inc, a Texas-based Fortune 50 company providing voice and data telecommunication products and services, with its markets covering California, Texas, and Illinois, has over 57 million phone lines in more than 13 states of the USA.

As long as the company was measuring its sales performance through sales quota, sales activity, closing ratios etc., it faced several selling challenges. Later, the top management decided to extend the company's reach and increase its sales performance by identifying any problems in the fundamental selling behavior of the sales personnel and addressing them. It wanted to establish critical selling competencies for the sales personnel and measure their performance against these. It appointed Blaire Group, a Chicago-based independent sales research and advisory firm, to assess its field sales team's preparedness by analyzing its selling behavior. The analysis was expected to help the company identify the root causes for the fundamental selling deficiencies of the sales team. SBC also wanted to implement training programs to improve the team's sales performance.

Blaire Group's sales audit methodology helped SBC in using a systematic approach to measure the sales force's performance. The audit helped SBC to identify a set of critical selling competencies that provided a basis for comparison and to create a sales simulation profile for auditing and rating the selling performance of the sales personnel. A scorecard reflecting the selling behavior of the sales force was also submitted to the management by Blaire Group and it helped the management to analyze the behavior of the sales force and take necessary measures to overcome the limitations.

The findings and recommendations of Blaire Group indicated the trends in the selling behavior of the sales force. Following the recommendations, SBC's Data and Networking group experienced a 13% gain in sales within six months of the audit.

Adapted from "Sales Audit Case Study, SBC Communications" <www.blairegroup.htm/case studies>

Evaluation of the firm's sales force management process helps the sales manager improve the performance of the sales force and effectively allocate resources for achieving the sales objectives. If conducted effectively, the sales force management audit will help the sales management to identify problems with the present system and also prevent them from recurring. Exhibit 10.2 describes the benefits of sales audit at SBC Communications.

Elements of Sales Audit

A periodic sales force audit helps sales managers to identify problems, ascertain the causes for them, and take necessary corrective action. A sales audit requires an in-depth evaluation of several intra and extra organizational factors. The elements of a sales audit are as follows:

Sales management environment

The sales management environment involves the study of intra-organizational and extra-organizational factors that affect the sales management policies and practices of the firm. The extra-organizational factors that might affect the firm's sales management decisions include customers and economic, demographic, competitive, technological, legal, or political forces. A sales audit should analyze these factors and identify their influence on the future sales management strategies of the firm.

Intra-organizational factors that are usually studied in a sales audit include the relationship between sales and other departments, the firm's marketing mix, the organization of the firm's activities, etc. The auditor identifies the objectives of the firm and those of the marketing department to ensure that the sales department's objectives are in consonance with the overall objectives of the firm.

The auditor examines the quality of communication between sales and other departments and also studies the suitability of the sales strategy for achieving the firm's sales objectives.

Sales management planning system

The focus of the sales audit is on the objectives of the sales department, the sales management program and its implementation. The auditor checks whether the objectives are clearly stated, realistic, and measurable and whether they are in accordance with the firm's available opportunities and resources. The auditor also examines the compatibility of the sales department's objectives with those of the marketing department and the firm's overall objectives.

The sales management program is audited to identify the strategies adopted by the sales department to achieve its objectives. The sales audit verifies the allocation of resources to ascertain that the allocation to the sales department is sufficient for it to meet its objectives. It also helps to ensure that the allocation of resources is in keeping with market opportunities.

Sales management organization evaluation

This involves evaluating the competence of sales managers and sales representatives and recommending appropriate measures to improve the sales team's effectiveness. The auditor also examines the appropriateness of the programs designed to improve the quality of the sales force, such as training, incentive, and compensation programs.

Sales management functions

The last phase of the sales force management audit comprises the evaluation of the sales management functions. It involves an in-depth verification of various aspects of sales management such as recruitment and selection, sales training, compensation and expenses, motivation, sales forecasting, budgeting, quotas, sales territories, sales and cost analysis, profitability analysis, and sales force evaluation.

The audit involves a detailed study of all the sales management functions to identify their strengths and weaknesses. It ascertains the adequacy with which the functions are being performed. In case of weaknesses or inadequacy, the auditor recommends steps to overcome them and ensures that the functions meet the adequacy norms of the organization.

MARKETING COST ANALYSIS

While a sales analysis focuses on the results achieved, cost analysis looks into the costs incurred to produce the results and examines if the returns justify the expenditure. A marketing cost analysis involves the collection, classification, comparison, and study of marketing cost data. Conducting a marketing cost analysis helps a company to identify opportunities to increase the effectiveness of its marketing expenditure. Cost analysis does not serve the purpose of profitability alone. Accurate cost information is also needed for planning marketing activities like pricing, promotion, etc.

Types of Costs

Marketing costs can be classified into various types.

Natural and functional costs

Natural costs are the costs that are recorded in the books of accounts. The term by which they are referred to is determined by the nature of expenditure. Examples of natural costs are salaries and rent.

Functional costs are the costs associated with specific business activities like sales, production, etc.

Direct and indirect costs

Direct costs are costs that can be apportioned to specific segments of sales like products, customers, etc. Salaries and commissions paid to salespersons are an example of direct cost in a sales organization. Indirect costs, on the other hand, are costs that cannot be apportioned to a specific sales unit but have to be distributed among all the sales units, as for example, administrative costs.

Fixed and variable costs

This classification of cost is based on volume sensitivity of cost behavior. Fixed costs do not vary with changes in sales volume whereas variable costs fluctuate with changes in sales volumes. The higher the sales volume, the higher the variable costs, and vice-versa. The variable costs are zero when no sales orders are received.

Fixed costs are not really fixed in the long run. They vary with the decisions of the management. So, the classification of costs on the basis of their variability depends on whether the costs are being viewed from a long-term or short-term perspective.

Procedure for Cost Analysis

The procedure for cost analysis involves the following steps.

Spread of natural costs

As stated earlier, natural costs are costs that are recorded in the books of accounts of a company and are titled according to the expense category. As a first step in cost analysis, these natural costs are converted into functional costs. This is done by breaking the natural costs down into smaller parts and apportioning these parts to specific functional activities. For instance, salaries, an example of natural costs, is broken down into smaller parts, which indicate the salaries for specific functional activities such as selling, sales research, advertising, order processing, customer service, etc.

Functional cost allocation

The next step in cost analysis involves allocation of functional costs to individual sales units such as products, sales territories, and customers. The basis for allocation depends on the type of functional account and the sales unit involved. For example, the basis for allocating indirect selling costs like those for field supervision, sales personnel training, marketing research, etc., is in proportion to the direct selling time or time records of the project.

Determining the efficiency and profitability of sales units

Next comes determining each unit’s efficiency and profitability. In sales management, this step in cost analysis should involve the evaluation of the sales generated from each sales unit and the expenses involved. The evaluation of profitability associated with each sales unit forms the basis for the management’s decision to continue or discontinue doing business with the sales unit.

Return on Investment (ROI) is a commonly used measure to evaluate the profitability of a business unit. Exhibit 10.3 describes how Spenco used Gross Margin Return on Space (GMROS), a subset of ROI, to help its retail partners maximize their gross returns.

Exhibit 10.3

Maximizing Gross Returns Using GMROS

The dissatisfaction of its retail partners with the profits they were earning on their inventory caused Texas-based company, Spenco, to offer them a solution that would maximize their gross return on inventory by utilizing minimal merchandize space. Spenco, which offers a range of foot care and shoe care products, based its solution on historical sales analysis of its retail partners.

The formula, Gross Margin Return on Space (GMROS), compared the sales analysis data of the retail partners with the actual floor space used by Spenco for the sale of its products.

The solution offered by Spenco was a combination of efficient management of store traffic, educating the store employees, and creating display solutions that focused on the consumer and on maximizing sales. Using GMROS, Spenco demonstrated that a company can maximize returns on current assets through careful sales analysis.

Adapted from "Spenco Introduces 'Performance Per Square Foot'," Sporting Goods Business, November 2003, Volume 36, Issue 11, 43.

In sales management, ROAM (return on assets managed) is yet another tool for profitability analysis.

$$\text{ROAM} = \text{contribution margin or net profit} \times \frac{\text{Sales}}{\text{Sales assets managed}}$$

The assets managed include average accounts receivable and the inventory that can efficiently meet the territory needs.

The efficiency of a sales unit is computed using the analysis of variance. The variance identifies the deviation from normal and the reasons for the deviation.

Initiation of action

The last and the most crucial step in cost analysis is deciding on the action to be taken. After identifying territories, customer segments, or products that do not justify the expenditures incurred, the sales management may decide to either eliminate the weak business segments or to improve the efficiency of these segments. Elimination of weak business segments forms a regular feature of sales organizations since there could be quite a few worn-out business segments that might hamper the progress of the organizations as a whole.

MARKETING AUDIT

Marketing audit is an efficient tool for evaluating and improving the marketing operations of a firm. It involves studying the effectiveness of a firm's marketing strategies, policies, and practices, considering the opportunities and resources available to it.

A marketing audit is a comprehensive or 'horizontal' audit that evaluates the marketing environment, strategies, organization, systems and objectives. The audit is said to be vertical when the focus of evaluation is on a single marketing function such as sales force, advertising, pricing, etc.

A marketing audit can be either an internal audit or an external audit depending on who is conducting the audit. In an internal audit, a person from within the firm who is not in any way connected to the operation that is being evaluated, conducts the audit. In an external audit, a third party, such as a consultant or a management consulting firm, undertakes the audit. An external audit is recommended to ensure objectivity. Exhibit 10.4 describes the procedure followed at 3M while conducting an internal marketing audit.

Exhibit 10.4

3M's Internal Marketing Plan Audit

3M uses an internal marketing plan audit procedure to help the divisional marketing managers improve their marketing plan function and formulate better strategies. 3M has a marketing plan audit office that audits the marketing plans of the divisional marketing managers. The findings and recommendations of the audit help the marketing managers add value to the marketing plans.

A divisional marketing manager formulates a marketing plan for a product or a product line for a year and invites the audit team from the marketing plan audit office at the headquarters to critically evaluate it. The audit team comprises a marketing manager of another branch, the national sales manager, marketing executives with technical knowledge, personnel familiar with the nature of problems observed in a marketing plan, and a person who is a novice in the area of marketing, markets, marketing plans, etc.

A summary of the marketing plan is provided to the audit team 10 days before the divisional marketing manager whose plan is to be audited, makes his presentation.

During the presentation, the auditors raise a number of questions that might involve a debate. After the presentation, a marketing plan evaluation form with numerical rating scales for questions is filled up by the auditors. The form also has provisions for comments by the auditors.

The findings and recommendations of the marketing plan audit are then discussed with the divisional marketing manager and based on them, he takes the necessary steps to improve the plan.

Adapted from Philip Kotler, William T. Gregor and William H. Rodgers, "The Marketing Audit Comes of Age," Sloan Management Review, Winter 1977, Volume 18, Issue 2, 25-44.

It is advisable to conduct a periodic audit when the company is doing well rather than follow the general tendency of companies to undertake an audit when sales have considerably dropped or when the company is experiencing problems. Conducting an audit when things are well in the company helps the management to identify aspects that can be made even better and those that may become problem areas in the future.

Thus, a marketing audit is a comprehensive, systematic, independent, periodic evaluation of a firm's marketing environment, strategies, objectives and activities to identify opportunities and likely problems and take necessary measures to improve the firm's marketing performance.

Procedure for a Marketing Audit

A typical marketing audit consists of setting the objectives and scope of the audit, collecting data for the audit, and preparing reports and presentation for the management to use in planning the action to be taken.

Setting the objectives

The initial step in a marketing audit involves an interaction between the management and the auditors to discuss the nature of the marketing operations and potential costs and benefits from the audit. The company has to then decide the objectives, scope, coverage, data sources, reports, and duration of the audit.

Collecting the data

A major part of the auditor's time is consumed in gathering data for the marketing audit. Detailed plans describing the interviews to be conducted to gather the data are prepared specifying the interviewee, interviewer, place, and time of contact. The interview reports are documented for review. The purpose of this exercise is to save on the auditor's time and cost.

Report preparation and presentation

Once the data collection phase is over, the auditors make a presentation to the management. The presentation involves restating the objectives of the audit, disclosing the findings, and presenting the major recommendations. After the presentation, the contents are rewritten as a final report and the presentation is made to a larger group of managers associated with the organization's marketing function. This, in most of cases, leads to discussions and debate among the managers and results in an action plan to overcome the problems or utilize the opportunities identified in the audit.

Components of a Marketing Audit

A marketing audit usually starts with a study of the marketing environment and explores the opportunities available and the potential threats that the market can pose to the company. This is followed by a study of the marketing strategies, objectives, and one or two key functional areas. The main components of a marketing audit are described below. A marketing audit comprises six component audits, which may be conducted individually and partially interdependently if the company does not want a comprehensive marketing audit. The components of a marketing audit are marketing environment audit, marketing strategy audit, marketing organization audit, marketing systems audit, marketing productivity audit, and marketing function audit.

Marketing environment audit

A company is normally affected by several factors pertaining to the industry to which it belongs. A marketing environment audit thus involves a study of macro economic factors like the economic, demographic, political, legal, technological, and socio-cultural forces over which the firm has no control. A firm is also affected by the immediate environment in which it operates. The marketing environment audit involves a study of the firm's suppliers, customers, dealers, competitors, markets, etc. It identifies the trends in the marketing environment and forms a framework for planning the marketing action.

Marketing strategy audit

The audit looks into the consistency of the firm's marketing strategy considering the opportunities and threats it is exposed to. The audit starts with a study of the firm's overall business goals and objectives, followed by a study of its marketing objectives and strategies to ensure that they are in agreement with the company's overall business objectives. The audit checks whether the marketing objectives are properly stated and are appropriate to the company's resources and opportunities.

Marketing organization audit

The audit studies the effectiveness and efficiency of the marketing and sales organization and also the interaction of the marketing department with other departments within the organization. It studies the capability of marketing executives and personnel. It aims to make the organization more market responsive.

Marketing systems audit

The marketing function of organizations involves collecting information, planning and controlling the marketing activities like sales forecasting, marketing planning & control, inventory control, etc. A marketing systems audit involves the study of the procedures that are used to perform the activities involved in the marketing function. The audit assesses whether the marketing function is being carried out with adequate systems that facilitate planning, implementation and control, or not.

Marketing productivity audit

A marketing productivity audit involves studying the accounting data of the firm to identify the profitable areas of the firm. It also examines the marketing costs and expenses to identify areas in which marketing costs can be reduced or eliminated.

Marketing function audit

A marketing function audit involves an evaluation of one or more key marketing functions like sales force, pricing, advertising, etc., to identify peripheral problems associated with the marketing function.

PROFITABILITY ANALYSIS

As discussed earlier, a marketing cost analysis analyzes sales volume and selling expenses to identify the profitability of sales activities. Marketing managers can improve their decision- making and take steps to ensure the firm's profitability by tracing sales revenues to market segments and relating the sales revenues to marketing costs.

There are some accounting and statistical tools and techniques that can be used to improve the decision making and control of the marketing efforts of a company. A decision-oriented and contribution-based accounting system can be used to evaluate the alternatives available in the marketing process. The system makes use of contribution accounting in which all unavoidable costs that are functionally related to a product are attributed to it.

The contribution made by each product towards overheads is determined by deducting these costs from the net sales. The accounting statements must provide the details of the sales figures and direct costs that facilitate the computation of the margin. These contributions are used for decision-making in product introduction, elimination, pricing, etc. The contribution measure can also be applied to measure the profitability of sales territories, representatives, and customers.

The profitability analysis of a firm can be done using techniques such as break-even analysis, capital budgeting, and Return on Assets Managed (ROAM).

Break-even Analysis

Sales managers commonly use break-even analysis to measure the profitability of sales. Though this technique has been criticized for its inadequacy and shortcomings, it can be used for the profitability analysis of firms operating in oligopolistic[2] industries, wherein the variable costs are more or less constant and are significantly less when compared to the final price at which products are sold. An example of an oligopolistic market is the commercial airlines market having players like Boeing, Airbus, etc., operating in it.

The technique of break-even analysis is based on calculating the break-even point of a firm. The break-even point is the point at which the total revenue from sales equals the total costs. This is a situation of no profit-no loss.

{Unit Sales Price × No. of Units} - {Unit Variable Cost × No. of Units}- Fixed Costs = Operating Income = 0

The formula can be rewritten as

{Unit Sales Price – Unit Variable Cost}× No. of Units –Fixed Costs = Operating Income = 0

[2] Oligopolistic markets lie between the extremes of monopolistic markets and the markets with perfect competition.

where Unit Sales Price – Unit Variable Cost denotes the Contribution Margin.

The following example demonstrates the calculation of break-even point for a retail shoe store.

The selling price per pair of shoes = \$30; cost per pair of shoes = \$21; fixed costs (rent, salaries, advertising, etc. = \$360,000.

{Unit Sales Price – Unit Variable Cost}× No. of Units –Fixed Costs = 0

(\$30 - \$21) x N – \$360,000 = 0

N = \$360,000/ \$9 per pair = 40,000 pairs of shoes

So, the company has to sell 40,000 pairs of shoes to break even, i.e., reach a stage of no profit-no loss.

If the company desires to have an operating profit of \$1,35,000

then,

(\$30 - \$21) x N – \$360,000 = \$135,000

N = (\$360,000 + \$ 135,000)/ \$9 per pair = 55,000 pairs of shoes.

So, the company has to sell 55,000 pairs of shoes to have an operating profit of \$135,000.

Capital Budgeting Tools

Marketing managers also make use of capital budgeting techniques like Net Present Value (NPV), Internal Rate of Return (IRR), payback period, etc., for taking decisions on marketing expenditure. However, making provisions for risk, future revenues and expenditures is a major drawback of using capital budgeting tools.

Sales managers also use profit variance analysis as a technique for profitability analysis. Changes in gross profit between different time periods can be because of variance in prices, sales volume, overall cost-price relation, etc.

Profitability analysis of a firm using Return on Assets Managed (ROAM) has been explained in the earlier part of the chapter.

PRINCIPLES OF ANALYSIS

The sales, cost, and profitability analyses are based on the principle that not every factor affecting the sales and the marketing function is revealed completely unless the details are probed.

Iceberg Principle

The iceberg principle suggests that aggregating the total sales figures of a firm and comparing it with past performance may reveal a positive picture of sales even though there may be a larger problem concealed. When individual sales figures are aggregated into totals, values that are too high or too low offset each other and so lose their significance. All strengths and weaknesses may not be revealed when aggregates are used for analysis. The same rule applies to marketing costs as well. Total costs may not reveal all aspects of the costs incurred or all the details that are necessary for efficient cost control.

This is like the visible portion of an iceberg being only a minute fraction of what lies underneath and thus the term ‘iceberg principle’. So, in order to obtain accurate and complete information about the sales figures, the sales data should be broken down into individual sales segments.

Exhibit 10.5

Strategies for Altering 80/20 Ratio

Companies facing the 80/20 situation can alter it by adopting the following strategies to bring about an increase in their profitability. They are:

- Substitution strategy
- Revitalization strategy
- Acceleration strategy
- Incremental strategy

Substitution strategy involves replacing a marketing unit showing marginal performance with a unit that promises better performance.

The revitalization strategy involves taking measures to improve the performance of marketing units that performed well in the past, but whose performance has declined subsequently.

The acceleration strategy can be used for newly introduced marketing units that have been showing an upward trend in performance. The management might adopt this strategy to speed up or accelerate the growth of the new unit.

Incremental strategy involves adding new marketing units that have the potential of becoming high performers.

Using these strategies, if a firm is able to alter the 80/20 situation to a 60/20 or a 50/20 situation, it can improve its profitability.

Adapted from Alan J. Dubinsky and Richard W. Hansen, "Improving Marketing Productivity: The 80/20 Principle Revisited," California Management Review, Fall 1982, Volume 25, Number 1, 96-105.

80-20 Principle

The 80-20 principle, also called the Pareto principle, is named after Italian economist Vilfredo Pareto. Pareto studied the distribution of wealth in an economy. He found that wealth was not evenly distributed in the economy and that only a few people controlled most of the wealth. Pareto proposed that 80% of the wealth in an economy was controlled by 20% of the people.

Joseph M. Juran, the quality guru who coined the phrase 'the vital few and the trivial many', generalized the Pareto principle and termed it the 80:20 rule. The 80:20 rule states that 20% of the elements are responsible for 80% of the results. The 80:20 rule can be applied to all areas of business and helps management to focus on the real problem or issues. In sales analysis, the Pareto principle states that 80% of a firm's sales volume comes from 20% of its customers. In other words, a large portion of the profits is dependent on a small percentage of the customers. Such a skewed situation, if not addressed in time, can lead to reduced profits in the long term. Thus not all business units of a firm contribute equally to its profitability. Firms facing the 80/20 situation can adopt certain strategies to alter the ratio and increase their profits. Exhibit 10.5 describes the strategies that firms can adopt to alter the 80/20 ratio.

The 80/20 rule has a similar implication for the costs and expenses as well. Cost analysis of firms shows that about 15% of expense categories account for about 80% of all the expenses. Therefore, management should focus its attention on designing measures that address the 15% category of costs that contribute to the bulk of expenses of the firm.

Cross-classifications

Cross-classifications can be used when the sales data has to be analyzed on the basis of more than one category. If sales managers require information on both customer and product categories, they can either opt for two separate analyses, one by product and the other by customer, or they can go for one analysis, by customer cross-classified by product. The latter helps the sales managers to arrive at the same information but with the product-customer detail added. Cross-classifications involving more than two categories complicate the information.

SUMMARY

Control is one of the most critical functions performed by a sales manager as it measures the performance of the system and helps the manager take corrective action if the performance of the system is not in agreement with the formulated plans. The present day dynamic marketplace has forced sales managers to shift their focus in sales control from sales volume alone and to lay equal emphasis on costs incurred in implementing the sales effort.

The objective of sales control is to ensure that the company's sales efforts are in tune with its sales plan by taking necessary measures in case of deviations. The sales control function measures the performance of the sales force and identifies the problems and opportunities that the firm is exposed to. The process of sales control involves setting goals, comparing actuals with the targets, and taking up corrective action if necessary.

The sales efforts of a company can be studied through a sales analysis that involves gathering, classifying, comparing, and studying the sales data of the company. A typical sales analysis involves deciding on the purpose of evaluation, comparing the sales figures with some standards and processing the data to generate reports. A sales analysis can be most informative when the sales data is broken down hierarchically. An analysis of volume of sales by categories is very helpful in identifying the root causes of the problems in the sales activities of the firm. Though a sales analysis helps identify the problems associated with the sales activities of the firm, it is also bound by a few limitations like dependency on accounting records, inability to reflect the profitability of sales, etc. Sales analysis involves analyzing the sales volume or the total sales of the company. It includes the total sales of the company by territory, customer, and product category. A sales audit is periodically taken up by the sales management to examine the entire selling operations of the firm. The audit involves an audit of the sales organization, the sales environment, planning systems, and sales management functions.

While a sales analysis measures the sales volume achieved, the marketing cost analysis looks into the costs and expenses incurred to achieve the sales volume and their justification. A cost analysis involves spreading the natural costs, allocating them to functional units, studying the profitability of the units, and implementing appropriate action depending on the findings of the analysis.

Just as a sales audit examines the entire sales operations of a firm, a marketing audit evaluates and enhances the effectiveness of a firm's marketing operations by studying its marketing strategies, policies, and practices.

Sales managers use profitability analysis to relate the sales revenues to marketing costs. This helps sales managers to take necessary measures to ensure higher profitability of the firm's sales transactions.

A number of principles such as the iceberg principle, the 80/20 principle and cross-classifications guide sales managers in conducting effective sales and cost analysis. These principles reveal the behavior of sales data and the actual reasons underlying them. They forewarn sales managers of impending dangers and help them to take measures to counter them.

Part III
Organizing and Directing the Sales Efforts

Chapter 11

Hiring and Training Sales Personnel

In this chapter we will discuss:

- Recruitment and its importance
- Determining specific requirements of the sales personnel
- Sales personnel selection process
- Importance of sales training
- Types of sales training
- Benefits of sales training
- Sales training programs

The hiring function includes recruiting candidates with the right qualifications, selecting the ones who suit the organizational requirements, and placing them in a suitable position in the organization.

Earlier, the ability of a company to grow and compete was taken for granted because of lack of competition in almost all industries. As the competition grew in the last few decades, companies needed to look for innovative ways to sell their products and services. The importance of the sales force in finding innovative ways to sell products and services also increased. The quality of sales personnel, therefore, is of utmost importance in deciding the ability of a company to compete in the business environment. Just as superior performers can add millions of dollars to a company's revenue, underperforming sales people can hinder its growth and drive the company towards losses. Therefore, companies need to devise systems and structures so that they can recruit the right people with the right qualification and attitude to take their sales to new heights. However, organizations also need to determine the training requirements of their sales personnel so that they can upgrade themselves continuously. Sales techniques that were successful a few decades back are no longer applicable today. Technology also plays a significant role in clinching sales deals. Therefore, sales personnel need to upgrade their knowledge and skills to sustain and thrive in this competitive world. And organizations need to provide a congenial environment to enable them to upgrade their knowledge and enhance their skills in the sales approach.

In this chapter, we will discuss the importance of recruitment of sales personnel in an organization and the personality traits or specific requirements of salesperson. The chapter also describes in detail a framework for the selection process of sales personnel. The sales manager's responsibility does not end with the selection of suitably qualified sales personnel. The personnel also need to be appropriately trained for effective personal selling. Therefore, in this chapter we will also discuss the importance of sales training and the types and benefits of sales training. The later part of the chapter discusses the components of sales training programs which includes designing of training programs, implementing training programs, and evaluating them to assess how useful these training programs have been in enhancing the selling skills of sales personnel.

RECRUITMENT AND ITS IMPORTANCE

Every company aims at recruiting the right person for the right job. The greatest challenge faced by organizations today is to be able to recruit the best talent and to be able to utilize that talent to achieve organizational objectives. Recruitment and hiring the right people is as important in a sales organization as it is in any other organization. Selecting a wrong person results in wastage of recruitment costs, including cost of placing advertisements, screening potential candidates, time taken for interviewing them, assessing them, and training them after selection. Further, when such a person is inducted into the sales force, the company incurs more costs by paying him a salary and reimbursing his sales expenses. All this amounts to wasteful expenditure for the company if the sales person is a non-performer.

In addition, if the management of an organization recruits a person of average talent in the sales force, instead of a competent individual, it would result in lesser profits or even losses. By hiring the wrong person in the selling job, a company faces the threat of lost future sales. An ineffective salesperson can cause a great deal of damage to a company's reputation, if he has poor product knowledge, fails to serve the customer properly, and uses poor selling techniques that only tend to alienate the customers. Often, not only does it take a long time for the company to discover the real reason behind the lost business but it also takes the company a longer period to repair the damage to its reputation and reestablish its image.

It is the salespeople who play a vital role in portraying the right image of the company during meetings with potential and existing clients. Further, the caliber of the salesman determines the conversion rate of potential customers into real customers. This is directly reflected on the bottom line of the company. There are substantial hidden costs associated with hiring the wrong person. However, unlike other costs such as, poor credit terms, which are instantly visible to the sales manager, the costs arising due to poor hiring decisions get concealed within various other accounts such as, salary account, travel expense account, and training account.

The sales force function is characterized by the highest turnover in any industry. For example, in one study, it has been estimated that in the global insurance industry, 80 to 85% of the sales force quit the organization within the first five years in the job. In other industries too, the sales force turnover has been estimated to be around 50% within two to three years in the job. Sales force turnover has become a major cause of concern to sales managers due to wasted efforts and costs incurred by the organization in training these individuals. Therefore, recruiting individuals with the right attitude and skills set in the sales force is one of the greatest challenges being faced by sales organizations across the world.

While recruiting salespeople, a sales manager has to source his requirement from a large database of potentially qualified candidates. Not only will this ensure that he has a large number of qualified people to select from, but it will also minimize the chances of him having to recruit individuals with inferior selling skills. The chances of selecting a salesperson with inferior selling skills are higher if the sales manager remains confined to a narrow database of applicants.

DETERMINING SPECIFIC REQUIREMENTS OF THE SALES PERSONNEL

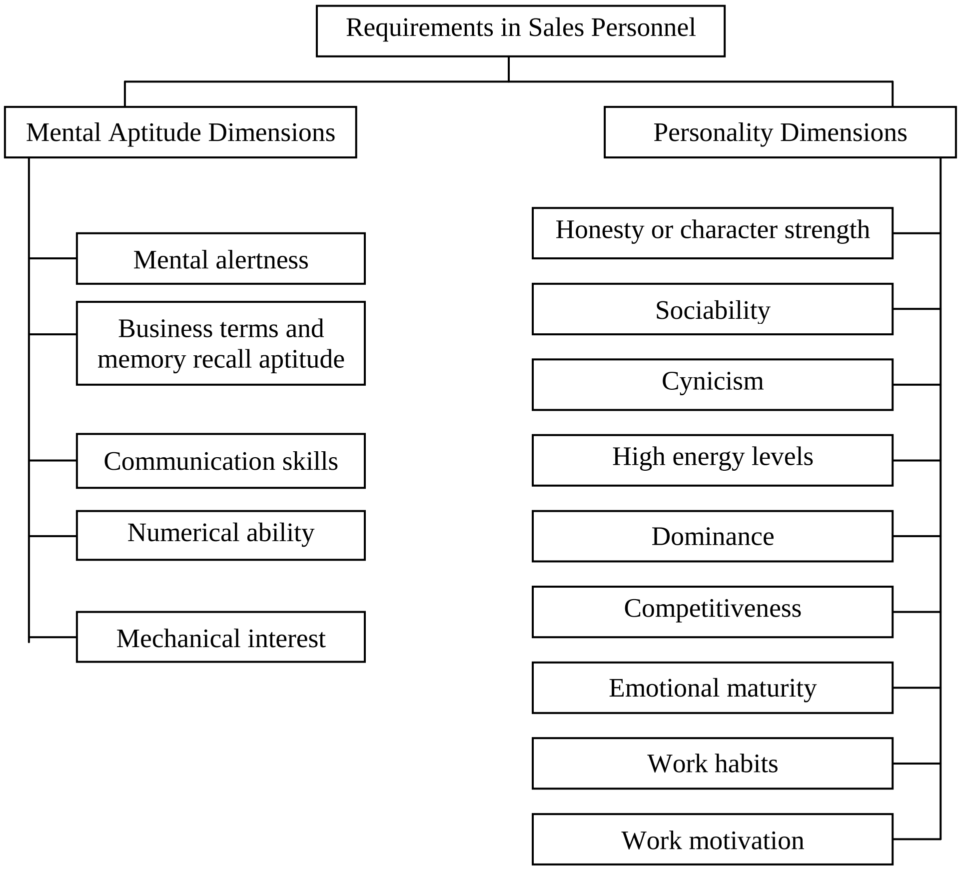
The question that haunts every sales manager is – Are successful salespersons born or can they be developed? The conviction of most sales managers that successful salespersons can be developed makes companies spend millions of dollars on sales training. Moreover, there are countless organizations whose only purpose is to train salespeople.

A super salesman is one who is able to sell ice to the Eskimos. A professional manner of selling appeals to almost everyone, making them purchase things they never intended to purchase at all. Call it what you may – gift of the gab, superior selling skills, or whatever – a super salesman can convincingly make the customer feel dissatisfied with the product or service he may be currently using and make him purchase the product or the service that the salesman is selling. However, not all companies are blessed with super salesmen.

Salespersons are the lifeblood of an organization. The survival of an organization depends on the effectiveness of its sales force in convincing customers to make the purchase decision and ensuring customer satisfaction with the purchase thereafter. And a super salesman is one who has the ability to create discontent in a customer about the product he is presently using and convince him to buy the new product the salesman is offering. Although it is a difficult and challenging task for sales managers to find top quality salespersons, it is not an impossible task altogether.

Many companies use their own criteria to determine what makes their best sales persons perform successfully in their job. The mental aptitudes and personality traits of the best and worst performers in sales are identified and based on this, a customized personality profile of sales personnel requirements is developed. By developing such a personality profile, companies hope that it will help them select salespeople who can fit well into the unique sales environment at these companies. Such a method, companies hope, will be an accurate, inexpensive, and consistent way to recruit only those people who will be successful salespersons. Figure 11.1 gives a diagrammatic representation of the requirements companies look for in a salesperson.

Figure 11.1: Criteria Used to Select Sales Personnel



The various dimensions that are considered while determining the mental aptitude of salespeople include mental alertness, memory recall aptitude, communication skills, numerical ability, and mechanical interest. The factors that are taken into consideration while assessing the personality dimensions of a successful salesperson include honesty or character strength, sociability, cynicism, high energy levels, dominance, competitiveness, emotional maturity, work habits, and work motivation.

Mental Aptitude Dimensions

As has already been stated, mental aptitude dimensions include mental alertness, business terms and memory recall aptitude, language skills, perception, and mechanical interest. To predict the capabilities of a prospective salesman accurately, an assessment of the mental aptitude dimensions of the sales person is necessary, because it gives the sales manager an idea about the problem-solving and critical thinking abilities of the sales person. Qualifications are not a good indicator of the mental aptitude of a person.

Mental alertness

The mental alertness dimension of mental aptitude indicates the quick thinking ability of the sales person. A person who scores high on this dimension learns and thinks fast. As a sales person, he will understand customer needs easily and come up with solutions quickly to fulfill the needs. On the other hand, a person who scores low on

Exhibit 11.1

Evolving Sales Force in Tune with Evolving Businesses

The ability to adapt to change, a key requirement for businesses today, applies to salespersons as well, if they want to build a successful career in selling. To be successful, a salesperson should be willing to take risks, have self-motivation, competitiveness and the ability to easily adapt to new situations.

United Parcel Service (UPS) is a company that has evolved over time from a package-delivery company to a global supply chain management company. The company has evolved from one that was involved in simple delivery of packages to one that delivers information, goods, and funds at a global level. With the evolution of its business model, the company realized that its sales force needed to simultaneously evolve its selling approach from that of transaction-based selling to solution-based selling. While transaction-based selling requires the sales person to simply sell the company's products or services, in solution-based selling, the sales person tries to understand customer needs and come up with a solution that would address the needs. The sales force that was earlier taking orders from customers' shipping department was now required to sell to executives. The new set of customers that the sales force had to now approach made it necessary for the company to upgrade its sales force in terms of communication skills, so that it would be able to interact with the executives in a confident manner. Further, the sales force needed to have an entirely different mindset while selling to this new set of customers.

The company follows a philosophy of training, retraining and refreshing the knowledge of its sales force. In addition to providing them with product knowledge, the training program equips them with three core skills required in the business. The company's training initiative has paid off by enabling the sales force to successfully provide business solutions to customers and helping the company move into a field having immense revenue opportunities.

Adapted from John Beystehner, "Playing a Brand New Game," Sales & Marketing Management, November 2003, Volume 155, Issue 11, 72.

the dimension of mental alertness will think slowly and take time to understand and grasp the situation. If hired as a sales person, such an individual would require repetitive training and constant supervision.

Business terms and memory recall aptitude

Business terms and memory recall aptitude refers to the inquisitiveness of the individual in terms of the ability to stay abreast of competition by keeping himself updated with knowledge on the latest advances in his field. A salesperson, who has a sound knowledge of business terms and happenings in the field of business finds it easy to strike a conversation with the prospective customer on a wide variety of topics. Also, his awareness of what is happening around him helps him know about the recent trends in competitor's products and communicate the same back to the company enabling it to improve its own products to match those of the competitors. A sales person who has strong memory recall aptitude can be an asset to any sales organization.

Further, as businesses evolve over a period of time, the sales force of companies also need to evolve in order to successfully meet the changing business requirements. Exhibit 11.1 describes how UPS upgraded its sales force skills to make them evolve with the evolution in the business model of the company.

Communication skills

The job of a sales person requires good oral and written communication skills. A sales person must have good oral communication skills to communicate effectively to the prospects. He also needs to be good in written communication, as a sales person has to file reports related to sales calls. A poorly written report fails to give the sales manager a clear picture of the efforts required to convert the prospect into a customer. Sometimes, a salesperson is required to communicate in writing with the customer informing him about the launch of a new product, which will meet the customer needs. Such communication requires the sales person to have strong writing skills in order to generate interest in the customer to make him purchase the product. A sales person also needs to have good written communication in order to respond to customer queries. Further, communication skills play an important role for a sales person to be considered for higher positions in the organization such as that of a sales manager.

Numerical ability

The numerical ability of a sales person refers to his ability to process data quickly and accurately. Accuracy in calculations is essential for a sales person while obtaining the sales orders or sales contracts. Inaccurate sales orders and sales contracts result in losses for the company.

Mechanical interest

Mechanical interest refers to the interest exhibited by a sales person to understand the technology associated with mechanical devices. This dimension is of particular importance in the case of a sales person who is in the job of selling mechanical equipment. For such sales people, learning the technology associated with the machines helps them in making more effective presentations to the prospects.

Personality dimensions

The personality dimensions of an individual include honesty or character strength, sociability, cynicism, high energy levels, dominance, competitiveness, emotional maturity, work habits, and work motivation. Knowledge of the personality dimensions of an individual help organizations know whether the candidate will fit in the position.

Honesty or character strength

To safeguard its image, it is essential for a company to hire salespersons who are honest and high in character strength. By being honest, persistent, dependable, and straightforward in their dealings, salespersons can earn the trust and respect of customers, lending credibility to the image of the company and adding to its goodwill.

Sociability

Although the general perception is that to be a good salesperson, one has to be very talkative in nature, it is not entirely true. It is not the talkativeness of a person but his sociability that makes him a good salesperson. Sociability refers to the tendency of an individual to have a liking for other people and the ability to interact with people. It is more often the need of an individual to be with people that makes him sociable. People who score high on the sociability dimension usually become better salespersons than those who score low. An extremely high score on the sociability dimension indicates that the individual is an extrovert in nature. However, such people fail to make good salesmen due to their tendency to talk too much and failure to listen to the prospect.

Cynicism

Successful salespeople do not accept anything at face value and tend to be rather cynical and mistrustful of others. This tendency makes them identify the reasons for the prospect not buying what they are trying to sell. By doing so, they are able to address the latent fear and hesitation of the prospect in making the purchase.

High energy levels

Successful salespeople need to have high levels of energy, drive, and enthusiasm to transform the potential of new business into an increase in sales. Energetic sales people are able to travel from door-to-door, one store to another store, and from one company to another without feeling drained. People in the profession of selling but having low energy levels tend to confine themselves to selling over the phone or from behind a store counter.

Dominance

A successful salesperson is one who is able to persuade the prospect to buy the product or service and close the deal. Salespersons need to be forceful and aggressive to successfully close a deal. These traits comprise the personality dimension of an individual. They produce enthusiasm and drive in a salesperson, which is necessary to successfully close a deal. However, many times people having these traits are considered to be overbearing by others.

Competitiveness

To be effective and be ranked among the top performers of the organization, salespersons need to be competitive in nature. Healthy competition among the sales personnel makes them strive to outperform one another in sales and contribute to the bottom line of the company. However, salespersons who score low on the dimension of competitiveness tend to be effective in organizations, which do not emphasize competition among their sales personnel.

Emotional maturity

While selecting a salesperson, organizations test his emotional maturity. Successful salespersons have a high level of emotional maturity. They display a lot of patience in answering the queries raised by their customers. They do not get upset or frustrated by failure in closing a deal. Salespersons who are intolerant in nature tend to antagonize their customers and are instrumental in the company losing customers. Therefore, sales managers look for a high level of emotional maturity in individuals while recruiting them in the position of salespersons.

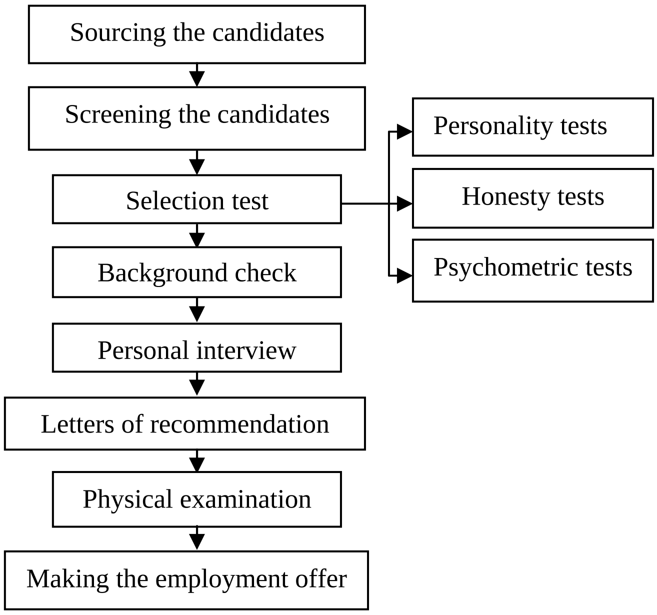
Work habits

Not all people are good planners. Sales organizations look for people who are organized in nature and plan their activities carefully. Such people are able to carefully plan out the various stages in the selling process and accomplish each stage one after the other in a planned manner. Individuals who score high on the dimension of work habits tend to be successful in their role as salespersons. Disorganized individuals, on the other hand, score low on the dimension of work habits and tend to follow varying or irregular work schedules. Such individuals tend to perform poorly in the selling job.

Work motivation

The two factors that motivate an individual are recognition and security. Salespersons who are motivated by recognition take risks and have a drive to perform. Such individuals are self-motivated, enthusiastic, and willing to work harder to earn more. Thus, individuals who have high work motivation make good salespeople. In contrast, individuals who have low work motivation are security-oriented and unwilling to take risks. Such individuals prefer to work in a risk-free environment that provides them with a stable job and secure income. Incentives such as, bonuses and commissions fail to motivate such individuals, who, therefore, cannot be successful as sales people.

Figure 11.2: Sales Personnel Selection Process



The success of a salesperson is determined not by intelligence or qualifications but by his personality. A successful salesperson is, thus, one who is energetic, has good language skills, is enthusiastic, forceful and aggressive, loves working with people, and is sincere and inquisitive by nature. As personality plays a vital role in the making of a successful salesperson, it is essential for companies, to match the right personality with the right job.

Successful salespersons also need training to make them perform even better. The importance of training to refine the skills of a person can be understood from the fact that training a person lacking the requisite personality traits fails to transform the person into a successful salesperson. Instead, it only results in wastage of time, money, and efforts. On the other hand, training a person who fits the job profile accurately and has the requisite personality traits makes him perform even better.

SALES PERSONNEL SELECTION PROCESS

The sales force selection process consists of a number of stages. These include sourcing the candidates, screening the candidates, conducting the selection test, holding personal interviews, checking letters of recommendations, conducting reference checks, physical examination, and making the employment offer. Figure 11.2 gives a schematic representation of the sales personnel selection process.

Sourcing the Candidates

Sales managers try to develop a pool of applicants by attracting candidates from various sources for filling the sales positions in their organizations. The various sources from which sales managers can source potential candidates include college and university campuses, use of placement agencies, responses to advertisements in newspapers and trade journals, direct mail to potential candidates, referrals from other salespeople, company executives, clients, or vendors, and salespeople from competing firms. Potential candidates for sales positions can even be sourced from within the organization. This trend is known as re-recruiting. For example, at Cigna and State Farm Insurance, internal people are given preference while recruiting to fill sales positions. At Cigna, people from the underwriting positions are preferred for sales roles. Internal sourcing of candidates makes it easier for the candidates to adapt themselves to the organization's style of functioning and culture, as they are already familiar with it. Re-recruiting has begun to gain increasing importance in recent times as has been described in Exhibit 11.2.

Exhibit 11.2

Become an Employer of Choice by Re-recruiting

In today's business environment, recruitment has assumed a highly sophisticated form with companies able to receive applications and conduct tests and interviews over the Internet. The Internet has not only facilitated the task of companies but also that of job seekers, who can now apply online. Thus, companies are flooded with résumés from candidates. While some resumes suit the job requirements, there are often many more, which in no way match the job requirements. Therefore, the process of recruiting from external sources is a very time-consuming and expensive proposition.

Companies, however, fail to realize that there is a likelihood of them finding the required candidate within the company itself. Failure of companies to have a centralized database of the skills of their employees and also the failure to properly communicate information about vacancies internally, results in most employees being unaware of the company's requirements.

Global 2000 companies, however, have realized the folly of overlooking internal talent and have taken to the concept of re-recruiting. In fact, re-recruiting is being thought of as the next HR frontier. Re-recruiting essentially means recruiting suitable personnel from within the company whenever a vacancy is created. Re-recruiting has various advantages. It enhances the morale of the employees by providing them with an opportunity to advance in their career without having to shift from the company. Moreover, the company also saves significantly in terms of costs of recruitment. According to a study, the cost of recruiting an external candidate amounts to 50% more than the cost of recruiting from within the organization. Also, recruiting from within the company helps to prevent loss of specialized knowledge and skills when disenchanted employees quit in search of better career and growth opportunities.

Re-recruiting can be a way for companies to reciprocate the commitment of their employees. Loyalty, after all, should be a two-sided feeling. Re-recruiting can be a challenge for companies operating in various countries in terms of compiling a database of employee skills, ensuring that communication regarding job vacancies reaches one and all within the organization, multiple languages, and differences in laws and regulations of various countries besides the administrative hurdles involved.

New advancements in technology and strategic workforce management initiatives by companies has made it possible for them to meet these challenges by helping them manage and monitor workforce planning and core competencies of personnel. Strategic workforce management also benefits the employees by keeping them updated on the internal job postings. Using the self-service approach, the employees are also able to update their career profiles whenever there is a change in their skills set, professional experience, and education and can proactively manage their career path by interacting constantly with managers, staffing, and recruiting personnel.

Therefore, re-recruiting can help companies become an 'employer of choice' by maximizing the potential of the employees, boosting their productivity as well as morale, and increasing employee retention, all of which together result in increased profits for the company.

The attractiveness of an organization to potential sales force candidates depends on its reputation, the training it provides to its personnel, its compensation package, the supervisory style prevalent in the organization, and the organizational culture. Once a large pool of candidates has been identified, the sales manager can proceed to the next stage of the selection process.

Adapted from Nicole Stata, "Re-recruiting: HR's Next Frontier," Recruiter Magazine Online, < http://www.recruiter.com/magazineonline/101502_feature_it_3.cfm>

Exhibit 11.3

Tests – A Crucial Part of the Selection Process

In an organization, a written test forms an essential, and often, the most crucial part of the selection process. The recruitment test for the post of a Deputy Probation Officer at the California Riverside County is an example of the crucial role that tests play in the selection process. Every individual who applies for the post of Deputy Probation Officer has to clear several stages before final selection.

The selection process includes employment tests, personal interviews, and background checks. The employment tests consist of a series of tests including a high-pressure writing test. A candidate appearing for a high-pressure writing test is placed in a room all alone and provided with nothing else but a few blank sheets of paper and a few pencils. The candidate is then asked to write an essay on a particular job-related topic within a specified time frame. The essay written by the candidate forms the basis for the evaluation of his grammar, spelling, punctuation, sentence structure, and content. A Deputy Probation Officer is required to resolve conflicts, solve problems, and write legal reports. Therefore, this test is particularly aimed to test the candidates in their writing, conflict resolution, and problem solving skills.

Adapted from T. L Stanley, "The Wisdom of Employment Testing," Supervision, February 2004, Volume 65, Issue 2, 11-13.

Screening the Candidates

The résumé of a candidate serves as the first screening tool in most organizations. However, except for providing information about the candidate's educational qualifications, his experience, and family background, the résumé serves no useful purpose in helping a sales manager to make the actual selection decision. Moreover, the varying formats in which the résumés come in make it all the more difficult for sales managers to adopt a uniform approach to compare résumés of various candidates.

Therefore, most organizations adopt the process of using the résumés to select those candidates who match the organizations' requirements and thereafter, ask these candidates to fill in a comprehensive standardized application form, which makes it easier for the sales manager to compare the candidates.

Selection Test

Tests serve as a selection tool to assess a potential employee's skills and abilities. Although tests help to weed out inappropriate candidates, they are not the most accurate and foolproof method of selecting the perfect salesman. The results of the selection test should not be the only criteria on the basis of which the hiring decision is made but should be supplemented with personal interviews and reference checks.

Organizations use different types of tests depending on their requirement. For example, International Business Machines (IBM) uses skill and aptitude tests to select people for entry-level jobs in the organization. Due to the difference in candidature requirement, the selection test conducted by an organization responsible for maintenance of law and order is quite different in its pattern and content from that conducted by a sales organization. Exhibit 11.3 describes the type of selection test administered to a candidate wanting to join a law and order department in the US. Further, although tests happen to be the most expensive selection tool, the benefits that can accrue to organizations by using tests as a selection tool far outweigh the costs incurred in conducting them.

Selection tests may be of various types such as personality tests, honesty tests, job knowledge tests, psychomotor tests, proficiency tests, cognitive ability test, polygraph tests, and interest tests. The tests that are particularly applicable to sales organizations include personality tests, honesty tests, and psychometric tests.

Personality tests

Personality, as defined in the dictionary, is a complex of all the attributes – behavioral, temperamental, emotional, and mental – that characterize a unique individual. Personality explains how a person is likely to think, feel or act in different situations. Personality tests evaluate a person's attitude, thoughts, emotions, and behavioral traits. Personality tests help organizations identify disturbances, if any, in the personality of a prospective employee. There are two types of personality tests – objective tests and projective tests. Objective tests have a very restricted format and allow the candidate to give only 'true' or 'false' as the answer to the questions asked. Projective tests, on the other hand, give the candidate a choice to choose between a set of options. The Myers-Briggs Personality Test is a well-known and commonly used personality test in many organizations.

Although personality tests are not foolproof methods of selection, they are quite effective in predicting how the individual would perform on the job. Personality tests also help organizations identify those traits of an individual's personality that may be difficult to identify during the personal interview.

Honesty tests

Honesty is one of the personality dimensions measured while selecting a salesperson. In a study of job analysis conducted for the Canadian Life Assurance Company by Life Insurance Marketing and Research Association (LIMRA), it was found that insurance companies rank honesty as the most important personality trait in selecting life insurance personnel.

Honesty tests became a popular alternative to polygraph tests after 1998 when the latter were ruled as unconstitutional except in special cases. Honesty tests comprise of a set of statements to which the candidate agrees or disagrees. Responses to these statements indicate the honesty of the candidate. These tests are relatively inexpensive and can be even administered and responses obtained over the telephone. Honesty tests are popularly used in organizations where employees have access to cash or valuable items.

In addition to personality tests and honesty tests, other tests used by organizations to recruit potential employees include job knowledge tests, psychomotor tests, proficiency tests, cognitive ability test, polygraph tests, and interest tests. Job knowledge tests test the candidate on specific job-related knowledge that is required to perform the job successfully. Psychomotor tests test the candidate for strength, dexterity, and coordination and are used for the recruitment of drivers, pilots, and crane operators. In proficiency tests, candidates are screened with the help of a sample of the work involved in the job. Cognitive ability tests test the knowledge base of the candidate along with his learning and problem-solving ability.

Psychometric tests

The word 'psychometric' consists of 'psycho' that is, the mind, and 'metric,' which means to measure. Thus, psychometric tests measure the mind of an individual and are also known as psychological tests. These tests are designed to test the candidate for skills, abilities, interest, aptitude, and aspects of the candidate's personality such as, the candidate's strengths and weaknesses, propensity of the candidate to act, react, or behave in a particular manner.

There are two types of psychometric tests, those that measure aptitude, and personality questionnaires that evaluate the personal qualities of the candidate.

Psychometric tests are believed to help organizations select candidates having the right mix of abilities and personal qualities. These tests are believed to help accurately predict whether a particular candidate is suited for the job and whether he or she will be able to do the job well or not. These tests, therefore, are particularly useful for selecting salespersons because not all people have the flair or aptitude for selling. Making a careful choice while selecting a candidate helps an organization avoid wastage of time, money, and effort in the selection process. However, psychometric tests are not used singly and are used along with other traditional selection tools such as, personal interviews.

Background Check

The purpose of background checks is to screen out undeserving and undesirable candidates. Background checks help organizations reduce their cost of hiring, reduce employee turnover, and avoid hiring candidates with a bad repute.

In many organizations, the background check precedes the personal interview stage in the selection process. Background check is the stage in which employers investigate about the background of the potential employee from the references provided by the candidate in his résumé. In background checks, organizations check the credibility of the references and try to ensure that the information provided by the candidate regarding his work experience, qualifications, and salary is correct. Background checks are also known as reference checks.

References may be both professional references as well as personal references. Professional references place the candidate in a vulnerable position especially, if the previous employer is biased in his opinion about the candidate. In such cases, there are chances that the previous employer may speak ill about the candidate, which may have a negative influence on his selection in the subsequent organization. However, the sales manager making the background check should be judicious in evaluating the feedback provided by professional references, more so, if the feedback about the candidate happens to be negative, because many times, even good performers are dismissed for no fault of theirs. Further, while taking the feedback from personal references, the sales manager should seek feedback from people who are not too close, so as to lie in favor of the candidate, but close enough to give an objective feedback about the candidate. Former colleagues and neighbors are a good example of people who can be contacted for personal references.

Personal Interview

In many organizations, a potential employee is called for a personal interview only after he or she clears the background check. A sales manager may adopt a structured or an unstructured approach for conducting a personal interview. In a structured interview, the interviewer asks the candidates, questions that have been framed beforehand and are aimed to test the candidate’s knowledge, skills, and ability. In an unstructured interview, the interview does not follow a predetermined course. The interviewer does not follow a set pattern. The interviewer frames the questions depending on the answers given by the candidate. The unstructured approach of conducting a personal interview gives the interviewer a lot of flexibility regarding the aspects on which to interview the candidate.

During the personal interview, an interviewer assesses the communication skills, confidence level, and decisiveness of the candidate during the early stages of the interview, and forms a decision about the candidate. For the rest of the interviewing time, the interviewer tries to support his decision about the candidate.

The personal interview technique of selection has, however, been criticized for being biased in nature. It is alleged that interviewers judge the candidates on the basis of the stereotype model of an ideal salesperson they have in their minds. Despite these criticisms, the personal interview technique is not without its utility. The assessment of a candidate's appearance, voice, and oral communication skills can be achieved only through a personal interview. Moreover, the personal interview also helps in determining whether the goals and aspirations of the candidate are congruent with that of the organization.

Many organizations conduct a second interview of the candidate before making the selection decision. The purpose of the second interview is to secure information that may have been missed during the first interview, such as gaps in the career path of the candidate and non-availability of background information. The second interview is the stage in the selection process when benefits and compensation package for the job are negotiated.

Companies such as, Nike are using a new computer assisted technique of interviewing, to select potential employees. In this technique, a candidate is shown three scenarios of a selling situation depicting a salesperson assisting a customer. The candidate is then asked to identify the ideal selling scenario. The candidate's choice helps the company determine his strengths and weaknesses.

Letters of Recommendation

There are chances of a candidate presenting false information about himself in his resume. Thus, letters of recommendation may also form a part of the selection process in some organizations. They describe the candidate from one more perspective – the perspective of someone who knows the candidate well and who is familiar with the candidate's background. Recommendations describe the candidate in general terms and by giving examples of specific incidents, the writer helps enhance the positive image of the candidate. The chance occurrence of a negative comment regarding the candidate in the letter of recommendation is not expected to harm the interest of the candidate as these letters are essentially documents of appreciation about the candidate and the occurrence of one or two negative comments fail to have an impact on the evaluator.

Physical Examination

A physical examination forms an essential part of the selection process for most organizations. The physical examination of a candidate helps the organization ensure that the candidate is physically fit to carry out the duties involved in the job for which he is being selected. The physical examination also helps the organization ensure that the candidate is not suffering from any debilitating illness that could increase the cost of medical claims of the organization in the future.

A qualified medical practitioner appointed by the company or someone approved by the company conducts the physical examination of candidates selected by it.

Making the Employment Offer

The last stage in the selection process involves making the employment offer to the candidate. The offer letter communicates to the candidate all details regarding the job including the start date, the term of contract, salary, benefits, the tests required to be undergone prior to joining, and all other terms and conditions pertaining to the employment contract. The employment offer, if accepted by the candidate, results in an employment relationship between the candidate and the sales organization.

IMPORTANCE OF SALES TRAINING

The success of an organization depends on the effectiveness of its sales force to convince customers to make the purchase. As sales force performance has a significant impact on the bottom line of an organization, it is necessary for sales managers to ask themselves how they can improve the performance of their sales force personnel. Very few salespeople have an inborn talent to sell. Not all salespersons are effective. Many acquire the art of selling through proper training. The purpose of a sales training program is to increase the effectiveness and productivity of the sales force and to refine its selling techniques.

The importance of training sales force personnel in an organization can be gauged from the fact that on an average, US companies spend more than $7.1 billion annually on sales force training. In fact, in any organization, the maximum allocation of training expenditure goes for the training of its sales force. Also, on an average, a salesperson spends up to 37 hours per year in training programs. In comparison to any other occupational category, salespersons receive the maximum amount of training.

TYPES OF SALES TRAINING

Sales training may be of various types depending on the timing and the target audience. Sales training may range from initial training given by an organization to its sales force, follow-up training or refresher training, training on product information given by the manufacturer to the distributor's sales force, and training on product usage given by the manufacturer to the customers.

The type of training offered by an organization also varies with the experience possessed by the recruit. An inexperienced fresh recruit requires training on all aspects of the organization such as, the company's history, policies and standards, product information, manner of use of the company's systems, and is even trained for attitude. An experienced person, on the other hand, requires to be trained in technical information pertaining to the product, systems and processes of the company, and how they provide the company with a competitive advantage over its competitors.

Initial Sales Training

Training in sales is not intended for those who have a natural flair for selling or who are super salesmen. These types of sales people will be successful, with or without any kind of training. Nevertheless, training will surely help them refine their skills further, as these types of people know how to utilize every opportunity they come across.

Sales training is also not intended for those who are unwilling to transform themselves into successful salespersons. No amount of training can improve sales people who are just not ready to make an effort at improving themselves. Training in sales, in fact, is meant for those who fall somewhere in the middle of these two types of sales people. These are the salespersons who have moderate selling skills but are willing to put in extra efforts to become successful salespersons. These are the people who can become super sales people with some help, encouragement, and supervision from the organization.

However, it is tough for an organization to decide early on, whom to offer training and whom not to. At the early stage, the sales organization cannot judge who among the new hires will become a successful salesperson, who will be moderately successful, and who will turn out to be a failure. Hence, organizations offer initial sales training to all new hires chosen for the job of selling. The initial sales training comprises of training modules wherein all the knowledge necessary to perfect the art of selling has been put together by the trainer.

Exhibit 11.4

Duration of a Sales Training Program

At Time Recorders Unlimited, a US-based company that sells time and attendance software and hardware to manufacturing companies, salespersons have to undergo the mandatory on-the-job training for an entire year. Even after completion of the training period, the salesperson undergoes continuous training in the form of weekly meetings.

The company's philosophy in having a training of such a long duration is to prevent any of its sales people from venturing into the field without having complete knowledge about the product. The company tries to ensure that salesmen should not promise more than what the company can deliver. By maintaining such a philosophy, the company has been successfully able to increase its sales by 35% each year. As a part of the training, each salesperson spends an equal amount of time in the service, support, and installation departments to gain in-depth knowledge about the product.

The company places great emphasis on handling support issues. This is evident from the fact that every new salesperson spends six weeks of his training, in the company of the telephone support staff and listens to the calls received by them. This makes the salesperson well versed with the support activities associated with the product and enables him to handle support questions during sales calls. Also, having spent a considerable time of their training period in installation and due to their familiarity with the installation process, the salesmen actually lend a hand during the installation of the product at the customer's location.

Thus, the training being provided by Time Recorders Unlimited is quite unlike traditional training programs. The company aims to achieve long-term growth by maintaining customer relationships and encouraging referrals. The company obtains a majority of its business from referrals on the basis of its successful handling of the support and service functions.

Adapted from Lisa Kerner, 'The Benefits of a Sales Training Program,' Business Solutions, November 1998, <http://www.businesssolutionsmag.com/Articles/1998_11/981105.htm>

The duration of initial sales training in various organizations ranges between 3 and 9 months. Studies have shown that the training tends to be ineffective if it is for a lesser duration than 3 months. Likewise, training beyond the duration of 9 months also fails to bring about any further improvement in performance than what can be achieved within the duration of 9 months. Exhibit 11.4, however, describes the training program in a company (Time Recorders Unlimited), in which the duration of the training is quite unlike that in most companies.

In addition to initial sales training, a new hire is also trained through field supervision. A new hire may be directly put into the field and made to accompany either a sales manager or an experienced salesman for sales calls. During these sales calls, the newly hired salesperson acquires training by field supervision. Both initial training as well training by field supervision may be imparted by the sales manager or by a professional sales trainer.

Follow-up or Refresher Training

Sales personnel need to acquire new skills and knowledge to be successful in the competitive world. Therefore, it is necessary that they are trained continuously. It is not enough for organizations to provide their sales force with initial sales training and consider it as an end of their responsibility.

In most organizations, it has been observed that sales people tend to forget most of what they have learnt in the training program when they go back to their job. In a survey conducted by Sales Performance International (SPI), a Charlotte, NC based consultancy and training company that offers services in sales process, sales management systems and sales force automation, it was found that sales force tends to

Exhibit 11.5

Sales Training at Chrysler

The sales training at Chrysler aims at training the sales force of local dealers to improve their selling process. The DaimlerChrysler Academy team, responsible for providing the training, visits each of the dealers and holds 'Effective Delivery Presentation' workshops for their sales force to help them improve their skills in selling the various products manufactured by Chrysler (Alberic Chrysler, Dodge, the Jeep, etc).

The trainers from the academy train the salespeople of the dealers on effective delivery of the sales talk and recommend tools and techniques to improve the selling process. The on-site training thus provided by the manufacturer to the sales force of its dealers takes place on a quarterly basis and helps them improve their selling skills and secure recognition in the form of gold, silver, or bronze certificates.

Adapted from "Chrysler Offers Sales Training," Caribbean Business, October 2, 2003.

forget over half of what it learnt within 5 weeks of completion of training. The survey covered a sample of over 6000 sales professionals. Another study conducted in the 1970s at Xerox Corporation found that 87% of the skills acquired by sales people during training tend to be forgotten within a month of training.

In order to ensure that the sales people are implementing and making use of the learning they gained in the training program, companies need to reinforce the skills and knowledge imparted in the initial sales training by conducting follow-up or refresher training programs. Follow-up training allows sales organizations to update their sales force with the most current information on selling techniques and to address grey areas of training imparted during the initial training program. General Electric (GE) provides classroom training of 20 days in a year to its sales force and ensures that their product knowledge is up-to-date. The training also ensures that the salespersons deal with their customers correctly. The healthcare industry is known for its volatile changes. Therefore, Merck ensures that its sales force has complete medical information about all the products they sell by providing them with 3 months of initial sales training followed by regular refresher courses.

Further, refresher-training programs should be held in coordination with the sales managers to ensure that the training programs are relevant to the requirements of the sales organization. This will also ensure that the time spent by the sales force away from the field is productively utilized.

The frequency and relevance of follow-up or refresher training programs determine how well salespersons implement and make use of the learning they acquired during the initial sales training. Reinforcing this learning by means of refresher training helps organizations ensure that salespersons adopt such techniques in the field. In this way, organizations manage to successfully obtain the maximum return on investment from training programs.

Training by the Manufacturer to the Distributor's Sales Force

Manufacturers often provide training to their dealers' or distributors' sales force to equip them with product information. Chrysler offers sales training to the sales force of its dealers (refer Exhibit 11.5).

Training by the Manufacturer to the Customers

Manufacturers may also provide training to customers on product usage. This type of training is common in the case of heavy equipment and electronic items. Providing training to customers helps a company build long-lasting relationship with them and attract repeat business. A US-based company, Global Imaging Systems, which manufactures office equipment, provides its customers on-site training to make them well versed and comfortable with the use of the equipment. ICB, an audio and video equipment manufacturer, is another example of a manufacturer who provides its customers with training on product usage at its Tennessee Avenue facility. The company also provides training to its customers at the installation site after completion of the installation.

BENEFITS OF SALES TRAINING

A super salesman is one who possesses complete knowledge about the product or service he is selling and complements the knowledge with his superior selling skills. A poorly trained sales force, on the other hand, lacks product knowledge and the desired selling skills. The failure of a company to properly train its sales force results in the sales people adopting a trial-and-error method of selling. This has an adverse impact on the company's image and affects customer relations. Inadequate training leads to the poor performance of the sales force. By providing proper training to the sales force, a company can increase its effectiveness and productivity. Moreover, proper training makes the salespersons more confident and enthusiastic about their jobs. This is reflected in their performance and they become more convincing and confident during their sales talks. This, in turn, enhances the company's image and improves customer relations.

Sales training motivates the sales force to perform even better. It makes the sales people feel useful, valued and important. It builds in them a loyalty towards the organization and plays a role in bringing down sales force turnover. Thus, companies, in a way, try to address their growing concern for sales force turnover by providing sales training. By providing proper training to their sales force, companies help them in their efforts to earn more commission by selling more of the products or services. The higher earning capacity and satisfaction that training provides, reduces the urge among salespersons, to change jobs.

Sales training becomes all the more essential for selling complex products like sophisticated equipment, turbines, and control and relay panels. Selling of complex products requires meticulous planning and effective execution of the plan. And this, does not come under the forte of an average salesperson, but requires proper training. Thus, sales training helps salespersons accomplish the sale of complex products successfully and speedily.

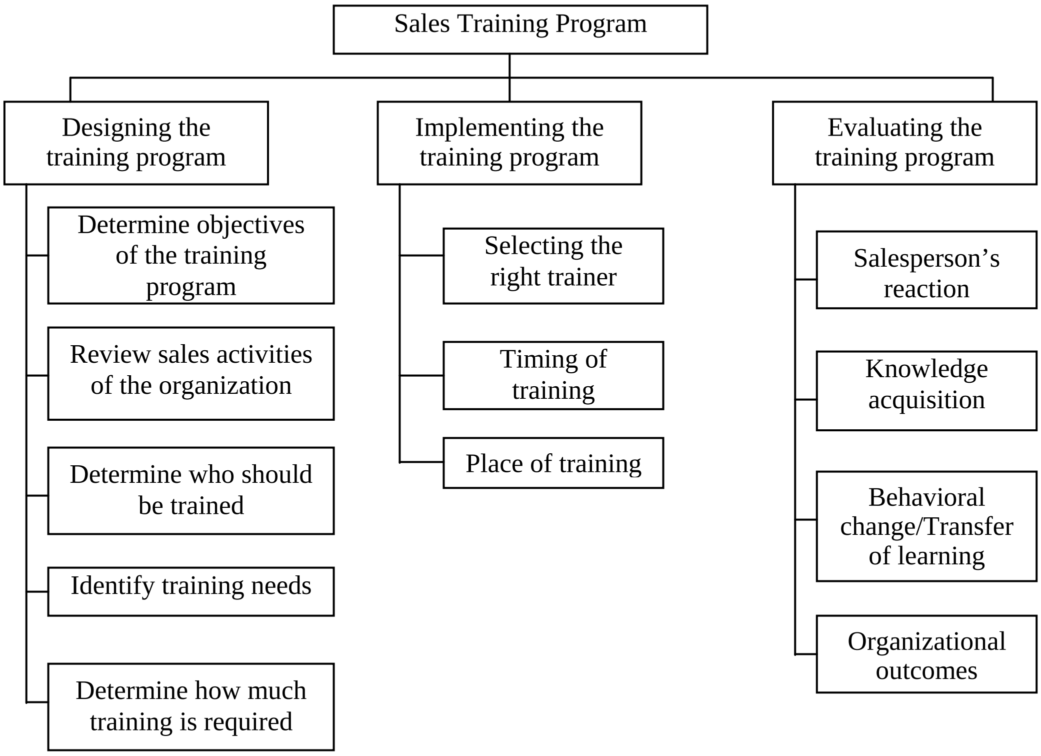
SALES TRAINING PROGRAMS

Training programs for sales personnel help organizations increase the productivity and effectiveness of their sales force, which in turn increase the profitability of organizations. A sales training program consists of three components: designing the training program, implementing the training program, and evaluating the training program. Figure 11.3 gives a schematic representation of the components of a sales training program.

Designing the Training Program

Training programs need to be properly designed so that they help in achieving organizational objectives. The purpose of a well-designed training program is to minimize the time sales people have to be away from the field and maximize their performance. An effectively designed training program is characterized by an appropriate mix of classroom instruction, self-paced learning using the e-learning mode and mentoring or coaching.

Figure 11.3 Components of a Sales Training Program



While designing a training program, various aspects are taken into consideration. First, a consensus should be obtained among all the key decision-makers of the organization regarding the training objectives. A training program may have diverse objectives. It may aim to increase sales or increase profits. A training program's objective may even be to open new distribution channels or simply new account penetration. Thus, while designing a training program, the key decision-makers in the organization should arrive at a consensus regarding the objectives of the training program. Other areas of concern that need to be addressed by the decision-makers while designing the training program include review of the existing performance standards, appraisal system, compensation plan, the organization structure, products or services, current competitors, sales cycle of the company, optimum level of sales activity, and techniques being used to measure the sales force performance. Sales activities include various activities that comprise a part of the selling process, which help convert a lead into a sale. These include making sales calls and follow-up calls.

The next stage in designing the training program involves a review of the various sales activities involved in the company's sales cycle and prioritizing them according to their importance in converting a lead into a sale. These activities are then reinforced in the training program according to their priority.

A crucial factor to be considered while designing the training program is that the training program should relate to the actual selling situation in order to be accepted by the sales force. The credibility of a training program depends on how closely it reflects the actual selling situations. This requires close observation of the salesman and the customer in the selling situation. By observing the selling team in action, the trainer can obtain an understanding of the selling environment in which the selling team performs. This allows the trainer to provide a realistic portrayal of the salesman and the customer in hypothetical selling situations, which form a part of skill practice sessions of a training program.

Implementing the Training Program

A well-designed training program is not sufficient to increase the effectiveness and productivity of the sales force. The training program also needs to be effectively implemented, if it is to achieve its intended objectives. The implementation of a sales training program involves extensive planning of the ‘who’, ‘when’, and ‘where’ aspect of training.

Selecting the right trainer

Organizations face a dilemma over who will train the sales force. To provide training to its sales force, an organization may either hire a sales training expert or may decide to entrust the task to someone in-house, for example, the sales manager or an experienced salesperson. There are advantages and disadvantages associated with each of these forms of training. A professional trainer is an expert in the subject, thereby making the training more effective. However, hiring a professional sales trainer has its disadvantages. It is an expensive option and sometimes, it may be difficult to customize the training program as per the company needs. As the professional expert is not a part of the organization, it may be difficult for him to relate the training to the cultural and other non-technical aspects of the organization. On the other hand, the training given by a sales manager is more customized to the needs of the organization and a thorough evaluation of the trainee is possible. However, the disadvantage associated with this form of training is that the sales manager is unable to devote adequate time to train his subordinates. Also, not all sales managers have the ability to train. The third type of training is the one imparted by an experienced sales person within the organization. In this type of training, the organization is able to allocate more time as well as resources for the training. The trainer too has good training skills and the training is customized to suit the needs of the organization. However, the training lacks credibility due to the in-house trainer’s lack of authority to make any changes to the training program.

The timing of the training

A sales person may be given training immediately soon after he is hired or the training may be delayed by a certain period. Both these approaches have their own advantages and disadvantages. The purpose of giving immediate training to the sales person is to ensure that the sales person is fully trained before being sent on to the field. Another reason for imparting immediate training is to avoid losing customers by exposing them to untrained or poorly trained sales persons. On the other hand, by delaying training of sales persons by a certain period, a company can drop the persons who are not suited for sales and train only those who have the potential. Also, delayed training makes it easier to train the sales persons because by the time of the training, the sales persons would have acquired at least some field experience. This makes it easier for them to grasp what is being taught to them in the training modules. Both these types of training come under the category of initial sales training.

Apart from the initial sales training, a sales person also needs to be trained at regular intervals to reinforce the learning that has taken place during the initial sales training. This form of training is known as refresher, follow-up or continuous training and is a means by which organizations continuously upgrade the skills and knowledge of their sales force. Depending on the training need identification method, an organization can decide the timing for trainings. In some organizations, quarterly performance reviews are conducted mainly to identify the training needs of the employees. They develop a quarterly schedule for training programs.

The place of training

Training programs may be conducted at a central point such as the head office or they may even be conducted separately for individual branch offices. The former is known as centralized training while the latter is termed as decentralized training. Both these types of trainings have advantages and disadvantages. In centralized training, the training is imparted at the home office and allows the sales representatives to interact with the home office personnel. Moreover, the training is more specialized and usually a qualified sales training expert is invited to conduct the training program. This makes the training more effective. In centralized training, the sales representatives have a totally focused approach since they realize that the only reason for them to be at the home office is to acquire training. However, centralized training is expensive and cannot be conducted for a long duration due to the expenses involved both in conducting the training as well as in keeping so many sales representatives away from the field for the entire duration of the training period. Also, keeping the sales people away from their family during the training period often affects their morale.

On the other hand, decentralized training or training conducted at the branch offices is less expensive and doesn't require the sales representatives to move to other location (such as headquarters) for training. Moreover, the sales manager can also play a role in the training program making it more relevant to the actual conditions on field and thus more effective. Training at the branch offices can be held for a longer duration of time because the timing can be selected on the basis of convenience to the sales force so that the effect on their work schedules is minimal. However, decentralized training may not be taken seriously and fail to retain the focus of the sales persons. This may make a waste of the company's efforts to train its sales people.

A company may offer training not just to its sales representatives but also to its dealers and customers. While the training given to the sales representatives and dealers is aimed at improving their skills in selling the company's products or services, a company offers training to its customers to make them comfortable in using the company's product.

Many companies like Sony, Panasonic and Hitachi offer more than one type of training which depends on who the company is targeting for the training (sales persons, customers or dealers) and also on the need of the situation. Let us now discuss the various types of training that can be offered by a company.

Centralized training

The training may be conducted at certain centralized locations and the company brings together its sales personnel or the customers at these locations to train them. This method of training is known as centralized training. Panasonic Broadcast & Television Systems Company uses the centralized training method for its customers across the US. The company has its regional training centers at four locations across the US –California, Georgia, Illinois, and New Jersey, the location of the US headquarters of the company. With the launch of every new product, the company ships and installs the product at these regional training centers. Using the centralized training method, the company successfully trains about 500 customers per year at these training centers. Sony is yet another company which offers centralized training programs to its customers at California, its US headquarters, and at its sales offices located at Florida and New Jersey.

Third party training

In this type of training, manufacturers assign the responsibility of training to a third party. Often these third party training companies offer training programs to more than one company. For example, Future Media Concepts (FMC), an independent training company in New York, offers training programs ranging from basic to advanced, to Microsoft/Softimage, Avid Technology, Quantel, and Adobe Systems products. Third party training companies provide manufacturers with the advantage of providing impartial training to the users as well as the ability to train a large number of customers than would have been possible for the manufacturer.

Training tours

Most training programs involve the customers approaching the trainer or instructor for being trained. Training tours, on the other hand, involve the instructor or the trainer going to the customers. As part of training tours, the manufacturer conducts seminars and workshops in local hotels for the convenience of the customers.

On-site training

In on-site training, manufacturing companies send an authorized instructor to the customer's facility to train the customer in the use of the product. This method of training is suited for those customers who are too busy with their schedules to be able to attend the training programs or workshops conducted by the company. Hitachi is one such company, which provides on-site training to its customers. The purpose behind providing this type of training is to avoid fetching bad reputation for the company due to the customer's ignorance in using the products, which can lead to operational errors. Sony is another company, which provides on-site training to its customers at their retail locations. The company also sends its retailer advance study material and pre-class exercises so that the duration of the training period can be utilized for acquiring hands-on experience about the product.

Training through postal material

Another way companies can train their customers is by sending the customers instructional material about the product either in the form of printed matter or in the form of videotapes. Companies like Tektronix and Hitachi practice this method of training. These companies dispatch how-to videotapes to their customers. These tapes assist customers not only in learning more about the product but also in providing them the support in case of any problem with the product.

Satellite-delivered training

Some companies provide training to their dealers, service centers and customers through satellite-based services. Panasonic, for example, set up the Panasonic Academy of Learning to provide training to its dealers and service centers located across USA through live and pre-recorded training programs beamed via satellite.

Online training

Due to the sluggishness in the economy, companies are beginning to slash their budgets to avoid unnecessary expenditure. As a result, one of the first areas to get affected is the training. However, studies have revealed that in those companies where training is still considered essential, about 66% of the sales force travels to the venue of the training leading to an increase in expenditure for the company. Therefore, companies have come up with a viable option in the form of training their sales force through online learning or e-learning. In e-learning, companies host technical and educational material on their websites. This material can be accessed by sales people or customers from anywhere in the world. Online training or e-learning also provides the facility of videoconferencing and multimedia thereby making the training more interactive learning experience. This method of training helps companies avoid having to withdraw their sales force from the field for days together, in order to train them. This kind of training involves less cost to the company both in terms of training costs as well as cost due to lost man-hours. Online training results in significant cost savings to the company, although the initial costs of setting up the system are high.

However, despite the cost savings, most companies are reluctant to adopt this method of training due to the fear of loss of face-to-face interaction. Companies that have adopted the online method of training include Sony, Tektronix, Panasonic, and Chyron.

Evaluating Training Programs

Companies across the world spend a large amount of their resources on sales training. As a result, a formal evaluation of the training programs is usually desired to justify the expenditure that goes into them. Evaluation also helps a company objectively examine whether its training program has been successful in accomplishing the objectives. Although sales training evaluation is of immense importance in organizations, most of them fail to adequately evaluate their training program. Moreover, there is a lack of understanding among firms on how to measure and evaluate the effectiveness of their training programs.

Companies use a variety of evaluation procedures to evaluate their training programs. These range from evaluating feedback forms obtained from the trainees, to informal debriefing sessions, to actual calculations of the increase in sales revenue as an outcome of sales force training. Debriefing sessions are those, which are held after the completion of a process and are aimed at reviewing the process and coming up with corrective measures wherever required. These differ from briefing sessions, which are held before a process is initiated. In the case of sales management, debriefing sessions are held by the sales manager to review the progress made by a sales representative regarding a particular sales account.

The most widely accepted approach to evaluate sales force training is the Kirkpatrick's four-stage model of sales force training evaluation. This model evaluates the training program on four levels, namely, reactions, knowledge acquisition, behavior change/ transfer of learning, and organizational outcomes.

Salesperson's reaction

Reaction refers to how the participating salespeople perceive a training program and the various aspects pertaining to it. The training program may be liked by some of the participants thereby motivating them to learn more, use the training material, and participate in future training programs. Some participants, on the other hand, may dislike the training program and fail to use the training methods and the material, thereby making the training ineffective.

The use of participants' reactions as a criteria for evaluating the effectiveness of training programs has been criticized for its tendency to be influenced by extraneous factors such as, the training venue, the trainer's personality, and whether or not the participants appreciate being away from the field for training.

Knowledge acquisition

Evaluating sales force-training programs on the level of knowledge acquisition measures the acquisition and retention of knowledge by the sales force at the end of the training program. The methods adopted to measure knowledge acquisition vary with the objectives of the training program. When the training objective is to impart information to the salespeople about the product, competitors, market dynamics or economic conditions, the acquisition of knowledge by the participant can be measured by means of a paper-and-pencil test. On the other hand, if the training objective is to teach certain skills or impart procedural knowledge to the participant, then along with paper-and-pencil tests, behavioral evaluation through role-plays and other methods are also used to measure knowledge acquisition by the participant.

Various approaches may be adopted to measure the acquisition and retention of knowledge by the participant. One, the knowledge level of the participant may be measured before and after the completion of the training program to assess the difference in knowledge level that can be attributed to the training program. A second approach of measuring knowledge is to only measure the post-training knowledge of the participant. There are also some firms which are not interested in knowing the degree of learning that has taken place over the course of the training program but instead, prefer only to know the extent to which the participant has reached a certain level of knowledge attainment.

Behavioral change/Transfer of learning

Training should ideally result in a transfer of learning thereby leading to a change in behavior of the sales person. Sales training programs are evaluated by measuring the extent to which there is a change in behavior of the sales person as a result of the training.

Behavioral change or the transfer of learning is influenced by three factors – the work environment, characteristics of the trainee, and the retention of learning by the trainee. Transfer of learning can take place only if the trainee is self-motivated and willing to implement what he has learnt in the training program. For the transfer of learning to take place, it is also essential that the trainee understands what is to be done and how it has to be done. Further, the sales management has an important role in ensuring transfer of learning. The sales management should provide a supportive environment by encouraging and helping the trainee implement the learning and by reinforcing the desired behavior in the trainee by means of rewards.

Change in behavior can only be measured through observation. In comparison to a sales trainer, a sales manager is in a better position to observe the change in behavior of a sales trainee by accompanying the trainee on joint sales calls. Thus, the three possible ways to measure behavioral change in a salesperson as a result of training include observations made by the sales manager during joint sales calls, self-assessment by the salesperson, and analysis of the salesperson's diaries and logs.

Organizational outcomes

At this level, the training program is evaluated for the extent to which it helps contribute to the achievement of organizational objectives. Researchers vary in their opinion regarding the ease or difficulty of evaluating training programs based on the organizational outcome level. Researchers, who opine that it is difficult to evaluate training programs based on organizational outcomes, attribute the difficulty in measurement to three factors.

First, the autonomy that sales force enjoys in the field makes it difficult to measure their behavior. Second, it is difficult to study the influence of extraneous factors on organizational outcomes, and third, it is difficult to assign dollar value to aspects such as improvement in customer satisfaction, salesperson loyalty, etc.

SUMMARY

Hiring is a personnel function that consists of various stages such as the recruitment of candidates with the right qualifications, selection of those who match the organizational requirements, and placing them in a suitable position in the organization. The quality of a company's sales force plays a crucial role in determining the ability of the company to compete and survive in the competitive business environment. While super salesmen can increase a company's revenue significantly, poor performers can hinder the company's growth and drive it towards losses.

The greatest challenge faced by all companies is to be able to hire the best talent and to be able to utilize that talent to achieve organizational objectives. Recruiting the wrong person costs a great deal to a company in terms of recruitment cost, cost of placing advertisements, cost of screening potential candidates and interviewing them, assessing, placing and training them after selection. In addition to these costs, the company also has to bear the cost of paying them a salary at least till the time they are asked to leave the organization. Reimbursement for the sales expenses incurred by such sales persons is yet another cost which has to be borne by the company. A greater area of concern is the opportunity cost that is involved in hiring an unsuitable candidate for a position and missing out on the profits that could have been generated by the company by hiring a competent person instead.

An ineffective salesman can cause great damage to the company's reputation due to his poor product knowledge, failure to serve the customer properly and poor selling techniques which only tend to alienate the customers.

Companies seek specific characteristics in a potential salesperson. These characteristics are clubbed together into two categories - mental aptitude dimensions, and personality dimensions. The mental aptitude dimensions of salespersons include mental alertness, business terms and memory recall aptitude, communication skills, numerical ability and mechanical interest. The personality dimensions, on the other hand, include honesty or character strength, sociability, cynicism, high energy levels, dominance, competitiveness, emotional maturity, work habits, and work motivation.

Salespersons are hired on the basis of the satisfactory fulfillment of a company's requirements. The selection process for hiring a salesman involves a number of stages. These include sourcing the candidates, screening the candidates, conducting the selection test, holding personal interviews, checking letters of recommendations, conducting reference checks, physical examination, and making the employment offer.

Once a suitable candidate has been hired for the position of a salesman, the candidate needs to be properly trained to increase his effectiveness and productivity in selling. Sales training is of four types - initial sales training, refresher or follow-up training, training offered by the manufacturer to the sales force of its distributor and training offered by the manufacturer to its customers. Sales training offers several benefits, both to the sales persons as well as to the organization. These benefits range from decrease in sales force turnover, enhanced morale of the sales force, to improved company image and customer relations.

Sales training programs consist of three components: designing the training program, implementing the training program and evaluating the training program. The designing of training programs should be done keeping in view the organizational objectives. However, a company's efforts must not just end with designing a training program to achieve its objectives. The company must also take measures to implement the training program effectively so that it helps the company achieve its objectives. The implementation of the training program takes into consideration issues such as – Selecting the right trainer, timing of training, place of training, etc. Looking at the large amount of expenditure that companies incur to train their sales force, evaluation of training programs becomes essential to justify this expenditure and to objectively examine whether the training programs have been successful in accomplishing their objectives. Kirkpatrick's four-stage model of sales force training evaluation is the most widely used method of evaluating training programs and evaluates the training program on four levels, namely, reactions, knowledge acquisition, behavior change/ transfer of learning, and organizational outcomes.

Chapter 12

Time and Territory Management

In this chapter we will discuss:

- Time management and its importance
- Territory management and its importance
- Criteria for territory design
- Methods of designing territories
- Procedures for developing territories
- Operating the territory management system

"Time is the scarcest resource of the manager, if it is not managed, nothing else can be managed."

- Peter F. Drucker

One of the most precious things in life is time. Time once lost cannot be regained. Whether it is a CEO of a company or a shoeshine boy, everyone has the same twenty-four hours to carry out his work. How the available time is utilized determines the success of an individual.

For businesses, time is money. Time is of utmost importance in business. It is of particular importance for sales people. Therefore, managing time skillfully should be one of the most important activities of a salesperson. The productivity of the sales force can be improved by developing effective strategies for time management.

In this age of the Internet and mobile communications, the time required for communicating has reduced drastically. While earlier it took at least a week for a letter to reach a foreign destination, one can now communicate in real-time with the help of the Internet. Similarly, the increasing use of cell phones has done away with the need for people to wait in long queues at public phone booths to make a call when outside their home or office. Thus, advancements in technology have dramatically transformed the way people spend their time.

Modern firms consume just a fraction of the time it once took traditional organizations to perform various activities. Paradoxically, however, technological advancements have also put immense time pressure on salespersons, who now have tighter deadlines to meet. He has to efficiently manage his time to improve his performance and productivity.

Better time management becomes possible when a salesperson assesses his work and the time consumed by various tasks. By focusing on certain critical activities and letting others in the organization handle trivial tasks, a salesperson can judiciously allocate his time to the most productive actions. Exhibit 12.1 describes the various critical activities that a salesperson needs to focus on for utilizing his time effectively. In order to manage time resourcefully, crucial and bigger tasks should be given more importance than smaller and less important ones. Let us consider an analogy to understand this concept more clearly. Take a bucket and fill it with big stones. Then put in smaller pebbles and later sand, followed by water. By filing the bucket in this way, ultimately it will be tightly packed with stones, pebbles, sand and water, without any gaps in between. Now try filling the same bucket the other way round. First, fill it with water, and then put in sand, pebbles and big stones. It will be easily seen that the bucket is not tightly filled using the latter method. From this analogy, we understand that larger tasks should be given priority over smaller ones for effective time management.

TIME MANAGEMENT AND ITS IMPORTANCE

While planning activities in advance will help salespersons to efficiently managing their time, the plan should be flexible enough to accommodate necessary changes. Exhibit 12.2 provides tips on time management.

In addition to efficiently managing his sales time, a salesperson also needs to know how to manage his scrap time, that is the bits and pieces of his time that get wasted in unproductive activities. Exhibit 12.3 discusses the ways in which a salesperson can efficiently manage his scrap time.

Exhibit 12.1
Critical Activities that Salespersons Need to Focus on

Focus on important aspects: Salespeople are involved in various activities, such as routine paperwork, preparing quotations, responding to customer queries etc. Devoting time to issues such as customer queries or sales quotations results in wastage of a lot of valuable time which could have been productively utilized to make sales calls.

Accept the need for change: When salespeople develop a routine way of life, they get so used to it that they do not like to change and make additional efforts to achieve more than what they are currently doing. This urge to maintain the status quo will stop them from putting in additional efforts to improve their time management skills. But it is important for the salespersons to realize that unless they accept, that there is a need for them to change and improve their time management skills, they cannot survive in the dynamic marketplace.

Delegate whatever possible: Most salespeople prefer to work alone, without involving others. Although this is a positive trait given the largely independent nature of the work, when it comes to doing certain tasks that can be delegated to other staff, the salespersons' resistance to involving others becomes a negative trait. Such resistance emanates from the lack of trust in others. As a result of the reluctance to delegate, salespersons end up spending a lot of time on tasks that could have been accomplished by others effectively and cheaply (in terms of the more productive use the time could have been put to). It is essential for salespersons to overcome such traits in order to contribute more to their organizations in the form of increased sales.

Planning is a very important part of sales activity. Scheduling time on the basis of yearly, monthly, weekly and daily activities gives a salesperson an added advantage. Efficient time management gives a salesperson ample scope to allocate appropriate time to accounts on the basis of size and importance.

Adapted from Dave Kahle, "Biggest Time Wasters for Salespeople," Salesvantage, 15 July 2004 <http://www.salesvantage.com/news/time/time_wasters.shtml>

Exhibit 12.2
Time Management Tips

It is generally believed that people who are high achievers place a lot of emphasis on time management. Brian Tracy, the author of *Time Power: A Proven System for Getting More Done in Less Time than You Ever Thought Possible*, provides five tips for efficient time management. They are

- Use a time planner: A time planner could be a personal digital assistant (PDA) or a paper-based planner, which enables the person to plan his activities for a year, month, week and a day. Also, it is good to maintain a master copy of the details of every task that needs to be performed and every action required to perform the task.
- Listing every small activity that needs to be performed in a day, is a very effective method of managing time. It provides a feeling of control over time and increases confidence.
- Prioritizing the task list is important. The importance of each activity that needs to be performed has to be recognized and the various tasks have to be performed in the order of importance.
- Whatever the means used (PDAs or computer or a file) to manage time, it has to be used regularly and mastered so that it becomes a daily habit.
- Finally, setting up a 45-file system immensely helps in managing time and various activities intelligently. A 45-file system is a time management system that contains 45 files in a box. Thirty-one files for the days of the month, 12 files for the number of months and another two files for the next two years. The responsibilities for each month should be written down in the file for the respective month. Then, at the beginning of each month, these responsibilities can be sorted out into daily tasks for 31 days and put into the respective files for each day.

Adapted from "Time Management Tools," Cumanagement, 24 May 2004, <www.cumanagement.org>

Exhibit 12.3

Spending Scrap Time Effectively

Every minute of a salesperson's time is valuable and needs to be used productively. Everyday, a salesperson might waste several minutes in unproductive activities. Taken in totality, time wasted in unproductive and unavoidable activities might amount to a substantial sum of money. However, if planned for properly, this time too can be used productively.

Scrap time may include time spent waiting for a client or colleague or for a meeting to begin; time consumed when caught in a traffic jam or while waiting for the traffic light to turn green; time spent in getting fuel filled in a vehicle or time consumed by various miscellaneous activities.

Usually, nothing worthwhile gets done during scrap time. However, it can be put to good use with a little forethought. A salesperson can first list all the activities in his daily schedule that consume time but fail to produce anything worthwhile. He can note down the duration of each such activity. After doing this for a few days, he will be able to arrive at a more or less accurate estimate of his scrap time. He can then determine how he can consciously put this time to some use. Some activities that a salesperson can engage in to make effective use of his scrap time are given below.

- Make necessary phone calls to the office, client or prospect.
- Review the requirements of the customer.
- Prepare for the next sales call.
- Do some paperwork.
- Assess the last sales call.
- Listen to some inspirational audio.
- Exercise to relax.
- Do yoga or meditation.
- Walk for a while.
- Clean up the workplace.

These activities can, however, be taken up only with prior planning, since the necessary resources should be available for the salesman to utilize his scrap time effectively.

Adapted from Rebecca L. Morgan, "Salvaging Sales Scrap Time," American Salesman, August 2000: 7.

Efficient time management in a sales organization offers several benefits. These include better market coverage, reduced selling costs, improved customer service and accurate evaluation of the sales force.

Better Market Coverage

Efficient time management by the sales force leads to better market coverage. Salespeople must be careful about the way they spend time and money to attract customers. The amount of time and money expended must be proportionate to the size of the account.

Sales reps can use promotional material such as brochures and pamphlets during their sales presentation to communicate better to customers. Use of these tools will facilitate better customer acceptance of the product. Also, salespersons can use appropriate software packages to improve their sales presentations. These specialized applications allow sales representatives to anticipate possible customer queries and come up with solutions to satisfy them. Customized solutions, in the form of spreadsheets and charts, not only help to convince customers regarding the utility of the product but also help the salesperson to utilize his time effectively.

It is generally found that salespersons fail to allocate time to customers proportionate to the size of their account. At times, a salesperson might spend a large amount of time with prospects who bring in very little business, while he may spend very little time on prospects who have the potential to give a large amount of business to the organization.

In order to ensure better coverage of the market, a salesperson can begin by assessing the purchasing capacity of the prospects (preferably on an annual basis). He can base this assessment on the product classification of the sales organization. Subsequently, the salesperson needs to assess the consumption patterns of customers to assess the quantity of the product required. After estimating the profitability of each customer and the amount of time needed for each account, the salesperson can remove unprofitable customers from the list of prospects. The salesperson can thus cover the market efficiently by identifying prospective customers who are willing to give business to the company.

Once a salesperson knows the amount of business each customer is likely to give, it becomes easy for him to allocate proportionate time for each account based on the profitability of the account.

Reduced Selling Costs

Some salespersons approach the wrong targets, that is, persons who are not the crucial decision makers in an organization. Others irritate customers to the point that they give business to the salespersons just to get rid of them. This will prove very costly to the company in the long run, as customers will develop a negative perception not only of such salespersons but of the company as well. These salespersons are responsible for the company’s loss of goodwill among customers.

The steps discussed below help sales representatives manage their selling time efficiently and significantly reduce the selling cost of the company.

- Identify the customer and the crucial decision maker, so that wastage of time and money in pursuing other people can be avoided.
- Approach the customer in a professional way. Give a realistic picture of the product and its benefits, provide appropriate solutions to the needs of the customer, and present a practical analysis of the competitor(s). An organized approach builds a positive picture in the mind of the customer and helps increase sales, decrease sales costs by reducing the necessary number of sales calls, identify the most important and urgent needs of the customers and try to solve these while ignoring things that are of no importance to the customer. This helps a salesperson achieve his goal of reducing selling costs by managing time effectively.

Improved Customer Service

Managing time effectively helps a sales representative maintain good customer relations and provide efficient customer service. In order to improve relations with the customer, the salesperson can send a personalized mail and ensure that there is proper communication between them. One advantage is that the customer will receive the salesperson warmly if the latter takes an appointment before making a sales call. Also, prior study of the customer’s buying habits will help the salesperson avoid asking irritating questions. Further, time management tools such as sales force automation (sales force automation has been elaborately discussed in Chapter 4) help a salesperson considerably improve his customer service abilities.

More Accurate Evaluation of Sales Force Personnel

When salespeople plan their activities and prioritize them according to importance, there are greater chances that they will put their best efforts into achieving sales targets. When salespeople manage their time efficiently, it becomes easier for the Sales Manager to evaluate the sales force accurately.

TERRITORY MANAGEMENT AND ITS IMPORTANCE

A sales territory comprises a number of present and potential customers located within a given geographical area. It is assigned to a salesperson, branch, or intermediary (retailer or wholesaling intermediary).[1]

Territory management has gained increasing importance due to the increasing costs of making sales calls. By assigning specific territories to salesmen, the management of a sales organization can significantly bring down the costs of making sales calls.

Most sales territories are designed geographically because it is easy to do so. However, geographically designed territories are not always profitable because assignment of territories on a geographical basis may result in unequal concentration of customers. In other words, it may happen that one geographical area of a city may contain elite customers while another area may contain people belonging to low-income households. In such situations, while the salesperson covering the former area can produce significant sales, the one covering the other area may fail to produce even the bare minimum of sales. Therefore, while designing and managing territories, the characteristics of the prospects and customer groups, transportation facilities in the territory and skills of the salesperson should be considered.

Benefits of Territory Management

Designing and managing territories in an efficient and effective manner has many benefits for an organization. These benefits include better customer coverage, increased sales, lower transportation costs and better performance evaluation.

Better customer coverage

If the salesperson is burdened with high work pressure, he will not be able to cover all the important and prospective accounts in his territory. By concentrating on smaller accounts, the salesperson might lose out on good market opportunities. On the other hand, salespeople working in territories that have very little workload may spend much of their time on unprofitable accounts. Therefore, managing territories is an essential aspect of sales management. Territory management helps ensure that areas with a lot of potential are given to salespersons who have the expertise to handle such work pressure. Through territory management, a sales manager can ensure that no prospective customer is missed out, thereby leading to better market coverage.

Increased sales

Poor territory design and management causes companies to lose millions of dollars worth of sales. By allocating territories to the salespersons in an equitable manner, sales managers can ensure that no salesperson gets too big or too small a territory. In this way, the sales of the organization can be enhanced significantly.

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[1] Rosann L. Spiro, William J. Stanton and Gregory A. Rich, *Management of a Sales Force*, Eleventh edition (New Delhi: Tata McGraw-Hill Publishing Company Limited, 2003), 372.

Equitable rewards

Imagine a situation where two salespersons with almost equal capabilities and motivation are assigned two different territories, one full of potential customers and the other not so. In such a case, the performance of the two salespersons will differ significantly. The salesperson having the territory with greater potential will naturally achieve higher sales and hence better rewards, compared to the salesperson having to cover the territory with less potential. Such allocation of territories and compensation of performance on this basis is completely unfair. The sales manager, by offering rewards in this manner, is in fact rewarding the territory and not the salesperson. Proper territory management helps in overcoming such discrepancies and ensuring equitable rewards to salespersons.

Reduced traveling costs

Good territory design and management helps a company reduce the traveling costs incurred by salespersons. Fuel and automobile expenses can be greatly reduced by efficient territory design. Moreover, lesser travel gives the salespersons more time to concentrate on their selling activities and also allows them more time to spend with their family, thus increasing their morale.

CRITERIA FOR TERRITORY DESIGN

While designing sales territories, the following criteria should be taken into consideration:

The sales territories should have sufficient potential, be of reasonable size, offer adequate coverage and have minimum of impediments.

Sufficient Potential

The sales territory should have sufficient potential to increase the sales of the company. A territory lacking in potential offers the salesperson little or no scope to identify prospective customers. In the latter circumstance, an organization cannot use a salaried salesperson to serve that territory. On the other hand, salespersons who are compensated on a commission basis will not like to work in such territories due to the poor market potential. It is therefore important for the sales manager to design territories in such a way that there exists enough potential for salespersons to leverage its potential.

Reasonable Size

While designing territories, sales managers should take adequate care not to assign areas that are too large. This is because prospecting in such territories will consume substantial time, much of it in traveling. On the other hand, the territories should not be too small, since this may result in a situation where the salesperson’s skills will not be optimally utilized.

Adequate Coverage

Sufficient coverage of the territory is an important aspect to take into consideration while designing sales territories. The sales manager should ensure that the design allows for sufficient coverage of the territory and that no prospective customer is left unattended. The methods for designing sales territories has been explained in a subsequent section in the chapter.

Minimum Impediments

The sales manager should design the territories in such a way that the presence of physical obstructions in the form of mountains, rivers, railroads, dams etc. is minimized, if not avoided. The presence of such geographical and man-made features within a territory creates hurdles in effective coverage and impedes the performance of a salesperson. Therefore, it is the sales manager's duty to ensure while designing territories, that there are a minimum of such impediments in the demarcated area, and even if such features exist, they form the boundaries of the territory and not a part of it.

METHODS OF DESIGNING TERRITORIES

The design of a sales territory determines the efficiency of the sales organization. Sales territories are designed on the basis of geographical factors or customer potential. It is the sales manager's responsibility to design sales territories and determine the number of accounts to each salesperson. Sales territories should be designed in a way that enhances the performance of the salespersons and improves organizational efficiency. There are three methods to design sales territories – buildup method, breakdown method and incremental method.

Buildup Method

The buildup method involves designing territories by assessing the potential or attractiveness of both current and prospective customers. In this method, current and prospective customers are identified and their sales requirements analyzed individually. Subsequently, salespersons are assigned to these territories on the basis of the sales volumes and the number of calls they are required to make to these accounts. Consumer goods manufacturers usually adopt this method of territory designing for wider distribution of their products.

Breakdown Method

This method is the reverse of buildup method. In this method, initially the market potential for the product is identified and the target share of the company is assessed. On the basis of this, sales are forecast. Then, the average number of sales required to be made by each salesperson is determined and the territories are then accordingly allocated to individual salespersons. This method is normally used for selling industrial products.

Incremental Method

In the incremental method, additional territories are created till the revenues generated through such territories exceed the costs of serving them. Once the revenues equal the costs, creation of additional territories is stopped. However, this method of creating territories is not without its difficulties. In this method, in order to identify the number of sales territories that can be created, a cost accounting system needs to be developed to determine the sales, costs and profits associated with varying levels of input.

Territories can be formed in many ways. However, the sales manager should be able to identify the most effective way of forming territories, that it not only helps achieve the sales objectives of the organization but also ensures that the salespersons are adequately compensated and motivated to work in these territories.

PROCEDURES FOR DEVELOPING TERRITORIES

While taking decisions about forming territories and allocating sales personnel to these territories, sales managers should ensure that the procedure is fair to all salespersons, in terms of both workload distribution and opportunity. The sales objective of the organization is yet another factor that needs to be taken into consideration while forming territories.

Identify Objectives and Criteria for Territory Formation

A major objective of designing sales territories is to identify the optimum size of territory for efficient performance of the salesperson. Another step is to distribute the territories among the salespeople on an equitable basis and ensure that salespeople are allocated territories on the basis of their capability and performance. Finally, the nature and type of product is an important consideration for identifying objectives and criteria for designing sales territory.

Bases for Developing Territories

The target market for a sales organization can be divided into various territories based on factors such as geography, service requirement, potential, and workload.

Geography

Territories can be developed on the basis of geographic limits such as boundaries of towns, cities, districts, states or countries. This is an easy way, since data regarding the geographical area is easily available from government publications, geopolitical maps etc. With the help of these maps, a sales organization can easily divide its target market into territories. However, dividing a target market into territories on the basis of geographic factors may give rise to territories that may not be lucrative. In such cases, dividing the market on the basis of commercial traffic flow is a better solution.

Service requirement

The service requirements of existing and potential customers should be kept in mind while forming territories. In this method, the company initially determines the overall sales potential it can achieve in the target market. The company then analyzes the sales potential of its salespersons and based on it, the number of territories is decided. For instance, if a company determines that the overall sales potential of the target market is ten lakh rupees per annum and analyzes that each salesperson can achieve a target of one-lakh rupees per annum, then the company can divide the target market into ten territories to ensure maximum and efficient coverage. However, a shortcoming of this process is that some territories might have very large accounts and others very small ones. To overcome this shortcoming, a company segments its customer accounts on the basis of the size of the business and then these are equally distributed among the salespeople to avoid inconsistencies of coverage.

Potential

Another method of forming territories is to divide the target market according to the sales potential. This is a method, which provides equal opportunity to all salespersons and exploits their maximum potential. In this process, the company initially estimates the overall market potential of the product. Then, it determines the amount of sales that an average salesman can achieve. The number of territories is then obtained by dividing the overall market potential by the average amount of sales that can be achieved in the market.

While forming territories, the company should keep in mind that these territories should have similar potential in terms of amount of competition, the number of prospective customers available and the efforts required to approach the customers and cover the market.

Workload

The workload method is a comprehensive method of developing territories. In this method, territories are developed on the basis of factors such as individual capabilities of the sales personnel, service requirements of the target market, competitive factors, territory coverage issues, customer density and so on. Other factors that need to be considered include equity of workload distribution among the salespersons so that their compensation and motivational levels are maintained. Some companies try to ensure equity of workload distribution among salespersons by fixing the number of sales calls a salesperson has to make in a day. However, this method tends to ignore a crucial issue relating to size of the account.

Assigning Sales Personnel to Territories

Assigning salespersons to territories is a critical task. Once the sales territories are established, the next stage for a sales manager is to allocate salespersons to individual territories. Although the formation of territories is done on the basis of several aspects, all salespersons might not perform equally well in spite of the equal sales potential of the territories. This may be due to differences in personal characteristics of the salespersons in terms of experience, age, physical condition, creative skills and so on. Therefore, while assigning salespersons to various territories, companies take steps such as allocating smaller territories to new salespersons, reasonably difficult territories to experienced salespersons, and so on.

OPERATING THE TERRITORY MANAGEMENT SYSTEM

A sales manager should be very careful in managing the sales territories under him. He should see that he neither exercises too much control nor provides too much liberty to the sales personnel. Either of these will have a vital impact on sales force performance. Sales managers can efficiently manage their sales territories by routing the movements and scheduling the activities of salespersons so as to maximize the efficiency of their sales efforts.

Routing

Routing involves the measures taken by sales management to minimize the travel expense, travel time and total distance traveled by salespersons. Routing also takes into consideration the call frequency and the length of time that needs to be devoted to each account. While routing a salesperson’s movement, focus should be on reducing his travel time, and at the same time, increase the territory coverage. Proper routing should be developed for the salespersons so that the entire territory is covered efficiently and effectively.

Routing the movement of salespersons is a very difficult and complex process, since customers do not live in areas where salespersons can approach them easily. Moreover, customers will not meet the salespersons according to salespersons’ convenience but according to their own convenience. Therefore, salespersons need to adopt a route that will take all these aspects into account. Having a pre-set plan for daily sales calls is very important for a salesperson. Absence of such a plan will dilute his efforts.

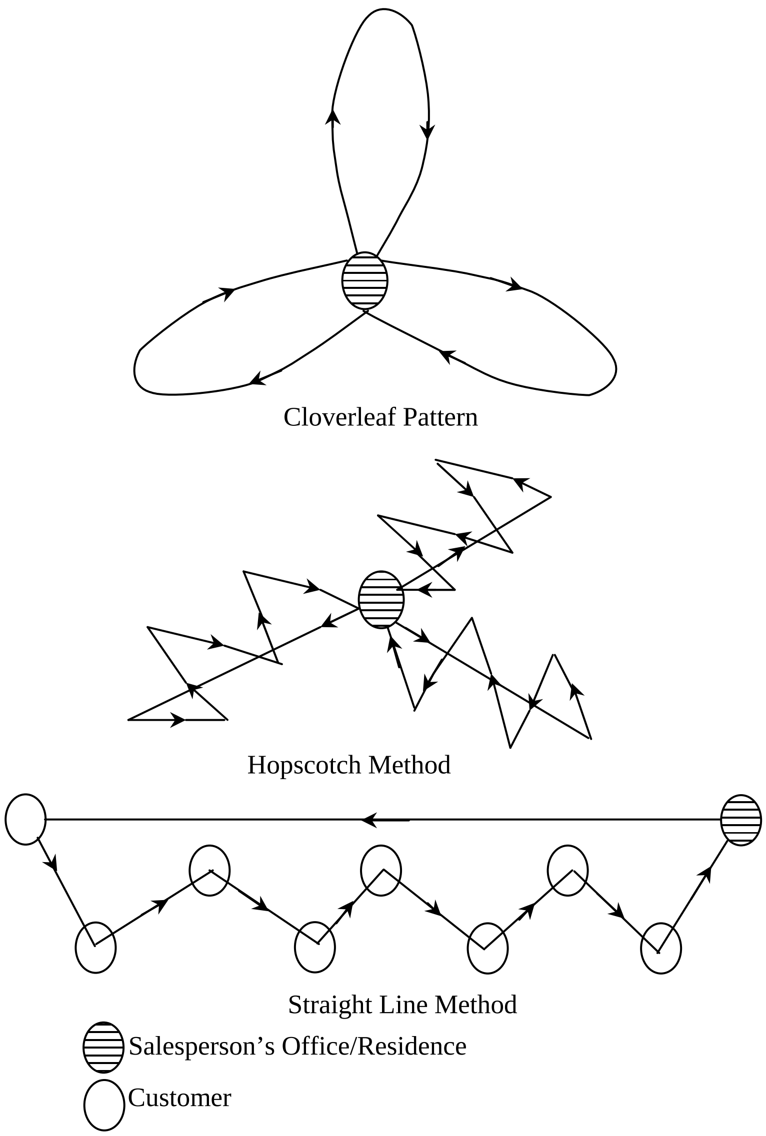
Routing involves identifying the existing and prospective customers according to their account sizes and business potential and highlighting them with different colors on a map. Certain other aspects that need to be considered are the climatic conditions, transportation facilities, ensuring minimal distance between two consecutive calls and planning things in such a way that the salespeople do not go through the same geographical locations more than once while meeting clients.

There are basically three patterns which form the basis for effective sales call planning. These are straight-line pattern, cloverleaf pattern and hopscotch pattern.

In straight-line pattern, the salesperson identifies the customers at the far end of his territory and calls on that customer and works backwards towards home or office, making sales calls on customers on the way back.

The cloverleaf pattern of routing is used if the territory is big. In this pattern, the salesperson meets the customers along a cloverleaf-like route consisting of adjoining circular sequences. In this pattern, the time period for the territory coverage is normally scheduled in terms of weeks.

Figure 12.1: Different Patterns of Sales Routing



In the hopscotch pattern of routing, the salesperson makes sales calls by following a hub-and-spoke pattern. In this pattern, the salesperson's office/residence forms the central hub and the path traveled by him on his sales calls form the different spokes that emerge from the central hub. In the hopscotch pattern of routing, the salesperson starts making sales calls from the place farthest from the hub and work backwards towards it in a zigzag manner.

Figure 12.1 shows the three different patterns of sales routing. Salespeople can follow any of these patterns for their sales calls. Moreover, if the sales manager involves the salespeople while developing the routing patterns, the chances of its success and salespersons adopting it significantly increase.

Scheduling

Scheduling refers to the allocation of appropriate time to all the activities that salespersons carry out during a day, week and a month. This involves planning the activities by taking into consideration the waiting time at the customer's place, the traveling time based on past data etc. The time estimate should then be used to schedule the salespersons' activities, keeping in mind variables like the fact that the waiting time may vary from customer to customer. Some additional time should also be provided for the salespersons in their daily schedules to give them some flexibility to meet contingencies.

Territory coverage by sales personnel

A few salespersons manage their territories excellently by allocating time proportionate to the size of each account and its importance to the organization. But a majority of salespersons spend substantial time either on their favorite accounts or on smaller accounts, and may even encroach upon the territory of other salespersons. A

Exhibit 12.4

Effective Ways of Territory Coverage

A salesperson can efficiently cover his territory by applying the 80-20 rule. That is, he can devote 80 percent of his time for major accounts, leaving the remaining 20 percent to serve smaller accounts.

Routing sales calls helps a salesperson avoid crisscrossing the same area repeatedly, thereby saving a lot of time.

Taking an appointment before calling on the prospects is a good habit. This will help the salesperson save time and also plan the route to be covered of a particular territory. A salesperson should assess his sales performance in a particular territory by comparing his achievement with that in the past. A salesperson may assess his performance effectively by addressing the following issues:

- Coverage of accounts in the territory
- Knowledge of the crucial decision makers for the accounts
- Balanced allocation of time to various types of accounts – difficult ones and easy ones
- Method of analyzing sales performance
- Continuous updation of selling techniques
- Continuous search for new prospects
- Knowledge of strategies adopted by the competitor in managing the territory

By addressing these issues, a salesperson can analyze his performance effectively and improve his performance in his sales territory.

Adapted from Daryl Allen, "Maximize Your Territory Coverage, Increased Sales and Higher Profits Will Follow," Sell!ing, June 2001:10.

sales manager should therefore try to explain his field staff about the importance of prospecting new accounts and also restricting themselves to their territories. The sales manager may further help them in planning their sales calls before making the field visits.

Initially, salespeople should carefully study a map of their territory so that they can plan an economical and profitable manner of covering the area. However, this plan should be flexible enough not to restrict the selling efforts of the salesperson and should allow him to make changes if necessary. Effective ways of territory coverage have been discussed in Exhibit 12.4.

SUMMARY

Effective time management will significantly help a salesperson improve his performance. There has been a fundamental shift in organizations' approach to time management with the advent of better technological options. Advancements in technology have simultaneously led to a significant increase in time pressure on the salesperson. However, technological advancements have also provided several techniques to help salespersons manage their time efficiently.

Efficient time management leads to better customer coverage, helps in reducing selling costs, improving customer service and helps in accurate evaluation of salespeople.

A sales territory comprises a number of present and potential customers, located within a given geographical area and assigned to a salesperson, branch, or intermediary. Sales territories should be designed efficiently so that the potential of salespersons can be exploited to the maximum.

Sales territories are designed using the three methods – buildup method, breakdown method and incremental method. The buildup method consists of designing sales territories by assessing the attractiveness of current and prospective customers. In this method, current and prospective customers are identified and their sales requirements analyzed individually. Subsequently the salespersons are assigned territories on the basis of the sales volumes and the number of calls they are supposed to make to these accounts. The breakdown method is the reverse of the buildup method and in this, the market potential for the product is identified and then the market share that the company is targeting assessed. Based on this, sales are forecast. This is followed by determining the average number of sales that each salesperson is required to make and the territories are then accordingly allocated to individual salespersons. In the incremental method, additional territories are created as long as the revenues generated from them exceed the cost of serving them. Once the designing of territories is completed, salespersons are allocated to individual territories according to their capabilities.

Routing and scheduling are two widely accepted techniques for territory management. Routing refers to the process of deciding the pattern of movement of a salesperson in his territory for making sales calls in a way that minimizes the total distance traveled, the travel expense and the travel time. Scheduling involves allocation of time to the various activities that a salesperson is involved in during a day, week and a month.

Chapter 13

Compensating Sales Personnel

In this chapter we will discuss:

- Objectives of compensation plans
- Characteristics of compensation plans
- Types of compensation plans
- Designing compensation plans
- Implementing compensation plans
- Sales contests
- Sales force expenses
- Fringe benefits

Selling is one of the few jobs in which a sales person has the opportunity to vary his or her earnings, depending on the extent of sales achieved. If a sales person wants a higher pay check for a particular month, improving sales volumes can fulfil his desire. The compensation and reward system is the single most important motivating factor for sales personnel in any industry or organization, all over the world. It is the key to directing the behaviour of sales personnel in alignment with organizational objectives. Therefore, a sales manager needs to be very prudent while establishing compensation plans. A compensation plan must explain clearly what activities a sales person is expected to carry out, how performance will be measured and how they can increase their compensation. Many organizations spend a lot of time reformulating strategies to take advantage of emerging opportunities in the changing business environment. However, they seldom reorient their compensation plans to suit the changing needs of sales personnel. These plans also do not reflect the changes that have taken place as organizations evolve in tune with changes in the business environment.

A well-formulated compensation plan not only helps the sales force to direct selling activities and achieve sales objectives, but also influences effective implementation of the organizations' marketing plan. In case an organization's marketing strategy is to enter new markets with existing products, the sales plan should focus on finding and entering new territories and sales promotion. To encourage the sales force to give priority to promotion activities, the compensation plan should have incentives and commissions for prospecting and promotion activities. Otherwise, sales personnel will be interested only in achieving set quotas, but will not shift activities. There is also a link with all other major functions of an organization. A good compensation plan affects the quantity of orders received by the production department, the recruiting and training requirements of sales personnel, the cash flow managed by the finance department and many other functions. This chapter examines important aspects and trends in compensation plans for sales personnel in the present day context.

OBJECTIVES OF COMPENSATION PLANS

It is imperative for an organization to define the list of objectives that can be fulfilled with the help of a compensation plan. Prior setting down of objectives enables sales managers to make reasonable estimates from the compensation plan, thereby avoiding overload with too many expectations. A compensation plan should be able to provide a balanced and secure additional income to sales personnel. It should also motivate them to align their efforts with organizational aims. It should also help retain talented personnel and finally act as a means to regulate sales force activities.

Balancing the Needs of Personnel

A compensation plan must be able to balance the needs of sales personnel. A plan that can cater to their basic needs like – security, creating a feeling of secure income, desire for personal recognition, reinforcement for doing good work and fulfilling the need for status within the organization – can be considered an effective plan.

Secure income and security

A compensation plan should essentially give a sales person financial security. Compensation plans usually provide for social security, pension and retirement benefits, insurance schemes and other employee benefits that enhance the sense of personal and family security among the sales force. This is especially true when the fringe benefits component of the compensation plan is taken into consideration.

Desire for personal recognition and status

A compensation plan can serve as a yardstick to measure the level of recognition in an organization. Sales personnel have an inherent need for recognition and respect from peers, subordinates and superiors. The size of the pay packet can act as a symbol of recognition and status. Whenever sales personnel win sales contests or get a bonus for their efforts, they get a feeling of achievement, which motivates them to work more.

Reinforcement for doing good work

A compensation plan must reward sales personnel in line with their expectations. This helps mould the behaviour of the sales personnel, who will then operate in a manner that benefits the customer as well as the organization. Organizations give commissions to their sales forces, if they complete their tasks within the allocated costs. However, financial incentives cannot alone bring out the best from a sales person until and unless they are clubbed with required training and direction.

Managing Effects of Time

An ideal compensation plan should provide a secure income to sales personnel at a low cost to the organization, operate in a balanced manner both at times of success and adversity and help create a feeling of goodwill among the sales force. The incentives should be planned so that they enhance sales performance in the present and the future.

CHARACTERISTICS OF COMPENSATION PLANS

A compensation plan is a tool that helps an organization achieve its objectives. It gives a push to sales force efforts, towards achieving desired goals. This will have an impact on other organizational functions too. It can influence the quantity of production, cash flow and the training needs of sales personnel. Therefore, the sales manager should study the characteristics of the compensation plan before going into the finer aspects of deciding on the type of compensation or the proportion of variable and fixed components. Any compensation plan should fulfil certain criteria. As they are meant to motivate, there should be equality in compensation to all sales personnel. The design should have flexibility to enable sales managers to modify it at times of changing emphasis in sales force activities.

Fairness to All

To reiterate, a compensation plan should give a fair deal to sales personnel. Compensation and reward should be equitable for all persons in the sales team, including managers. The plan must also be in tune with the compensation trends and patterns followed by other organizations in the industry.

Flexibility

A flexible sales compensation plan goes a long way in achieving the objectives of an organization. The plan must provide for modification to suit changes in the external environment, products, market life cycle and the evolution of the organization and the industry.

Provide Incentive and Motivation

The compensation plan should provide a direct link between effort, results and rewards. Unless this is ensured, the objective of motivating sales personnel is difficult

Exhibit 13.1

Use of Compensation Websites

The Internet helps organizations reduce administrative costs and efforts in implementing a compensation plan. Websites help provide constant updates to sales personnel on their incentives status at any given time. It helps in a similar manner during sales contests. Many companies have started putting their compensation plans online. MCI Telecommunications Corporation was one of the earliest to have an Internet- based sales incentive program. IBM Corporation also uses the Internet to enable its sales personnel to be constantly aware of their pay plans and the amount of money they can possibly earn. IBM uses a tool called the 'estimator' that enables the sales person to know the relative difference in pay that can arise based on the difference in sales performance. For example, a sales person can simultaneously find out the differences in the incentive mix on achieving 105% or 110% of the set quota. Such websites have considerably reduced the expenditure incurred to print and distribute brochures for each incentive scheme, to the entire sales force. Printing brochures every year cost IBM $130,000 whereas the one-time investment on developing a website cost only $120,000. Further, the website enabled sales personnel to become compliant with Internet technology. It also reduced the time spent on getting customized information that enables sales personnel to concentrate more on selling activities.

Adapted from Geoffery, A.C.Brewer, "Sales Contests Go Interactive", Sales & Marketing Management, July 1996, Volume 148, Issue 7, 45-46 and Michele Marchetti, "Helping Reps Count Every Penny", Sales & Marketing Management, July 1998, Volume 150, Issue 7, 77.

to achieve. A proper mix of salary, commissions and incentives must be put in place so that sales personnel try to do their best to achieve organizational objectives. If they feel that the plan is not commensurate with their efforts, it will be difficult to get the best out of them.

Lead to Direction of Efforts towards Company Objectives

The compensation plan should direct the activities of sales personnel in such a way that it leads to fulfilment of company aims. Compensation plans also vary depending upon the selling activities the management wants to focus upon at that time. For example, if the organization is introducing new products, it can formulate a compensation system that rewards sales personnel in the form of special incentives or bonuses for each unit of new product sold. Sometimes, a sales contest is held and rewards are given to sales personnel who achieve the maximum sales volumes for the new products.

Ease of Administration and Comprehension

Sales compensation plans facilitate the easy administration of all activities of the sales force. If a plan is formulated in consultation with sales personnel, they will trust the plan. The basis for a particular type of compensation plan should be clearly communicated to sales persons, especially how it helps accomplish organizational objectives and coordinates selling activities. A well- designed compensation plan not only motivates sales personnel but also influences their recruitment, training and staffing activities. There must be a link between sales force effort, performance and reward. This link helps in coordinating the activities of the sales people and also other non-selling functions like recruitment, training, evaluation and control. A compensation plan that cannot be easily comprehended or designed properly fails in administering sales activities. Nowadays, companies use the Internet to communicate compensation plans to sales personnel, significantly reducing administrative costs and time for the organization (refer Exhibit 13.1).

TYPES OF COMPENSATION PLANS

Organizations can make use of several ways to compensate employees. The main types of compensation plans are categorised as a straight salary plan, a straight commission plan and a combination plan. A straight salary plan consists of a fixed amount that is given to the sales person in a predetermined time period. In a straight commission plan, compensation is linked to the performance of the sales person. A combination plan involves a mix of these components. Let us look at each of these categories in some detail.

Straight Salary

It is a type of monetary compensation given to a sales person for a fixed time period, at a predetermined rate, for example, Rs 5000 per month, Rs 20,000 per quarter, etc. The salary may constitute the entire pay of the sales person or it may be a part of the total compensation. A straight salary is most appropriate when organizations require sales personnel to primarily sell and maintain relationships with existing customers. It is also useful when prospecting is their primary activity. Organizations that manufacture technical products prefer a straight salary as selling such products requires more than one sales person, usually an entire team. Team selling involves the combined efforts of a sales person, a service engineer, product trainer and R&D personnel. For example, companies like ABB, that sell heavy industrial machinery, have a sales person, a sales engineer, a service engineer and a customer service representative, who together manage a single account. In such instances, incentives or commission cannot be given to a single individual. So, the company pays them a salary commensurate with their qualifications, experience and job profile. In such cases, compensation cannot be primarily based on commissions as this will lead to some sales persons getting undue rewards irrespective of whether they contributed to the success of the team or not. Consumer goods manufacturers also prefer straight salaries due to faster sales cycles. This condition can cause extreme variations in compensation during the declining stage of the sales cycle, if the plan is commission based.

Advantages of straight salary

- It provides a regular, fixed and guaranteed income to sales personnel irrespective of fluctuations in sales volumes or stability of the business. It provides a sense of security to a sales person, which is critical for success.
- A straight salary compensation plan reduces the costs incurred on compensating the sales force of an organization. This is especially true when the sales volumes achieved by sales personnel are higher than the set target, because the same salary is paid in spite of higher sales volumes.
- A straight salary plan is the easiest to administer and direct in comparison to other compensation plans. Calculations are simpler because of the absence of variations in income among sales personnel.
- Switching territories and reassigning quotas of sales personnel is easier and there is least resistance from the management because such changes will not lead to any difference in the salary structure of sales personnel.

Disadvantages of straight salary

- Sales personnel do not have any reason to put in extra effort in selling, as it does not yield any rewards.
- A straight salary does not aid uniform sale of all products, since sales personnel will prefer selling those products that require the least effort. This leads to certain products being undersold, reducing the net margin for the organization.

- Such a compensation plan does not distinguish between efficient and inefficient sales personnel as both get the same, fixed salary irrespective of differences in performance.

Straight Commission Plans

In this type of compensation plan, a percentage of the sales volume or profits obtained is given to sales personnel as a commission. The income is proportional to the sales volume achieved by a sales person. Sometimes, commissions are fixed depending on the number of units of products sold, instead of total sales volume in terms of money. This type of plan is most effective for smaller or new organizations, as opportunities are greater for a new organization and sales personnel can be given a higher commission to promote products. Owing to time taken to establish sales territories and quotas, which are necessary when deciding on compensation plan, organizations can use commissions as the primary mode of payment. In a straight commission plan, a rate, base or starting point is required to calculate commissions for the sales force. The rates used for calculating commissions vary. They may also be different for different products, constant for the total volume of sales or may be a combination of both. They may be calculated on the basis of gross sales by a sales person, sales volumes above the fixed quota, pooled sales or profits (if a sales team is operating in a region), net profits calculated after reducing sales expenses, or on the basis of the actual cost of products in the total sales volume. Sometimes, a salesperson becomes eligible for a commission only if the sales quota is achieved. In other words, he or she will get a commission only for sales volumes above the sales quota.

Advantages

Commission-based compensation plans are more precise than other plans as they pay sales personnel on the basis of their performance, weeding out the possibility of over-payment or under-payment, which is possible in a straight salary plan. This is because the straight salary plan does not consider the efficiency or sales volumes obtained by sales persons and pays them the same.

- Commissions are easily acceptable and preferred by sales personnel as they help them decide their pay on the basis of sales volumes achieved. They can easily understand that their potential earnings are dependent on their performance in the market.
- It is an objective measure to judge the performance of salespersons.
- In such compensation plans, as the sales volume increases, the per unit sales expense decreases.
- It helps in setting targets for the sales force.
- It motivates sales persons to achieve higher sales targets, to earn high returns.

Disadvantages

- Non-selling activities like relationship building and prospecting suffer because sales personnel focus entirely on increasing sales volumes and thereby earn higher commissions.
- The focus of the sales force is on increasing sales, without consideration for the net profit margin obtained.
- Customer service may be overlooked, as the sales personnel will be primarily interested in making a sale, and not in assessing the utility of the product to customers.

- A commission plan hinders the regular transfer of sales personnel between territories. It also impairs designing of new territories on the basis of current market conditions, as the whole compensation plan has to be redesigned in turn. This increases the time spent and the administrative and supervision costs.
- A commission-based plan may lead to wide differences in pay among sales personnel, depending on their performance. This may give rise to dissatisfaction or conflict among sales personnel.
- The income of sales persons would depend on the economy or industry performance. In boom times, they will get excessive pay while in times of recession, their pay will be too little.
- Excessive turnover of sales people will occur when organization performance declines.
- Sales people may focus on selling themselves rather than the company or its products.
- Sales people may focus on developing short-term relationships with customers rather than long- term relationships.

Combination Salary Plans

This type of plan includes a combination of salary, commission and other types of incentive plans. For example, a combination plan may be a salary plus commission plan, salary plus bonus plan or a salary plus commission plus bonus plan. A combination plan provides greater control over the excesses in variable income expenses incurred by the organization. This type of plan is suitable for organizations that have a wide range of products and divisions. This is because these plans have flexibility and can be tailored to suit the sales force, by using a variety of different combinations. The most important factor to be established in this type of plan is the probable ratio between the fixed and variable components of the compensation plan. Organizations generally adopt 80% base salary and 20% incentive component. Sometimes a 70%-30% mix or even a 60%-40% mix is used.

While fixing the pay package, an analysis of the base salaries in the particular industry, past sales performance of sales personnel and performance of the company should be considered. Organizations usually pay the fixed salary component on a monthly basis, the commission component bi-weekly or monthly, and bonus on a quarterly, half-yearly or annual basis.

Advantages

- As sales people get regular income (bi-weekly, monthly, quarterly) in the form of monetary incentives, they are continuously motivated.
- It provides sales persons with the advantages of both a fixed salary and variable income.
- This plan can compensate sales personnel for all activities that they perform, without overlooking their efforts in non-selling activities, thanks to its inherent flexibility.
- Sales personnel have the opportunity of earning more than what is possible in a straight salary or a commission plan.
- This type of plan is preferred by younger sales personnel because it provides financial security as well as the potential to earn more.

Disadvantages

- This plan involves a lot of calculation and administration because of the number of combinations possible for different sales personnel.
- The administering costs are higher than other plans because complex calculations are needed and more number of personnel have to coordinate.
- These plans have to be regularly analysed due to changes in the external environment. If they are not revised periodically, the variable component may become very high. This will lead to loss of morale when the pay reduces drastically during lean selling periods, due to a low commission or bonus.
- Monitoring and control has to be greater than for other plans, especially when the incentive proportion increases.

DESIGNING COMPENSATION PLANS

A compensation plan must meet the needs of an organization and its products or services. It must attract as well as retain existing employees. Designing effective compensation plans has become difficult for sales managers because of the varying expectations of the sales force and the multitude of changes in global markets. A common problem faced in plan preparation is that sales managers consider the compensation plan as a substitute tool for supervision and control of sales personnel. But, it must be remembered that the basic role of a sales compensation plan is to act as a tool to help an organization attain the desired sales volumes (by satisfying the basic need of sales personnel to have a secure income). Thus, sales managers must keep in mind this basic aspect, when designing compensation plans.

A host of variables should be considered while designing the sales compensation plan. It is necessary to decide on the specific objectives, the levels of sales force compensation and the methods of sales force compensation in comparison to the industry average before the sales compensation plan is to be designed. Other than these three factors, the sales manager must also keep in mind some other aspects. They are :

- The type of industry and the position of the organization in the industry in which it is operating
- Awareness of company objectives that include decisions on whether to secure new clients, increase average order size, reduce expenses on selling or to focus on new or existing profitable products.

We will focus our discussion on the three important factors that must be kept in mind while designing the sales force compensation plans. .

Determine Specific Objectives

A compensation plan must have certain basic objectives, which will enable the sales manager to know what to expect from the plan. If specific objectives are not established, it might lead to high expectations, which cannot be met. The most common problem faced by managers while setting objectives is conflict between different objectives. As we have discussed, any compensation plan must provide income, security, be fair and have the flexibility to change with time. But, while setting objectives, there is a possibility that one objective will be in conflict with another. For example, the objective of providing satisfactory income to sales personnel will not align with the objective of minimizing costs for the organization. Therefore, the sales manager must maintain a balance. Any compensation plan that tries to fulfil the following objectives ought to be successful.

Income and security: The compensation plan must provide financial security to sales people. It should not lead to sales personnel being either overpaid or underpaid, as both are detrimental to the organization's performance. If sales personnel are underpaid, they will not be motivated and it will be difficult to retain them. If they are overpaid, it can lead to financial inefficiency due to higher operating costs.

Equity: The compensation plan should be transparently fair and equitable towards sales personnel. It should help the manager reward performance objectively, contributing to improving sales force morale. The sales force must be rewarded only on the basis of performance, keeping in view differences in territory, potential, composition of products sold and the nature of selling activities.

Flexibility: The compensation plan should be designed so that it has the flexibility to operate satisfactorily during good and bad business periods. Emphasis on the fixed component of sales force compensation helps fulfil this objective. We have discussed this earlier in the chapter.

Exhibit 13.2

Choosing the Best Compensation Plan based on Sales Objectives

Increasing sales volume: The compensation plan should be more commission based if the primary objective is to increase sales volumes. The commission can be directly proportional to the increase in sales by sales personnel. A salary or bonus component will not have the required impact.

Increasing sales of certain products: Commissions have a good response when the sales manager wants to focus on selling certain existing or new products. A sales contest or a quarterly or half-yearly bonus can also elicit a good response from sales personnel.

Achieving a particular sales level: A substantial bonus can be fixed on achieving the desired quota or sales level. Sales personnel will be motivated to reach the desired levels to become eligible for the bonus. This method can be used when certain products in the sales mix need to be sold more aggressively.

Selling a balanced product mix: The organization can devise a combination of all these payment methods to ensure that sales personnel achieve a judicious mix of sales volumes for the entire product range or line being handled. This helps the organization have a net profit margin at the end of the sales activity.

Increasing customer base: The compensation plan can be based on the extent of credit given to new customers. Depending on the number of credits given to various customers, sales personnel are given incentives. Such an approach can lead to sales personnel indiscriminately giving credits, irrespective of a customer's need.

Establishing long-term customer relationships: In such cases, the compensation plan must focus on the fixed salary component because the results of the exercise are not measurable immediately. Sometimes commissions can be given based on the number of calls made to a particular account. This approach is feasible only for major accounts that produce large sales volumes.

Monitoring credit and collections: To achieve this, a compensation policy of deducting the loss due to non- collections from the total commission earned, can be set up. Another approach is to stop commissions for all sales where collections are not made by sales personnel.

Increasing customer satisfaction: Commissions and other incentives can be paid to sales personnel based on the results of customer satisfaction surveys conducted by the organization. A sales person who ranks higher in the survey is given a higher incentive. This type of plan also directs sales force activities towards improving customer satisfaction.

Adapted from Harry R. Tosdal, "How to Design The Salesman's Compensation Plan", Harvard Business Review, September/October 1953, Volume 31, Issue 5, 61-70.

Economy: The compensation plan must be economical to the organization. Expenditure on salaries must lead to substantial generation of profits, in the form of sales volumes. The proportion between expenditure and compensation can depend on the industry average.

Sales function objectives have a bearing on the proportion of fixed and variable components in compensation plans. This is explained in Exhibit 13.2.

Establish Desired Levels of Earnings

Once the objectives are established, the level of compensation for the sales force is decided. It is formulated by considering the pay structures offered by competitors, the industry average and the type of selling activities the organization carries out. The experience and ability of sales personnel must also be kept in mind while setting payment levels. The compensation should be appropriate to the nature of the job. Otherwise, retaining younger sales personnel will be difficult as, once they get training from the organization, they will leave for a concern that offers them better pay. This can happen with experienced sales personnel too. Such personnel have gained specialized knowledge and skills and developed strong customer relationships, especially in technical areas where product expertise and knowledge of key decision makers in the customer organization play a significant role in making a sales presentation. Compensation plans for such personnel need not depend on the industry average because the cost of losing such people cannot be measured.

Methods of Payment

The payment methods an organization adopts depend on the analysis of selling activities. Sales activities are segregated into various constituents like the extent of attention required to develop customer relationships, time spent on negotiating prices, time spent on training and educating customers, prospecting time and so on. The proportion of these activities will vary for different organizations. Therefore, every organization must devise its own methods of payment periodically. This is necessary because the relative importance of activities changes over time. For example, greater emphasis is placed on product training for customers during the early stages of the product life cycle, while relationship building is important during the maturity stage of the product life cycle, especially when there are equally competent brands available. The method of payment should respond to a good sales performance by ensuring higher pay than competitors and maintain a uniform spread among different payment combinations. This will prevent over-reliance on a particular payment method for the sales force. The compensation plan generally includes one or more of the following methods of payment:

Salary: Here, sales people are paid at a predetermined rate at regular times, which vary from a week to a month to a quarter. It is usually in the form of a monthly salary, which forms the basic source of assured income to sales personnel. This mode of payment ensures financial security.

Commission: Most organizations adopt a standard commission rate for achieving fixed sales levels, for the product mix. Some organizations have a variable commission rate for the sales force (depending on the product or customer category they are handling) to calculate profitability or the progress of strategic objectives. Sometimes, sales people are eligible for commissions only when they cross the sales quota.

Bonus: Bonuses are lump sums paid to sales personnel for achieving sales objectives in a defined period. The bonus can be calculated and paid on a quantitative or qualitative basis. The first involves payment on reaching designated sales volumes, while the second is dependent on aspects such as selling to certain key accounts. It may also be related to a customer satisfaction survey.

Employee stock options: This mode of payment has become one of the most commonly used methods, especially in the Information Technology industry. Many companies in the US and Europe have been using this method of rewarding their sales personnel, since the early 70's. Usually, a certain number of shares of the organization are allotted to an individual as an incentive. It not only creates a sense of ownership but also encourages the sales person to perform at higher levels.

Special Prizes: Organizations reward sales personnel with special prizes either in the form of money or valuable gifts like a flat screen television, Rolex watch or an expensive dinner set. These can be awarded to sales personnel after routine competitions or sales contests.

Drawing Account: This is more like an advance given to a sales person. It involves periodic monetary advances given at a fixed rate of interest or commission that must be repaid by the sales person to the company within a certain time frame.

Special Cash Incentives: These are given to sales personnel during certain periods of time, for performing specific activities or for achieving extraordinary results. Such cash awards are usually not part of the regular compensation package for sales personnel.

Non-Cash Incentives: These include merchandise, travel, status and recognition awards that are given for specific periods of time, especially during sales contests. Sales personnel gain points for achieving defined objectives, which are later exchanged for merchandise that are available from a catalogue. Such incentives are given in the form of status awards and/or recognition rewards. Status awards include club memberships, company car and so on. Recognition awards include trophies, photographs and special mementos from the Chairman or CEO of the organization.

Fringe benefits: These are benefits given to sales personnel in the form of medical reimbursement, pension scheme, group insurance and other benefits. This method of payment is dealt with in detail later in the chapter.

Sales force expenses. It includes reimbursement of expenses incurred by sales personnel as part of their selling activities. It may be travel and lodging expenses, daily allowances and so on. This is also dealt with separately later in the chapter.

Many organizations have started using software programs to facilitate easy calculation and implementation of payment methods. Companies like Oracle Corporation, Siebel Systems and SAP have developed software programs that are used by large corporations with numerous divisions and range of products, to develop effective payment structures for their sales personnel.

IMPLEMENTING COMPENSATION PLANS

While implementing the compensation plan, sales managers must know which tasks sales personnel are to be compensated for. This is followed by deciding the features of the compensation plan that will help attain organizational objectives. Otherwise, it is probable that sales personnel may not be interested in tasks that they consider unimportant and for which sufficient rewards are not present in the compensation plan. Different elements like salary, commission, bonus, drawing account, expense allowances, fringe benefits and profit sharing, individually or in combination, help in designing a proper compensation plan. Sales managers try to achieve numerous objectives with the help of different combinations of elements in a compensation plan. The combination varies with the nature of the objectives. For example, to increase sales of particular products or while selling a new product, special commissions or bonus may be given on attaining desired sales volumes. If the aim is to increase the rate of sales calls, a bonus may be given on all those calls that yield results in the form of a sale. Compensation plans are successfully implemented through proper pre-testing and periodic monitoring.

Pre-testing

Once the compensation plan is formulated, it should be pre-tested. This must be done against probable sales or expected profit volumes at both possible extremes, i.e. against maximum possible sales and minimum probable sales. Pre-testing involves determining how the plan would work if implemented a few years earlier. Sales managers estimate the costs of implementation and the possible results that would have accrued if the plan had been put in action earlier. This can be done by using computer simulation programs. Pre-testing can also be conducted by considering the past performance of sales personnel and the historical performance of a particular territory. A compensation plan can be applied to a particular territory for a pre-assigned period and results can be evaluated. If satisfactory, the plan can then be extended to all the regions where the organization operates. While testing, care must be taken to consider the extreme variations in the market life cycle and other environmental factors to reduce the possibility of sales personnel being overpaid or under paid.

Periodic monitoring

The objectives of the plan must be clearly explained to sales personnel so that no misunderstanding arises. People and operating procedures have to be set up to ensure successful implementation of the compensation plan. Appropriate measurement criteria, information systems that provide data needed for measurement and regular communication of information through newsletters have to be set up. Monitoring must include non-selling activities like relationship management. Regional and territory managers must have the authority to periodically monitor and implement the plan. Periodic monitoring ensures that operating problems are minimized and appropriate modifications made when needed. For example, changes in bonus or commission levels have to be made when deciding to add or remove certain customers from the existing list, or when changing the credit terms of customers. Expense accounts too may have to be readjusted if expenditure on travel and entertainment is above desired levels. Incentives sometimes may not reflect the areas that sales managers want to emphasize. For example, the compensation plan may justify the bonus given to a sales person for higher number of orders achieved, but may contradict the sales management's focus on team selling through joint product presentations or cross referrals. So, it is necessary to monitor whether the compensation plan is encouraging sales personnel to focus on the right kind of sales effort. To better understand how plans are used by organizations let us consider the basis of compensation among companies in the South African pharmaceutical industry. Exhibit 13.3 gives a good understanding of the methods of compensation employed for the sales force.

SALES CONTESTS

Sales contests are an important compensation tool widely used by organizations to achieve their objective of increasing profits. Primarily, contests are used to increase profits by encouraging sales personnel to increase their individual sales volumes. It is a useful short- term compensation tool, when the management does not want to change the basic compensation structure for its sales force. Contests are also conducted to fulfil short-term objectives like increasing emphasis on prospecting or on selling certain products, as part of a push strategy for a set period. The primary objective of most sales contests is to obtain new customers. They are also used for selling certain designated products. Increasing the sales volume per call is an aim that organizations try to achieve through sales contests. Travel, special prizes and privilege awards are some incentives given to sales personnel in sales contests. Money is also given, but only occasionally. Sales contests are mainly used for sales personnel, but they are also conducted for dealers, distributors and consumers. Sales contests for the

Exhibit 13.3

Sales Compensation Plans in the South African Pharmaceutical Industry

Based on a survey conducted by Russel Abratt and Manfred Klein in 1995 among companies operating in the pharmaceutical industry in South Africa, the types of compensation approach by these companies were identified.

Method of payment: These companies have a combination plan with a base salary and one or more incentives like commission or bonus. A combination of salary, group bonus, commission and sales contest reward is the preferred method of payment. This is followed by the salary plus commission combination.

Fringe benefits: Most pharmaceutical companies offer medical aid, disability insurance, expense allowances and pension schemes. In addition, sales personnel are given a cell phone and a company car, or the benefit of a car scheme.

Purpose of incentive schemes: The companies' main purpose is to provide incentives for motivating sales personnel to perform better and direct their activities towards achieving organizational objectives.

Criteria to increase pay levels: The main criterion considered in the industry to decide increases in compensation for sales personnel is performance appraisal. Many companies take into account the prevailing compensation levels in the industry to hike compensation from time to time. Cost of living is another important factor that is taken into consideration. Strangely, the number of years a person has worked in the organization or seniority is not considered a criterion for increasing pay. This is markedly different from the Indian context.

Designing the compensation plan: Sales managers primarily design the compensation plan for sales personnel, in a majority of companies. Some companies involve the General Manager or the Marketing Manager for designing the plan. Interestingly, the personnel department is not involved. It is observed that very few companies consult their sales personnel before designing the compensation plan.

Factors considered to award incentives: Companies primarily consider the achievement of set quotas to award incentives to sales personnel. The organization's overall performance along with uniform product sales mix achieved by sales personnel is also deemed important.

Compensation mix: The combination of salary and incentives preferred by many companies is 80% salary and 20% incentive mix. Some companies use a 90% and 10% or a 70% and 30% mix. Most companies have an upper limit for fixing the incentive component. On an average, it is 40% of base salary.

Evaluating compensation plans: Most companies in the industry evaluate the effectiveness of compensation plans by measuring them against budgets fixed earlier. Sales per product or total sales before and after the introduction of incentives are also considered to evaluate success.

Adapted from Russel Abratt and Manfred Klein, "Sales Force Compensation and Incentive Schemes: Practices in the South African Pharmaceutical Industry", South African Journal of Business Management, September 1999, Volume 30, Issue 3, 65-72.

sales force involve individuals as well as groups. A contest may be held between sales personnel or between different teams. Sales contests are often thematic. The theme may be a current event or occasion like 'Diwali Dhamaka'.

Planning Sales Contests

Sales managers should choose an appropriate theme to promote a contest, the format which will achieve the desired objectives, the timing of the contest, the number of awards and winners and the extent to which the expenses on conducting the contest justifies the attainment of objectives. Many organizations consider a sales contest as a

Exhibit 13.4

Designing an Effective Sales Contest

The main concern of the sales manager while designing a sales contest is to ensure that the contest influences the attitudes and efforts of sales personnel, towards achieving organizational goals. The success of a sales contest can be ensured if the following points are kept in mind.

- *Feedback from sales personnel:* The sales manager should gather feedback from contest participants during the contest or as soon as it is over. While considering the opinion of contestants, the feedback of losers should also be examined. It helps the manager know whether the contest was equitable or favoured some personnel. Generally, the opinions of winners tend to be favourable because the parameters used helped their successful performance.
- *Awareness of the task specific self-esteem factor:* The sales manager should be aware of the differences in the task specific self-esteem factor among sales personnel. Some of them are excited by the challenge of a contest irrespective of their performance in the field. Sales personnel with a low task specific self esteem focus more on the shortfalls in a sales contest and prefer not to participate or the discontinuation of the contest altogether.
- *Commitment:* The success of a sales contest is dependent on the extent of commitment sales personnel have towards the organization. When they have greater commitment, they look at contests as a means to help the organization succeed. Committed sales personnel overlook any shortcomings present in the contest design and are interested in the larger purpose. Sales personnel who are not committed point out shortcomings and are more interested in the rewards of the contest.
- C*areer stage of the sales force:* Depending on the extent of seniority of the sales force composition, the theme and rewards of the contest have to be designed. If the sales force composition is younger, there should be more emphasis on the recognition aspect than rewards, such as cash, goods or travel. The contest theme and the recognition angle have to be promoted throughout the contest period. If a majority of the sale force is senior and experienced, emphasis on recognition can be minimal.

Adapted from William H. Murphy and Ravipreet S. Sohi, "Salesperson's Perceptions about Sales Contests", European Journal of Marketing, 1995, Volume 39, Issue 13, 42-65.

ready tool to achieve specific organizational aims. They conduct contests without planning and use them indiscriminately. This invariably leads to poor results. Therefore, it is necessary to plan a sales contest meticulously. This is because it acts as a mechanism that guides sales managers to direct and influence the activities of sales personnel. The sales contest must be in synch with the organization's corporate and marketing goals and should not be used just because competitors are using it. In large corporations, a period of three to four months is required to plan, prepare and communicate contest details to sales personnel throughout the organization. The theme must create excitement and interest among sales personnel. It is necessary to promote the theme throughout the period of the contest, to maintain the hype among contestants.

Designing a proper sales contests is crucial to achieve the desired sales objectives set by the sales organization. Exhibit 13.4 describes sales contest design.

Evaluating Sales Contests

A sales contest must be evaluated objectively. The timing of the evaluation is not fixed. It can be evaluated before, during and after the contest. To measure the effect of a sales contest, its impact on the organization and impact on the sales force have to be considered. The sales manager must remember that a sales contest will impact sales and profitability, sales force motivation and morale, customer relationships and product service, composition of the product mix and the functioning of other departments. The contest may also have an impact on the behaviour of sales personnel in anticipation of the contest, before, during and after the event. Similarly, the response of customers may change and remain altered even after the contest is over.

The first step in proper evaluation involves identifying and assessing the effect of the contest on various business functions. The next step involves ranking each aspect according to the extent of impact, objectively. Finally, the impact of the contest is measured. The probable situation without the contest must also be taken into view while analysing the difference the sales contest has made. This will help identify any variations in actual outcome from the situation that would have prevailed without the contest. This step ensures that effectiveness is measured accurately and that probable remedial measures are taken. The contest should be evaluated not only on the basis of its own goal but also on the basis of other aspects like customer response, effect on organizational resources, call rate and ratio and other long-term effects.

To sum up, sales contests should be used only as a promotional tool in tune with the organization's strategy.

To run a successful sales contest, a manager has to be aware of the nature of sales personnel and spend reasonable time to design and periodically review and improve the contest contents. This helps motivate the sales force to conduct selling activities along expected lines.

SALES FORCE EXPENSES

Sales managers have to keep tabs on the expenses incurred by sales personnel. Managers seek answers to questions like what is the appropriate size of the sales force; what are the methods of compensation suitable to achieve objectives and should profit-based quotas be set to reflect income versus expenditure of the sales force. Sales force expenditure constitutes a considerable part of an organization's marketing budget. Companies should clearly state what expenses can be incurred by a sales person. Let us discuss the characteristics of an expense plan and the types of expense plans companies implement for their sales forces.

Expense Plans

A compensation plan should clearly mention the type of expenses that sales personnel are allowed to undertake during selling activities. Expense plans vary in different organizations and different industries. A compensation plan should specify all the expenses the company will reimburse. A good expense plan must be:

- **Beneficial to salesperson:** Salespersons must be able to carry out selling activities comfortably without personal discomfort in travel, food and lodging.
- **Beneficial to the organization:** The organization should not be overburdened with the costs incurred in selling activities. Expenses should be controlled so that the net profit margin for selling a product is maintained.
- **Easy to administer:** It should be simple and easy to administer. It must not require many people to monitor and control.
- **Easy to understand:** The restrictions on expenses, changes in expense plans and timing of reimbursement should be clearly communicated to sales people. Clarity can be ensured if sales personnel are also involved in expense plan preparation. Details on how much can be spent entertaining clients and policies restricting giving bribes and other related issues, if any, should be clearly communicated. It not only reduces confusion but also helps direct the behaviour of the sales force.

Types of Expense Plans

Most organizations follow one of the following three types of expense plans:

'Company pays all' expenses

Here, the organization pays for all expenses incurred by sales people to carry out selling activities. The advantage is that it gives the sales person the freedom to spend money to successfully fulfil organizational objectives. It also reduces the costs and time of the management in calculating limits on expenses for each sales person, depending on the territory and type of activities. The disadvantage is that sales personnel may not spend money judiciously for selling activities. There is a possibility of sales personnel hiking expenses to earn extra money. Organizations that pay all expenses try to restrict sales force expenditure by putting in place activity and expense quotas that direct and restrict the expenses of sales personnel, within permissible limits.

'Sales person pays all' expenses

This type of plan is adopted when organizations pay sales personnel through a straight commission plan. The commission is above standard levels, and a certain percentage is paid keeping in mind the probable expenses of sales personnel during selling activities. This expense plan keeps sales force expenses within permissible limits. It also enables organizations to prepare expense budgets accurately. The organization has to keep in mind the areas where sales personnel may need to spend money and formulate necessary steps. For example, if customer entertainment or presence at trade fairs and exhibitions is necessary, then the compensation plan must encourage the knowledge, contacts and experience gained by sales persons through these activities by making necessary provisions in the expense plans.

The disadvantage is that the organization cannot control the selling activities of sales personnel to ensure that objectives are achieved economically. Sometimes, sales personnel may ignore certain activities to control their expenses, so that total expenses remain within the limit. For example, even if the relationship- selling approach is stressed by the sales manager, a salesperson may make only few calls to customers to reduce travelling expenses and keep overall expenses in hand.

'Company partially pays' expenses

This arrangement takes a middle path in comparison to those described above. In this method, an organization sets a ceiling for expenses for various essential activities. For example, a fixed travelling or daily allowance is set for sales personnel. Anything that exceeds the limit has to be borne by them. Another method is to give sales personnel a one-time fixed amount that can be utilized over a fixed time-period, say a week or a month. Again, anything in excess will be borne by the salespersons. The advantage is that it helps the management to accurately estimate selling expenses. It also eliminates conflicts that might arise when sales personnel are asked to justify expenditure. The disadvantage is rigidity, since it does not take into account the differences in activities and territory potential among the sales force. The reason is that the expense amount disbursed is common for the entire sales force irrespective of the possible differences in territories.

Costs of making a sales call is one of the components that make up the total sales force expenses that an organization incurs. Exhibit 13.5 highlights the differences in costs per call based on the type of industry, the size of the sales force and the kind of selling approach.

Exhibit 13.5

Cost of Making a Sales Call

Based on a survey conducted in the US by Sales & Marketing Management along with Hay Group's Sales Force Effectiveness Practice and C&C Marketing Research Inc. in the year 2000, it was concluded that though traveling and entertainment costs and sales force benefits remained stable, sales force compensation rates had increased. This rise was observed in companies that focused on consultative selling. For such companies, the costs incurred per customer call averaged around $211.56.

The sales approaches used by organizations were classified into – transactional approach (focus of selling on price and not product), benefit approach (focus on price and product features), solution approach (focus of selling on customer needs) and value-added approach (team selling with focus on providing solutions than price). It was found that companies that used a value-added approach to selling incurred maximum costs per call, followed by those that used a solution and benefit approach, respectively. Transactional selling approach incurred the least selling costs per sales call.

Companies that had a very small sales force (1-5) or a sales force greater than 50 incurred higher costs per sales call than companies that had a sales force below 50 (but more than 5). Companies selling industrial products had a higher cost per sales call than consumer product companies. An interesting finding of the survey was that service- based organizations incurred higher sales costs per call than consumer product companies.

Adapted from Marchelli Michelle, "The Cost of Doing Business", Sales & Marketing Management, September 1999, Volume 151, Issue 9, 56-57.

FRINGE BENEFITS

Fringe benefits, also termed indirect compensation, have assumed great significance over the years in the sales function. These benefits were earlier given to employees in traditional functions like production, personnel and finance, but it has now gained equal importance in the compensation package of sales and marketing personnel too. Fringe benefits are usually not directly linked to money but act as an important source for attracting prospective employees. Since the beginning of the twentieth century, organizations started providing fringe benefits to their employees. The National Wallpaper Company was one of the earliest companies to have an arrangement for benefit plans, in the form of a guaranteed annual salary way back in 1894, in the United States.

Elements in Fringe Benefits

The various elements that fringe benefits include are:

- Benefits provided by organizations under the legal framework on the basis of the Labour Act. These include social security, unemployment compensation and compensation in the event of termination of employment.
- Pension and retirement programmes that include provident fund and gratuity.
- Insurance against unforeseen events that include life, medical and accident insurance.
- Reimbursement for time not worked like vacations, sick leave and casual leave.
- Other miscellaneous benefits such as employee stock options, reimbursement for education, entertainment and personnel counselling.

Social Security

- For employees, salaries are adjusted on the basis of their location. A higher benefit is given to employees in metros than in Class-2 cities. It may include housing allowance or city compensatory allowance.
- Higher amounts are disbursed by employers at the time of lay-offs in the form of fringe benefits.
- Income security also acts as a kind of social security for sales personnel, especially in a globalized environment where companies are going for cost-cutting and downsizing measures. Organizations that sponsor sales personnel to attend training programmes to upgrade their selling skills give them an opportunity to add value to organizational activities. This provides a sense of security to sales personnel.
- Employers contribute in the form of various short-term and long-term security schemes for employees, including sales personnel.

Pension and retirement programs

- Deferred payment programs like pension are used to ensure tax benefits and provide for a continuous monthly income when sales personnel retire.
- Benefits are given to the family in case a person dies when he is in employment.
- Retired employees are eligible for old-age treatment, subsidized by the organization.

Insurance

- Group insurance, where family members eligible for insurance, make a claim from the company in the event of accident or death.
- The organization provides medical and accidental insurance for on-the-job mishaps.
- Medical insurance is provided to employees for major illnesses such as heart attacks, etc.

Holidays

- Organizations provide earned leave, which employees can either encash or avail of.
- Yearly company paid holidays for the employee with family.

Time-off with pay

- Fully paid leave to take up further studies or attend training programs.
- Maternity leave for working mothers
- Leave to attend seminars or present papers.

Other benefits

- Company car
- Interest-free loans
- Subsidized housing and food.
- Mobile telephones
- Customer entertainment expenses

Many multinationals are nowadays offering flexi-time jobs, work from home options, sales automation tools and Internet selling systems. These have led to greater demand from employees for better medical allowances and retirement benefits, increased focus on allowances for higher education and more claims for recreation and vacation benefits. Employees are attracted to a compensation package that has a better fringe benefit component than a plan that is purely salary or commission based. With a rising proportion of the workforce being women, many organizations in India are adopting newer ways to provide benefits to employees. The main reason for this change is the emergence of the service sector as a boom industry in India, which provides a more amicable working environment than traditional sectors.

Advantages of Fringe Benefits

- The major advantage of fringe benefits is that they are largely non-taxable, except for benefits that employees get at the time of retirement.
- Certain benefits like educational and vacation allowances and group insurance for the family are highly valued by employees. They attach significant importance to these benefits, sometimes more than direct compensation or salary.
- Sales personnel are increasingly on the move and travel and relocation benefits provide a sense of security to them.

SUMMARY

There is no single sales compensation plan that is suitable for all organizations. Every organization has to design its own compensation plan that will enable it to fulfil sales objectives and to attract and retain sales personnel. A truly successful sales compensation plan must help achieve overall organizational goals and not just sales goals. The objectives of a compensation plan should be clearly stated, so that it becomes easier to determine whether the organization is able to achieve them. The compensation plan must fulfil the primary objective of balancing the needs of the sales personnel, and provide them income and security. It should also be effective in all business conditions – good or bad. It should be fair, flexible, easy to administer, fulfil the needs of sales personnel and lead to the achievement of organizational objectives.

Organizations compensate sales forces in many ways. The compensation plan may be a straight salary type, a commission-based type or a combination of salary, commissions and incentives. While deciding on the type, it is necessary to consider the differences in territory characteristics, sales activities and objectives of sales personnel. Sales contests are widely used as a source of compensation, especially when an organization wants to emphasize certain activities with the primary aim of increasing profits. A sales manager must plan a sales contest well in advance and avoid indiscriminate usage. Otherwise, sales contests will lose their efficacy.

Compensation plans have an impact on recruitment, training, evaluation and control functions too. While designing a compensation plan, its objectives must be stated. Next, the level of payment should be established. Different industries have different levels of payments. The last step in designing the plan is deciding on the method of payment for the sales force. It may be in the form of a straight salary, commission or bonus or a combination. Drawing account, special cash and non-cash incentives and fringe benefits are also used as a form of payment to the sales force.

The effectiveness and success of a compensation plan depend on its execution. The plan should be tested in a territory before it is implemented throughout the organization. To ensure success, periodic monitoring is also essential. Sales force expenses make up a large portion of total organizational expenditure. To ensure profitability, a sales manager should control sales force expenses in the form of expense quotas. An expense plan must be easy to administer, beneficial to the organization and sales personnel and must be communicated clearly to the sales force. In most organizations, selling expenses are be reimbursed either completely, partially or in the form of an excess commission that sales personnel must use for meeting selling expenses.

Fringe benefits have become a common method of compensation in most organizations. This is also called indirect compensation. Fringe benefits may be in the form of retirement benefits, insurance schemes, employee stock options, medical benefits and paid holidays.

With changes in the global environment, organizations have started formulating tailor-made sales compensation plans for individual sales personnel. Ultimately, the success or failure of a compensation plan is dependent on its ability to motivate sales personnel to fulfil organizational objectives and to retain the best talent in the organization.

Chapter 14

Motivating the Sales Force

In this chapter we will discuss:

- Concept of motivation
- Motivational theories
- Motivation and productivity of the sales force
- Effect of personal characteristics on sales force motivation
- Sales motivational mix
- Motivating the sales personnel at different stages of their career

Of all the tools that comprise the promotional mix, personal selling is the most flexible and competitive tool. It gives salespersons the opportunity to pursue a customized approach for different customers. Personal selling is not something that one would term glamorous and it doesn't appeal to many people. A salesperson, in his daily schedule, meets a variety of customers hailing from different social, educational, religious and cultural backgrounds. In order to be effective, he should be able to adjust his behavior to suit the needs of various sets of customers. Moreover, the salesperson should also be able to take rejections in his stride and still remain committed to the goals of the organization.

The sales force plays a crucial role in generating revenue and helps sustain the growth and survival of companies. It is the responsibility of the sales force of an organization to constantly improve its sales. In their job of personal selling, the sales force is more or less free from direct supervision, except for reporting to the sales manager regarding the targets achieved and to formulate or revise sales plans. Because of the nature of the job, salespeople have to be self-motivated in order to derive maximum satisfaction from the job.

When self-motivation fails, it is the task of the sales manager to ensure that his team remains motivated and committed to the task. Organizational theorists like Frederick. W. Taylor propounded the carrot-and-stick approach to motivation. The carrot-and-stick approach is based on the analogy of tying a carrot at the end of a stick and dangling it in front of a donkey to make it work. When applied to individuals, this approach propounds that individuals can be motivated to deliver the desired performance by providing them incentives (the carrot), and at the same time, having an appropriate system of controls or punishment (the stick) can control undesired behavior. However, such an approach does not always work. The carrot will motivate the donkey to work only if the donkey likes carrots, not otherwise. Similarly, in the case of sales personnel too, sales managers have to be sure that the incentives and rewards which they perceive as motivators are indeed motivators to their sales personnel.

In this chapter, we discuss the various aspects of motivation and the theories that have been propounded for motivation. We also examine how motivation is linked to the productivity of the sales force. This is followed by a discussion on the effect of personal characteristics of sales personnel, on their motivation and on the sales motivational mix. The chapter concludes with an examination of how sales personnel can be motivated at different stages of their career.

CONCEPT OF MOTIVATION

The word *motivation* is derived from the Latin word *movere* which means *to move*. Motivation is a process that instigates goal-directed behavior in an individual. In other words, motivation deals with the force within a person, or which acts on a person, to initiate desired behavior and directs it toward the attainment of organizational goals.

Stephen P. Robbins defined motivation as the willingness to exert high levels of effort toward organizational goals, conditioned by the effort's ability to satisfy some individual need.[1] Fred Luthans defined motivation as a process that starts with a physiological or psychological deficiency or need that activates a behavior or a drive that is aimed at a goal or incentive.[2]

[1] Stephen P. Robbins, *Organizational Behavior – Concepts, Controversies, Application*, Eighth edition (New Delhi: Prentice-Hall of India, 1999) 168.

[2] Fred Luthans, *Organizational Behavior*, Eighth edition, (Singapore: Irwin McGraw-Hill, 1998) 161.

Thus, from the above two definitions, it is clear that motivation is a process that essentially consists of three components – need, drive and goal. Need is a physiological or psychological state of imbalance created in an individual which stimulates the individual to take certain action to satisfy the need and thereby restore the balance. Drive is the desire generated in the individual to satisfy or fulfill his need. In other words, drive is the goal-oriented action taken by an individual to move from a state of felt deprivation to a state of fulfillment. Goal is the instrument to induce the individual to follow a certain course of action. Achievement of the goal restores the physiological or psychological balance in the individual by satisfying his need. Satisfaction of the need in turn cuts off the drive in the individual to work towards need satisfaction.

The sales function plays a crucial role in the success and growth of an organization. The attainment of goals in an organization depends on the effectiveness of its sales force, and hence requires that its sales force be highly motivated. In sales force management, motivation refers to the amount of effort a salesperson is willing to expend to accomplish the tasks associated with his job. A salesperson's motivation plays a crucial role in influencing his performance in selling, and his achievement of sales targets. The salesperson's motivation affects not just his selling performance, but also has an impact on the sales force expense, turnover, absenteeism and need for supervision.

MOTIVATIONAL THEORIES

Behavioral theorists have proposed several theories to explain what motivates people. Of these, the major theories of motivation that affect the performance of salespersons include Maslow's hierarchy of needs theory, Herzberg's two-factor theory, goal setting theory, expectancy theory, and job design theories.

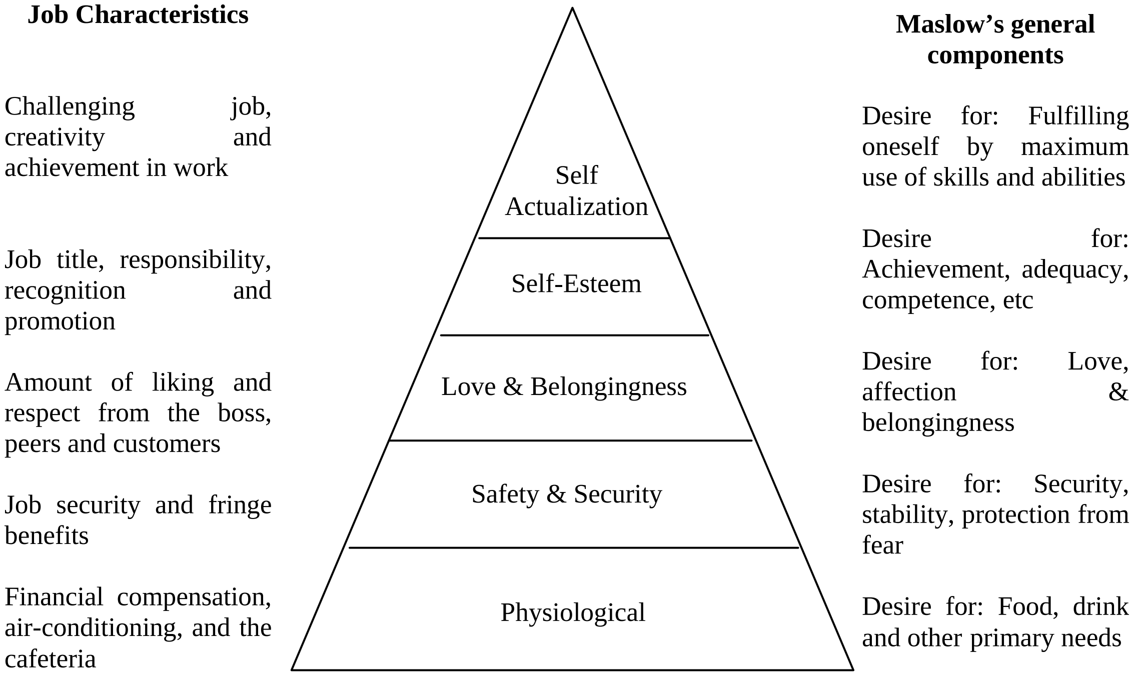
Maslow's Hierarchy of Needs Theory

Maslow's hierarchy of needs theory propounded by Abraham Maslow states that human needs can be classified into five categories – physiological needs, safety and security needs, social needs, self-esteem needs and self-actualization needs. These needs act as motivators and occur in a hierarchical order with physiological needs forming the lowest-level and self-actualization needs forming the highest level of needs. Fulfillment of lower order needs creates a higher order need in the individual and makes him work toward fulfilling it. Maslow's hierarchy of needs is shown in Figure 14.1.

Physiological needs form the lowest or most basic level of needs and include the need for food, drink, clothing, etc. Safety and security needs include the need for security and protection from physical, psychological and financial harm. Social needs include the need for love, affection and belongingness. Self-esteem needs include the need for achievement, recognition and status. Self-actualization needs form the highest order needs in Maslow's hierarchy and involve seeking fulfillment by making maximum use of one's abilities or skills.

When applied to the sales function, physiological needs take the form of need for a steady income and good working conditions. Safety and security needs include the need for job security and safe working conditions. Social needs include the need for acceptance by peers and good interpersonal relations with organizational members and customers. Self-esteem needs include the need for status or job title, recognition, rewards and promotion. Self-actualization needs of an individual in the workplace refer to the need for growth in one's career, need to achieve one's potential, need for autonomy and need for self-development.

Figure 14.1: Maslow's Hierarchy of Needs



Source: Robert L. Berl, Nicholas C. Williamson and Terry Powell, "Industrial Sales force Motivation: A Critique and Test of Maslow's Hierarchy of Need," *Journal of Personal Selling & Sales Management**, May 1984, Volume 4, Issue 1, 33-39.*

Organizations such as the Moore Corporation which motivate their sales people on the basis of these aspects of their behavior have succeeded in becoming global leaders in their field. Moore Corporation's recognition program for its sales force has been described in Exhibit 14.1.

Herzberg's Two-Factor Theory

The Herzberg's two-factor theory states that the job environment of an individual is characterized by two fundamentally different sets of factors – hygiene factors and motivational factors.

The hygiene factors are also known as maintenance or job context factors. These factors are not a part and parcel of the work but are matters that relate to the work. While presence of these factors does not motivate an individual, the absence of these creates dissatisfaction or has a negative impact on work motivation. Work conditions, job security, salary, company policies and quality of technical supervision and interpersonal relations are examples of hygiene factors.

Motivational factors are job content factors and related to the content of the job. Absence of these factors causes dissatisfaction while their presence motivates the individual. Responsibility, the work itself, promotion, recognition, and achievement are examples of motivational factors. Herzberg's hygiene factors correspond to Maslow's physiological, safety/security and social needs, while the motivational factors in Herzberg's dual-factor theory correspond to Maslow's esteem and self-actualization needs (as shown in Table 14.1).

Exhibit 14.1

Recognition as a Motivating Factor

Every human being likes to be given recognition in front of others. Salespersons too like it when their efforts are appreciated and praised by the management in the presence of their peers and subordinates. The Toronto-based company, Moore Corporation, that provides information solutions to its customers, makes good use of this aspect of human behavior to motivate its sales force to excel in their selling performance.

Salespersons who exceed their sales quota become members of the Moore's Achievement Club, and some of them receive the 'officership' title. All the salespersons who make it to the Achievement Club are invited for an annual week-long Moore's Achievement Club sales meeting at a resort or some other exotic location. The salespersons who are chosen for officership are individually recognized and awarded the title at a grand banquet attended by all the members of the Achievement Club. Among the officers, the top performer is awarded the title of the CEO for the duration of a week at the annual Moore's Achievement Club sales meeting. The recognition is bestowed on the salesperson in the presence of all the top salespeople in the organization. The recognition given to the top salesperson and royal treatment that follows in terms of extra days of stay and the best accommodation at the resort motivates those in the audience to aspire for the CEO title for the next year and makes them get better in their sales performance.

Publicity for Moore's recognition program is built up throughout the year through the internal monthly newsletter of the company. The newsletter distributed to all the sales people tries to inspire them by describing what the annual Achievement Club Sales meeting will be like and highlighting the previous year's winners. Further, every salesperson receives a monthly update from his sales manager as to where he stands with regard to making it to the Achievement Club. This allows the salespersons to know what they have to do to be part of the Club.

Moore's recognition program is not confined only to salespersons but covers everyone who is involved with sales such as the sales support staff. All these individuals can try to make it to the Achievement Club. Sales support staff are judged on other aspects such as their efficiency in processing orders. In addition to the public recognition they are given at the annual Achievement Club sales meetings and incentive trips, sales support staff are also given additional payoffs such as a promotion followed by a choice posting to any location of the company across the country.

Thus, Moore Corporation's recognition program motivates not just the sales force but also the sales support staff to work harder. A video recording of the event is sent to all the sales divisions. The visibility that the video provides to the event inspires and motivates the rest of the sales force to work towards such recognition.

Adapted from Andy Cohen, "Hail to the Chief," Sales & Marketing Management, January 1995, Volume 147, Issue 1, 101-105.

Table 14.1: Comparison of Maslow's and Herzberg's Theories of Motivation

<table>
<tr><th>Maslow's Hierarchy of Needs</th><th>Herzberg's Two-Factor Theory</th></tr>
<tr><td>Self-actualization needs</td><td rowspan="2">Motivators:
Responsibilities
Challenging work
Recognition
Achievement</td></tr>
<tr><td>Esteem needs</td></tr>
<tr><td>Social needs</td><td rowspan="3">Maintenance Factors:
Job security
Good pay
Working conditions
Type of supervision
Interpersonal relations</td></tr>
<tr><td>Safety and security needs</td></tr>
<tr><td>Physiological needs</td></tr>
</table>

Based on Herzberg's dual-factor theory, it can be concluded that the job performance of a salesperson depends on his level of motivation. This, in turn depends on the extent to which the salesperson is satisfied or dissatisfied with the factors related to his job.

Goal Setting Theory

Goal setting theory presumes that people have specific needs and aspirations, and in order to fulfill these, they set certain goals for themselves. They go about achieving these goals by taking purposeful action. Goal setting is also known as 'management by objectives (MBO)'.

The goal setting theory proposed by Edwin Locke, an organizational behaviorist, states that setting higher goals produces higher output. Further, the theory also states that goals that are specific in nature, rather than vague statements such as "Do your best", tend to produce higher output. Also, the goals set by the individual regulate his behavior.

Setting goals encourages a person to work persistently towards achieving goals. It also helps salespersons plan their activities better, align them with the organization's objectives, and formulate action plans to achieve their goals. Goals also regulate the efforts of an individual such that the individual learns to prioritize and manage his time effectively. Further, purposeful action by the individual toward achievement of the goals is possible only if the goals are clear and not too difficult to achieve, and if the individual is committed to achieving these goals.

Expectancy Theory

According to the expectancy theory (proposed by Victor Vroom), the perceived consequences of his actions are what motivate an individual. Expectancy theory states that motivation is a function of three factors – first, the individual has certain expected outcomes (expectation); second, the extent to which the outcome is valued by the individual (valence); and third, the probability that the efforts expended by the individual will help in attaining the outcome (instrumentality). According to the expectancy theory, motivation is a function of expectation, valence and instrumentality and is represented by the equation:

Motivation = $f(e \times v \times i)$ where e represents expectation, v represents valence and i represents instrumentality.

The expectancy theory of motivation has been applied to study sales force management problems, especially problems related to a decrease in the level of motivation of the sales force when sales managers undertake territory realignments. When territories are realigned, the loss of territory of one salesperson becomes a gain for another salesperson. Territory realignments give rise to concerns regarding changes in sales potential. Changes in sales potential, in turn, result in changes in salesperson's expectations about sales volume. Territory realignment can lead to a gain or loss of territory and accordingly can result in positive or negative expectations in sales people regarding sales potential and sales volume. Sales managers can make use of the sales force's expectations and motivate them to achieve organizational goals.

The positive expectations of sales people arising from a gain in sales territory can be reinforced and amplified by projecting the gain in sales territory as an opportunity to increase sales volume and thereby the income of the salespersons. On the other hand, even sales people who lose sales territory can be effectively motivated by sales managers. The sales manager can try to reduce the negative expectations of the salesperson and boost his morale by emphasizing the existence of sufficient sales potential within the territory that remains and encouraging the salesperson to cover the territory more intensely to maintain sales volume and income. The sales manager can also tap other expectations of the salesperson by making him realize the benefit of reduced territory in terms of reduced travel time and by putting him at ease with the assertion that the reduction in sales territory would not affect his chances for promotion.

Job Design Theories

Job design theories correlate motivation with job satisfaction. Job satisfaction is the feeling of pleasure that one derives from one's experiences in a job. Job design theories suggest that job satisfaction can be created by means of job enrichment, job rotation and job enlargement.

Job enrichment is a management approach to retain employees by making their work more challenging and rewarding. It is a form of vertical expansion of a job and involves the addition of more tasks in the job. It provides a greater variety of tasks in the job and increases the responsibilities of the individual.

Job rotation enhances employee motivation by periodically assigning the employee to alternative jobs. This can be beneficial to both the organization and the employee. The employee would be relieved from a monotonous cycle and the organization would benefit from his motivated performance.

Job enlargement is the horizontal expansion of a job by adding more tasks to the job with no increase in responsibility. The purpose of job enlargement is to prevent the employee from getting bored.

Job design theories assume that all individuals have the same needs and that these needs can be satisfied by ensuring certain job characteristics. However, job satisfaction is not be the same for all individuals in a similar job, because job satisfaction is influenced by various other factors in addition to job characteristics. These include factors relating to the individual such as age, physical and mental capabilities of the individual, etc.

MOTIVATION AND PRODUCTIVITY OF THE SALES FORCE

The two prime determinants of sales force performance are the ability to perform and the willingness to perform. The performance of the sales personnel in achieving targets serves as an indicator of their productivity.

Productivity is defined as the ratio of output to input and is represented in the form of the following equation:

$$\text{Productivity} = \frac{\text{Output}}{\text{Input}}$$

Sales productivity is defined as the ratio of sales revenues to sales expenses.

$$\text{Salesproductivity} = \frac{\text{Sales revenues}}{\text{Sales expenses}}$$

Sales force productivity is not the same as manufacturing productivity. Unlike manufacturing, sales force productivity is influenced by various factors other than the inputs such as customer reaction and volatility of the market. Further, it may take days, weeks, months or even longer to convert a prospect into a real customer. Thus, the constraint of time factor makes it difficult to assess sales productivity accurately.

Sales force productivity is a function of many factors such as work environment, work methods, selling skills of the salesperson and salesperson motivation.

Exhibit 14.2

Innovative Ideas to Pep up the Sales Force

Sales meetings are famed for their boring and routine presentations. Firms have therefore started taking steps to make their sales meetings lively. For example, in order to make the salespersons interested and involved in what's going on at the sales meeting, the president of a firm came up with the idea that each salesperson would contribute a dollar at the beginning of the sales meeting with his name written on it. Further, an announcement was made that there would be a lucky draw at the end of the meeting in which the salesperson whose dollar was picked would win the entire amount of money. However, the condition that applied to win the money was that the winning salesperson would make a summary presentation of the meeting. This ensured that all the salespersons tuned in and took notes throughout the meeting to help them in the presentation at the end.

Apart from interesting sales sessions, companies now use contests and prizes to motivate their sales force. Some sales organizations even get the spouses of salespersons involved in motivating their salespeople. These companies send mailers to the spouse humorously egging them on to push their partner to make more sales in order to win various gadgets or appliances for the home.

A few other sales organizations use the tool of embarrassment to motivate their sales force to perform better. They publicize the monthly sales of every salesperson in the company so that each salesperson gets to compare his performance with that of his peers. While such publicity brings fame and recognition to the top achievers, it also serves to embarrass those performing poorly and makes them improve their performance in future at least to avoid being embarrassed.

Adapted from Greg Conderacci, "Can Gimmicks Fire up the Sales Force?" Management Review, December 1970, 47-49.

The level of motivation of a salesperson influences his performance and thereby his productivity. Salespeople need to be self-motivated to perform their responsibilities well. The diversity, flexibility and challenge associated with the selling job and the lack of direct supervision necessitates the salesperson to have high motivation levels in order to achieve his sales targets. Salespersons having a high level of motivation tend to perform well in the selling job and have high productivity. On the other hand, salespersons who lack motivation tend to be poor performers and fail to achieve their sales targets. Such salespersons hence tend to have low productivity.

Sales managers can take various measures to motivate the sales force and boost its productivity. These measures can be in the form of sales quotas, sales contests, well-designed compensation plans and reward systems. Sales managers can even come up with innovative ideas for activities to boost the enthusiasm and morale of the sales force. Exhibit 14.2 describes some of the innovative ideas that are being implemented by a number of sales organizations to pep up their sales force.

Some organizations transform themselves into fun workplaces to motivate the employee to excel in his job. Exhibit 14.3 describes the various measures that organizations adopt to transform themselves into fun workplaces.

In addition to the above methods, sales managers can also improve sales force productivity by improving communication, participation, job enrichment and by giving salespersons a share in company profits.

Sales force managers can enlist the participation of the sales force in decisions pertaining to the improvement of selling techniques and by inviting their participation in surveys, questionnaires and suggestion schemes. Sales managers can take steps to improve communication within the sales department of the organization by ensuring that they are always accessible to the field sales force for guidance. Job enrichment measures to enhance the motivation of the sales force include measures such as providing sales personnel opportunities to continue their education while working.

Exhibit 14.3

Motivate Employees with Fun

The biggest problem faced by organizations today is to attract and retain good workers and keep them motivated so as to make them more productive. High turnover of employees is a problem that organizations across the world face. It costs an organization much more to attract and train new employees than to retain existing employees. Employers have begun to realize that money cannot alone hold back people to work for them. At the most, money can get people to join the organization but it doesn't prevent them from leaving.

Employees seek fun-filled lively workplaces which offer them flexibility, freedom, responsibility and fun. Organizations too have begun to see the relationship between workplace innovation and employee motivation and are coming up with innovative methods to keep their employees motivated. Organizations are trying to provide a fun workplace where employees can enjoy themselves while contributing to the achievement of organizational goals.

Some examples of ways in which organizations are introducing elements of fun at work are given below.

Humor corner – Organizations having a humor corner allocate a special section such as a room within the organization for employees to put up cartoons, jokes, and other objects that help employees to relieve stress. Further, there are weekly awards given away to the employee who makes the best submission.

Employee dollars – Phoenix Solutions Inc. has come up with this method of motivating its employees. Employees award their fellow employees with employee dollars for having done something special or for having exceeded company expectations. The dollars are totaled at the end of every month and the employee who has received the highest number of employee dollars is presented with movie tickets, a dinner and a plaque declaring him as The Employee of the Month.

Talking stick – Some organizations follow the 'talking stick' approach to motivate their employees. Each employee in the organization has a 'talking stick' for a month during which time the employee enjoys special rights and privileges. As the holder of the talking stick, the employee can grant his fellow employees special concessions such as an hour of administrative leave in a month. The talking stick method appears to have its origin in the native American tradition.

Man overboard awards – Man overboard awards are given to employees who go beyond company rules to satisfy the customer. The man overboard awards at CIGNA are sometimes as high as $25,000.

Management by fooling around – Herb Kelleher of Southwest Airlines is a CEO who believes in the philosophy of management by fooling around. In Southwest Airlines, employees play pranks on each other and on their customers to make the work environment more lively and fun. For example, customers of Southwest Airlines find airline crew popping out of the baggage area. In such organizations, fun is combined with work to motivate the employees to work harder.

Adapted from Gregory P. Smith, "Employers Use Fun to Fight Turnover," <http://www.salesvantage.com/news/management/employers_fun.shtml>

This helps them realize their self-actualization needs and helps motivate them. The sales force can also be motivated by offering them a share in the company's profits. Under such schemes, since greater sales volume translates into a greater share for the sales force, the sales force is encouraged to increase their selling efforts in order to increase their personal gain.

Exhibit 14.4

What Motivates the Japanese Salesperson?

US companies doing business in Japan find that managing the Japanese sales force requires an altogether different set of sales management techniques. In US companies, salespersons are willing to compromise on their personal values, and money can make them work for a company with values differing from their own. In contrast, money is not the chief motivating factor for Japanese salespersons. Sales managers of US companies operating in Japan often don't understand how to motivate the Japanese salespersons. They are uncertain as to whether they will be successful in motivating the Japanese salespersons by applying the same techniques of sales force management as in the US or whether they need to change their sales management strategy and follow the adage – Do in Rome as the Romans do!

American sales managers find that rewarding Japanese salespersons with expensive dinners, Rolex watches and fancy vacations fails to motivate them the way it motivates American salespersons. Instead, Japanese salespersons are motivated when they are part of a team having common goals and values. In a research study conducted to learn about the attitudinal characteristics of American and Japanese salespersons, it was found that the link between salary and the level of performance was 18 times stronger for American salespersons compared to that for the Japanese. Similarly, the study also found that the link between salary and job satisfaction was 5 times stronger for American salespersons than their Japanese counterparts.

The study concluded that Japanese salespersons are motivated when they work in an organization having a congenial culture, shared values and goals and where tasks are accomplished by teamwork.

Adapted from Judith A. Ross, "Japan: Does Money Motivate?" Harvard Business Review, September-October 1997, Volume 75, Issue 5, 9-10.

EFFECT OF PERSONAL CHARACTERISTICS ON SALES FORCE MOTIVATION

Sales managers often make the mistake of using the same technique for motivating all sales personnel. The commonly used method to motivate salespeople is to give them incentives in the form of cash. However, not all salespeople are motivated by money. The Japanese salesperson, for example, has an entirely different attitude and this has put many sales managers from the US in a fix as how to motivate them (as described in Exhibit 14.4).

In general, salespersons have been categorized into four personality types on the basis of a study conducted by The Gallup Management Consulting Group. These personality types are competitor, achiever, ego-driven, and service-oriented. These types differ in their needs and motives and require to be motivated in different ways.

Competitor

Competitors are the type of personalities who thrive on beating the competition. They only believe in the win-lose philosophy and do not think that a win-win situation is also possible. For salespersons having a competitor type of personality, someone has to lose for them to win.

Salespersons having a competitor type of personality are motivated by sales contests, plaques, and perks. Salespersons having this type of personality require some form of quota to serve as a challenge for them to utilize their selling skills.

IBM, for example, conducts contests for its sales representatives and the top ten percent of them are sent on a holiday to a resort along with their spouses. IBM terms its sales contest as the Golden Circle Program. In order to figure in the top ten percent, salespeople have to achieve their sales targets while delivering customer satisfaction. Similarly, MetLife Insurance Company in India conducts sales contests for its Financial Advisors in which the one who makes the highest sales in the country is declared the winner of a free holiday to Singapore.

Sales managers usually take advantage of this personality trait in the competitor type of salespersons and pit them against other well performing salespersons in order to make them excel in their selling efforts.

Achiever

The achiever is a person who sets his or her own goals. Achievers perform purely on self-motivation and do not require the sales manager to motivate them. It doesn't bother them who gets the credit as long as the team wins. Thus, achievers are good team players and excel in team selling.

Sales managers find it difficult to motivate achievers who are already self-motivated. However, one way to further improve the performance of such salespersons is to give them continually challenging tasks or by designing long-term plans for their professional development and growth. For instance, the sales manager, in consultation with the salesperson, can identify the key aspects of the salesperson's job. These may pertain to aspects in which the salesperson is good, aspects on which he can improve, and aspects in which the salesperson is not good. After identifying the key aspects of the salesperson's job, both the sales manager and the salesperson can together set goals for the salesperson. The purpose of this exercise would be to make the salesperson learn the aspects which he is not good at.

Since achievers can manage their time, territory and customer base on their own, they resent being micro-managed. The autonomy and freedom to do things their own way motivates salespersons having this type of personality. Achievers make good managers and can be groomed by sales manager to take on leadership and managerial roles.

Ego-Driven

Plaques and perks do not motivate ego-driven personalities. These types of salespersons consider themselves as the best in the organization. They like to be given importance and opportunities for decision-making. They like to be idolized and therefore make good coaches and mentors. Ego-driven people are super-performers in the job of selling. It boosts their morale when others approach them for advice. Hence, sales managers can exploit this trait in ego-driven salespersons and keep them motivated by making them a part of the advisory committee, including them in the decision-making process or by involving them in some committee.

Service-oriented

The greatest strength of service-oriented salespersons is their empathy and the ability to build relationships. Service-oriented salespersons may not be able to get big business for the sales organization but their ability to delight the customer helps the company maintain its territory irrespective of the competition. Unfortunately, when it comes to motivation, service-oriented salespersons are often neglected by sales managers. This may be because, by and large, companies do not measure service the way they measure sales quotas. Hence, quite often the service rendered by the salesperson just tends to get overlooked and ignored. Also, most sales managers find it more rewarding and easier to train highly aggressive and competitive salespersons on customer skills rather than train service-oriented salespersons to be competitive.

However, taking into consideration the emphasis on the customer in organizations across the world, neglecting service-oriented salespersons can be the greatest mistake that any organization can afford to make. Every sales and marketing manager needs to realize how much more difficult it is to attract new customers than to retain existing ones. Hence, sales managers need to be careful in the way they treat their service-oriented salespersons and ensure that the customer service efforts do not go unrecognized. Sales managers can motivate service-oriented salespersons by publicizing their customer service efforts in the form of company-wide circulated memos and ensure that these people get recognition in the company. Also, these salespersons can be given perks in the form of higher car allowances, or larger sales expense accounts to help them look after their customers' needs properly. Further, the sales organization can also take steps to measure customer service offered by salespersons by surveying customers, collecting letters of praise and by measuring customer retention in the company.

SALES MOTIVATIONAL MIX

One has to get into the shoes of a sales manager to realize how difficult it is to motivate the sales force. Sometimes, motivating salespersons can be a frustrating task. While some sales managers go by the adage "Good sales people are born, not made," and focus their efforts on recruiting salespersons having the right attitude, there are other sales managers who believe that money is the prime motivator of salespersons. They believe that paying for performance ensures that effective performance is delivered. However, sales managers and sales people differ in their perceptions regarding motivating and demotivating factors. For instance, salespersons consider fringe benefits as the prime motivators whereas sales managers consider sales incentives for achieving targets, sales competitions and prizes as the prime motivators. Similarly, while salespersons consider lack of advancement opportunities, lack of financial security and working hours as the main demotivators in the selling job, the sales managers consider that personal problems of the salespersons and their relations with superiors are the prime demotivators in sales personnel. In general, salespersons consider motivation to be a result of recruitment practices, compensation plans and effective sales management. The question of what other elements can comprise motivation has become a subject for debate.

While rewards and recognition programs serve as long-term motivators for sales force, sales managers also need to realize the importance of keeping the salespersons continuously motivated. Exhibit 14.5 describes some examples of small motivators which can go a long way in the salespersons achieving big results.

In general, sales managers use a variety of methods and techniques to motivate salespeople. The various methods that are commonly used by sales managers to motivate the sales force fall into seven broad classes – sales culture, sales training, leadership, basic compensation, special financial incentives, nonfinancial rewards, and performance evaluation.

The sales culture of the organization affects the motivation of its sales force. Sales culture consists of various elements such as ceremonies and rites, stories, symbols, and language. Organizations use various elements of sales culture to motivate their sales force. For example, award ceremonies such as annual sales award functions satisfy salespersons' need for recognition and motivate them as well as others in the organization to perform better. Stories of successful salespersons of the organization in the past inspire and encourage the current sales force of organizations to emulate such sales performance. Symbols such as gifts, plaques, etc. are yet another way to motivate the sales force. For example, top achievers in sales in the Mary Kay Cosmetics company are presented 'Cinderella gifts'. These gifts are in the form of pink Cadillacs, diamonds and luxurious vacations.

Exhibit 14.5

Use of Small Motivators to Continuously Motivate the Sales Force

While rewards such as a vacation at an exotic location, a home theatre, or a large sum of money serves as a long-term incentive for sales force, sales managers also need to realize that small motivators go a long way in ensuring that the sales force is continually motivated. Sales managers however have to take care to come up with diverse and innovative ideas to motivate the sales force and need to maintain an element of surprise in doing so. They need to create curiosity among the salespersons as to what would the next motivator be like. This will ensure that the sales people focus their attention on diverse aspects of their job and not just on selling. These aspects could be providing customer service, helping coworkers, winning back former customers, adding new business, etc.

Some of the small motivators that can be used by sales managers to pep up their sales force are listed below.

- Writing a note of encouragement to a salesperson whose performance has been slumping, pointing out what is praiseworthy in him.
- Holding a cold-calling contest on a particular day wherein every salesperson in the company makes cold calls to prospective customers, after which the salesperson who meets with the maximum success, is rewarded.
- Sales managers can accompany each of their salespersons on sales calls and take the opportunity to praise the salesperson on what he or she is doing right.
- Inviting the top sales performers to a strategy breakfast and seeking their inputs in assessing a sales compensation plan or in designing a new strategic initiative.
- Sales managers can walk around the organization with small cash and dole out on-the-spot rewards to salespeople who are found being helpful to customers or to coworkers.
- Making announcements over a public address system when a salesperson closes an important deal.
- Sales managers can invite the salesperson who has achieved the most sales during the month for lunch with them and another senior executive of the company.
- Inviting the top salesperson's entire family for a dinner and thanking each member of the family for their contribution to the success of the salesperson.
- Holding trouble-shooting sessions with salespersons who are unable to achieve their sales targets, and generous praise when any improvement takes place in their performance.
- Holding a pizza party to honor the salesperson who has received the most praise from customers.
- Allow a top performing salesperson to accompany and assist a poorly performing salesperson in his sales calls for a brief period.

Adapted from "Little Carrots, Big Results," Sales & Marketing Management, February 2003, Volume 155, Issue 2, 36-37.

The founder of the company, Mary Kay believed that these were possessions which people desired, but would never think of purchasing them on their own due to the costs involved and due to other household priorities. By gifting her salespeople with such extravagant gifts, Mary Kay ensured that her sales force remained motivated to sell the products of the company. The elements of sales culture have been dealt in detail in Chapter 2 – The Sales Organization.

Sales training makes salespersons knowledgeable about the product and increases their confidence. Inadequately trained salespersons are usually ill-equipped to respond to customer queries and this affects their sales performance and thereby their motivation. The importance of sales training has been described in greater detail in Chapter 11 – Hiring and Training of Sales Personnel.

The leadership style of sales managers has an impact on the sales performance of salespersons. A sales manager who is a good leader can influence the sales force to perform to their maximum potential. On the other hand, salespersons working for a manager who constantly uses the threat of firing tend to avoid risks and perform only to the extent of protecting their jobs. Such a leadership style of the sales manager naturally has a negative impact on the bottom-line of the company. The various leadership styles that can be adopted by sales managers and their impact on the motivation of salespersons will be dealt with in detail in Chapter 15 – Leading the Sales Force.

Compensation of the sales force may be in the form of salary, or commission, or a mix of both. Money is known to be the prime motivator for many salespersons. Compensation serves as a means of living and establishes a relation between salesperson's performance and rewards. Compensation plans such as performance-linked packages help motivate salespersons to perform better. Compensation, special financial incentives and nonfinancial rewards have been explained in detail in Chapter 13 – Compensating Sales Personnel.

Performance evaluation is the means by which sales managers evaluate the performance of the sales force and based on the evaluation, fix their compensation, rewards, incentives and promotion. A fair and just performance evaluation system motivates salespeople a great deal. Performance evaluation of the sales force will be dealt with in detail in Chapter 16 – Evaluating Sales Force Performance.

MOTIVATING THE SALES PERSONNEL AT DIFFERENT STAGES OF THEIR CAREER

With the passage of time, several changes take place in an individual's perceptions and his/her attitude towards life, career, etc. Changes take place even in the working life of an individual over time. There may be a change in the individuals' goals and concerns as well as a change in his attitude and perceptions regarding his job.

Career stages refer to the various stages in one's career from the entry stage to the stage of retirement. The study of career stages is important in sales management because many people continue to remain in a sales position throughout their career, right from the entry-level till they reach the age of retirement. In sales management, a lot of research has focused on the changes taking place in a salesperson's perception and attitude toward his job over the span of his career. According to the career stage model, a salesperson's career passes through four stages – exploration, establishment, maintenance and disengagement (as shown in Figure 14.2). At each stage in his career, a salesperson identifies specific career concerns and struggles to resolve his career concerns if they happen to clash with those identified during the earlier stages of his career. In the process, the salesperson may tend to disregard some of the career concerns which might have been important to him earlier and adopt a whole new set of career concerns. The career concerns of the salesperson at each stage of his work life form the basis of how he perceives, interprets and reacts to the environment at each stage. Table 14.2 shows the career stage characteristics of an individual.

Sales managers are increasingly concerned about the need to motivate salespersons as they move through various stages in their career. The primary concern of sales managers is to motivate salespersons in the various stages of their career to direct them toward greater selling efforts and enhanced sales performance.

Figure 14.2: Career Stages and Growth in Career of a Salesperson

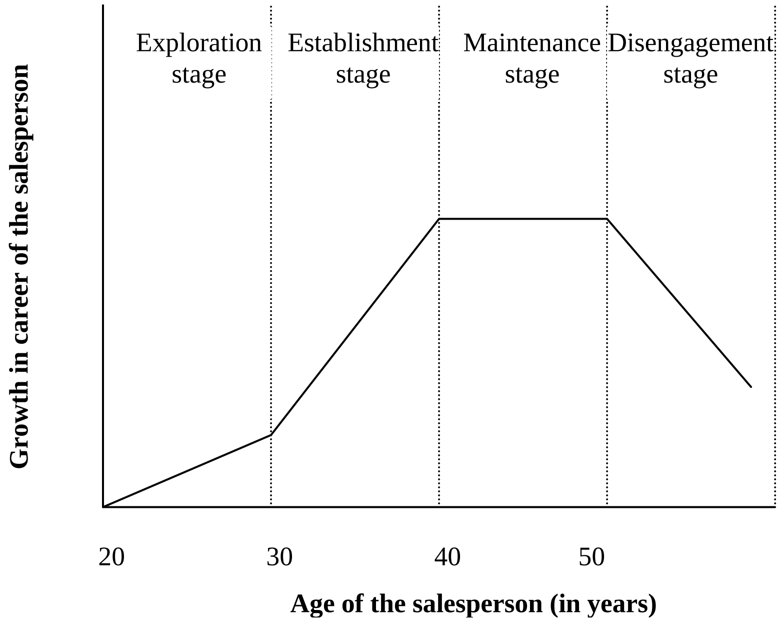


Table 14.2: Career Stage Characteristics

	Exploration	Establishment	Maintenance	Disengagement
Career Concerns	Finding an appropriate occupational field.	Successfully establishing a career in a certain occupation.	Holding on to what has been achieved. Reassessing career, with possible redirection.	Completing one's career.
Developmental Tasks	Learning the skills required to do the job well. Becoming a contributing member of an organization.	Using skills to produce results. Adjusting to working with greater autonomy. Developing creativity and innovativeness.	Developing broader view of work and organization. Maintaining a high performance level.	Establishing a stronger self-identity outside of work. Maintaining an acceptable performance level.
Personal Challenges	Must establish a good initial professional self-concept.	Producing superior results on the job in order to be promoted. Balancing the conflicting demands of career and family.	Maintaining motivation though possible rewards have changed. Facing concerns about aging and disappointment over what one has accomplished. Maintaining motivation and productivity.	Acceptance of career accomplishments. Adjusting self-image.

Psychosocial Needs	Support. Peer acceptance. Challenging position.	Achievement. Esteem. Autonomy. Competition.	Reduced competitiveness. Security. Helping younger colleagues.	Detachment from organization and organizational life.

Source: William L. Cron, "Industrial Salesperson Development: A Career Stages Perspective," Journal of Marketing, Volume 48, Fall 1984, 45.

Exploration Stage

The exploration stage in one's career usually occurs between the ages of 20 and 30 years. In the exploration stage, an individual lacks work experience and is only concerned with finding the right occupation rather than worrying about lifelong commitment to a particular occupation. This stage in one's career is rather stressful because the individual is not sure whether his abilities match the job requirements. The exploratory stage is marked by the individual's efforts to create a self-image. The individual accomplishes this by showing competence in his area of expertise and by gaining the acceptance of his peers in the organization. Also, stress during the exploratory stage of one's career is due to the wide variety of career options available to the individual at this stage making it difficult for him to choose and plan his career path. Job hopping is a common feature during the exploratory stage and reflects the individual's attempts to find the occupation that best suits his abilities.

Usually, salespeople in the exploration stage tend to be dissatisfied with the job due to the uncertainty as to whether they are in the right occupation. The brief sales career of the salespeople and their lack of experience make them skeptical regarding the rewards associated with achieving high sales. Therefore, a sales manager faces a challenging task in motivating salespeople in the exploration stage to achieve high targets.

Establishment Stage

The establishment stage usually occurs between the ages of 30 and 40 years in one's life. In this stage, individuals shift their focus from searching for the right occupation to settling down in a particular occupation and advancing in it. This tendency is influenced by expectations of others because by the time an individual reaches this stage of his life, his family, friends, and acquaintances expect him to settle down in his career. Nevertheless, the search for the right occupation may continue in some individuals. Thus, one cannot precisely say at how much experience and what age the exploration stage will end and the establishment stage will begin for an individual.

In the establishment stage of career, the pressure to succeed and advance in one's career replaces the pressure to find the right occupation. The achievement of professional success reigns supreme in the individual and this is often accompanied by a desire for promotion. Although the long hours put in by the individual in order to attain his objectives tend to increase his performance in the job, it also places great demands on the individual in terms of family responsibilities and health concerns. Thus, in this stage, the individual tries to seek an effective balance between his work life and personal life.

Advancement in one's career in a sales organization also involves the question whether there are suitable positions in the organizations to which successful salespersons can be promoted. In most sales organizations, career enhancement of salespersons usually involves the salesperson getting promoted to a sales management position. However, not all salespersons are willing to take up a sales management position due to the entirely different set of skills required in the new position. Also, salespersons dealing in products that have reached the maturity stage of the product life cycle find very few opportunities for further growth in the organization. Hence, they switch their jobs during the establishment stage in order to enhance their career opportunities.

To avoid turnover in this stage, organizations create senior sales positions in the organization to motivate salespersons to aim for promotion to these positions. At the same time, sales managers make the salespersons aware of the requirements to get promoted. In organizations where there are limited opportunities for promotion, sales managers address the problem by suggesting dual career options to salespeople. This is especially true of organizations in which lean management is the trend. Market trends such as centralized buying and frequent new product introductions have created a need for specialized non-management positions. Examples of dual career positions include key account sales positions and product group specialists. Salesmen, who are transferred to these specialized non-management positions as part of the dual career strategy of the management, often tend to perceive the transfer as a promotion and are satisfied that their promotion aspirations have been fulfilled.

Maintenance Stage

The maintenance stage in one's career usually starts around the age of 40 to 50 years. In the maintenance stage, the individual is under a lot of psychological strain due to growing awareness of physical aging, limited opportunities for career growth and increasing threat of technical obsolescence. In order to remain in his current position, an individual feels the need to be up-to-date with the latest developments in his field and to acquire new knowledge and skills in order to enhance his job performance. Thus, this stage, in an individual's career, is marked by a lot of changes which may be of a physiological, attitudinal, occupational or social nature. At this stage, the individual perceives the need to bring about a change in his self-image.

Unlike the earlier stages in his career where the individual makes efforts to succeed and achieve more in his career, the maintenance stage is characterized by the individual holding on to what he has already achieved and maintaining his position, status and performance level in the organization. The individual reaches a stage in his career where he is satisfied with his level of performance and doesn't feel the need nor the interest in competing with his peers for career advancement. The individual adopts a mentoring approach toward his subordinates. Even status-wise, when an individual reaches the maintenance stage, he is most likely to be already at a position of fairly high status in the organization and therefore feels no desire to strive for a still higher status. For example, a salesperson may be in the position of a senior sales executive and is unlikely to expect to move up further in the organization.

Whatever the level of performance he might have achieved (whether as a top performer, average or below average performer), the salesperson is satisfied with his position in the organization and does not try to improve his position further by way of promotion or achievements. Even if the salesperson is dissatisfied, he does little to change the status quo and is unlikely to change his job at this stage of his life. The maintenance stage in an individual's career often coincides with the mid-life stage in the life of the individual.

There are various ways in which individuals try to cope with the emotional pressure that characterizes this stage of the career. Some may choose to take up a job in an entirely new occupation while others may learn to cope with the idea of limited career opportunities in their current occupation. It is difficult for sales managers to motivate salespersons who are in the maintenance stage of their career since promotion and rewards no longer motivate them after having achieved all these in the course of their career.

Disengagement Stage

The disengagement stage in the career stage model is characterized by an individual's attempts to withdraw or disengage himself from his career. In this stage, the individual is no longer interested in maintaining or enhancing his professional position and begins to anticipate and plan for retirement. There may be some individuals who retire early in the disengagement stage and involve themselves in activities that give personal satisfaction or help them gain public attention. Examples of such activities include hobbies, religious, social and philanthropic activities.

In the disengagement stage too, there is little that sales managers can do to motivate the salespersons and make them improve their job performance.

SUMMARY

Motivation is the process that produces goal-directed behavior in an individual. It helps to initiate desired behavior in an individual and direct it toward the attainment of organizational goals. Motivation consists of three elements – need, drive and goal. Satisfaction of the need in the individual cuts off the drive in him to work toward satisfaction of the need.

The effectiveness of the sales force plays a crucial role in the success and growth of an organization. In order to attain the goals of the organization, it is essential that the sales force is highly motivated. Motivation in the sales function refers to the amount of effort a salesperson is willing to expend in the selling job. While some salespersons are self-motivated, there are others who need to be motivated to perform.

Sales managers can motivate their team by following any of the theories of motivation, namely, Maslow's hierarchy of needs theory, Herzberg's two-factor theory, goal-setting theory, expectancy theory, and job design theories. Maslow's hierarchy of needs theory classifies the needs of an individual into five categories – physiological, safety or security, social, self-esteem and self-actualization needs. Physiological needs are the lowest order needs while self-actualization needs are the highest order needs. Further, as lower order needs get satisfied, an individual strives to satisfy higher order needs.

Herzberg's two-factor theory states that the job environment of an individual is characterized by two types of factors – hygiene factors and motivational factors. The goal-setting theory presumes that people have specific needs and aspirations to fulfill for which they set certain goals for themselves. They then go about achieving these goals by taking purposeful action. Further, setting higher goals produces higher output. The expectancy theory states that an individual is motivated by the perceived consequences of his or her actions. According to this theory, motivation is a function of expectation, valence and instrumentality. Job design theories assume that all individuals have the same needs, and that ensuring certain job characteristics can satisfy these needs.

A salesperson's motivation plays a crucial role in influencing his performance and thereby his productivity. Salespersons having a high level of motivation tend to perform well in the selling job and have high productivity. On the other hand, salespersons who lack motivation tend to be poor performers and fail to achieve their sales targets. Such salespersons hence tend to have low productivity. Sales managers can take various measures to motivate the sales force and boost its productivity. These measures can be in the form of sales quotas, sales contests, well- designed compensation plans and reward systems, etc.

Further, the personality traits of the salesperson play a vital role in influencing his motivation. Salespersons can be divided into four types – competitor, achiever, ego-driven, and service-oriented.

Sales managers are increasingly concerned about the need to motivate salespersons as they move through various stages in their career. The primary concern of sales managers is to motivate salespersons in the various stages of their career to direct them toward greater selling efforts and enhanced sales performance. A salesperson's career passes through four stages – exploration, establishment, maintenance and disengagement.

Chapter 15

Leading the Sales Force

In this chapter we will discuss:

- Nature of leadership
- Characteristics of an effective leader
- Leadership styles of sales managers
- Skills essential for a leader

Leadership is the ability to convince people to follow a path they have never taken to a place they have never been – and, upon finding it to be successful, to do it over and over again.

John Mariotti, president of The Enterprise Group.

Mary Kay of Mary Kay Cosmetics is not only known for the pink Cadillacs she gifts the top performers in her sales force, she is also known for her leadership potential, which, combined with her hard work, initiative, discipline, and superior selling skills, helped her transform her company from an upstart into a global leader in ladies' cosmetics. Mary Kay possessed the ability to compound her success as a business leader by sharing her vision with her employees and accomplishing it through them – by encouraging them towards superior sales performance and by honoring those who achieved such performance. The world of business is replete with examples of many such business leaders.

In an organization, the leadership style of a sales manager plays a vital role in influencing the effectiveness, performance, motivation, and job satisfaction of the sales force. In recent times, when organizations are trying their best to meet the challenge of increasing the performance of the sales force and prevent turnover among sales personnel, the role of a sales manager in motivating and leading a sales force towards the attainment of organizational goals has become all the more significant. In an organization, all those who are in a position to lead, such as the vice-president of sales, director of sales, the regional sales managers, and field sales managers play a key role in determining the growth and development of the organization.

In this chapter on *Leading the Sales Force*, we examine various aspects of leadership behavior of a sales manager. We begin the chapter with a discussion on the nature of leadership and go on to describe the characteristic traits that are essential for leading a sales team. We then explain the various leadership styles that a sales manager can possibly adopt. The chapter concludes with a discussion on the various skills that are essential for a sales manager to be successful in his role as a leader.

NATURE OF LEADERSHIP

Leadership can be defined as the process by which one person influences others to accomplish a mission, task, or objective. The display of leadership traits by individuals in organizations helps in the attainment of organizational objectives and leads to the growth and development of the organizations. The various attributes that help develop leadership qualities in an individual include beliefs, values, character, knowledge, skills, and most important of all, the ethics of the individual.

In the words of Robert Galvin, former chairman of Motorola Inc., the most important aspect of leadership is the ability to take people to places they would fear to go on their own. It cannot be taught but can only be modeled or emulated.

Leaders can take their followers down a path of glory or of doom. True leaders are those who help their followers decide where they are going and chart out a path for their getting there. They help their followers overcome any hurdles and pitfalls that may arise on the way.

Successful organizations thrive on successful leaders. A weak leader heading an organization tends to demotivate others in the organization, causing most of them to leave. Thus, effective leadership is not optional but a prerequisite for the success of an organization. Therefore, many organizations take measures to develop leadership potential within the organization (Refer to Exhibit 15.1).

Exhibit 15.1

Developing Leadership Potential in Organizations

Companies such as 3M, Johnson & Johnson, General Electric, and Hewlett Packard use the approach of decentralization to develop leadership potential in the organization. By decentralizing, they delegate authority and responsibility to the lower levels in the organizational hierarchy and make the jobs at these levels as challenging as those higher up in the hierarchy.

In some of these companies, smaller units are set up as part of the decentralization efforts. This creates challenging management positions in these units, and these are filled by identifying people with leadership qualities from within the organization. These organizations also emphasize the continuous development and introduction of new products and services in the market. In 3M, the emphasis of the top management is on earning at least 25% of the revenue from products introduced during the previous five years. Introduction of new products and services takes place with the setting up of new ventures which, in turn, create challenging management opportunities for individuals who have leadership potential.

Adapted from John P. Kotter, "What Leaders Really Do," Harvard Business Review, December 2001, Volume 79, Issue 11, 85-90.

Leaders play a significant role in an organization. They help their followers understand the current situation and skillfully create a feeling of healthy dissatisfaction in them regarding this situation. They then present a vision of an improved situation for the future and convince their followers to believe that there is a path that will take them and the organization there. Finally, the leaders ensure that the followers have sufficient motivation to traverse the path to the desired future situation by providing them with the right environment to do so. Some organizations train their managers to become good leaders and motivators of their salespeople (Refer to Exhibit 15.2).

CHARACTERISTICS OF AN EFFECTIVE LEADER

Sales force automation, increasing emphasis on team selling, empowerment, re-engineering and maintenance of customer relations, and service quality have resulted in an evolution in the role and functions of the sales manager. Functions such as sales administration, communication with the field force, sales training, forecasting, providing customer support and call reporting have all become electronic. Managing the sales teams in the current circumstances requires the sales managers to train their sales people to manage themselves and empower them to take decisions on their own.

How do leaders differ from managers? Leaders energize and motivate their team (the salespersons) to accomplish seemingly impossible goals. They have a mission and a purpose. Leaders are innovative and risk taking by nature. They set things moving and make things happen. Leaders motivate followers to make maximum use of their potential and make them perform at their best.

Managers, in contrast, merely manage. They make sure the process or system works. A sales manager, for example, makes sure that the call reports come in on time. The difference between leading and managing is the difference between winning and losing in a highly competitive business environment. Organizations run the risk of losing precious market share by hiring managers who are ineffective as leaders. If it could, every organization would clone the leaders it has to ensure its success.

There are several characteristics that make a sales manager an effective leader. These include the personal characteristics or traits of the sales manager, his needs and motives, the bases of his power as well as his past experience.

Exhibit 15.2

Training Managers to Become Effective Leaders

At Saturn, a subsidiary of General Motors, all managers need to undergo a three-day course on leadership. The course named 'Managing the Saturn Difference', trains the managers to become effective leaders. In addition to teaching them strategies on how to sell more cars, the course trains them in skills to keep the sales force motivated and focused on customer satisfaction.

At Saturn, customer satisfaction is given utmost importance. The company is known to even go to the extent of transporting prospective customers from their homes to the nearest dealer showroom and back, just to allow them to see the car for themselves before making the purchase decision.

Customer satisfaction is the organization culture at Saturn and it is ingrained in every salesperson, sales manager, and every other employee in the organization. The company realizes that to keep the customer satisfied, it has to first ensure that its salespersons are satisfied and that their morale is high. This then becomes the responsibility of the sales managers. The leadership course trains the sales managers on the aspects that are necessary to keep the customer satisfied.

The compensation plans for salespersons at Saturn are designed by the sales managers and consist of a base salary and a commission. The sales managers evaluate the performance of a salesperson by obtaining feedback from a customer to whom a car has been sold, two weeks after the sale. The incentive to be given to the salesperson is based on the extent of the customer's satisfaction and the achievement of the team goals.

Adapted from Andy Cohen, "Saturn," Sales & Marketing Management, November 1996, Volume 148, Issue 11, 58.

Personal Characteristics of the Manager

Several surveys have been conducted to assess the requisite traits in sales managers to make them effective leaders. Some of the traits that are necessary to make a sales manager an effective leader are clarity, consistency, urgency, assertiveness, ego drive, ego strength, risk taking ability, innovativeness, empathy, and an eye for talent. These traits have been described below.

Clarity

A leader should be able to clearly communicate the organizational expectations to his team. A sales manager, to be a successful leader, should have the ability to clearly communicate the sales objectives to the sales team. Making the sales team clearly understand which accounts are of strategic importance to the organization and the type of sales deals that the organization is best qualified to serve helps enhance the sales team's performance.

Consistency

In addition to clarity of expectations, a leader should also be consistent in communicating the expectations of the organization to the sales team. Consistency in what the organization expects from the sales force results in an environment that helps to bring out the best in the sales force. Consistency in the organizational mode of functioning may be reflected in its compensation model, regularity of sales meetings, appraisal systems and communication process.

Urgency

A leader should be able to perceive the urgency of a situation as well as communicate it to his team. Attracting and retaining customers is crucial for the survival and growth of businesses. Thus, urgency is a trait that differentiates a competent and efficient sales manager from one with a laid-back attitude. By creating the feeling of urgency in his team, a sales manager is able to ensure that sales representatives take matters seriously, especially those pertaining to customer queries and problems. To be a successful leader, he should address customer problems with the utmost urgency and make sure that his sales team too shares this sense of urgency. When this kind of a feeling prevails over the entire sales team, it makes employees work to their maximum potential. However, the sales manager has to be judicious in deciding which matters require to be treated with urgency. Treating all matters as urgent can lead to a burnout among the salespersons.

Assertiveness

If a sales manager has to effectively lead the sales force, he needs to be assertive. He should be able to assert his authority so that his sales team obeys his orders. A leader needs to be tough when the situation calls for it. Only by being assertive can he earn the respect of those who follow him.

Ego drive

Ego drive is the level of satisfaction that a person derives by persuading others to take a particular action. For a sales manager, the ego drive is determined by his ability to convince his sales representatives to perform in the way required to reach the desired goal. By persuading salespersons to perform better, he satisfies his ego drive.

Ego strength

Sales is a difficult occupation and the salesperson often has to face rejection from the customer. However, the salesperson should not take such a rejection too seriously and allow it to affect his optimism and confidence in future sales calls. To lead a sales force successfully, the sales manager should be able to remain optimistic even in the face of rejections. In addition to himself possessing ego strength, a sales manager should ensure that his salespersons too possess such a strength of ego rather than getting demotivated on facing a rejection and letting it affect their attitude in future sales calls. A sales manager should think positive and also influence his team to think the same way.

Risk-taking ability

An effective leader is one who can take risks. A sales manager who always follows the tried and tested path and is averse to taking risks can neither face the competition nor be a good leader. On the other hand, a sales manager who, purely on gut feeling, takes the risk of doing business with a new client with no reputation to back him, succeeds in earning the client's goodwill. Thus, taking calculated risks pays off in the long run.

Innovativeness

A sales manager should be able to come up with innovative solutions to problems. For example, a salesperson who has brought in a new mega-client might want to manage the client's account in other sales territories as well. However, allowing him to do so would antagonize the salespersons handling those territories. On the other hand, refusing to accede to the salesperson's request might hurt his feelings and cause him to quit the organization and join elsewhere. In such a situation, the sales manager can come up with an innovative solution -- allow the salesperson to manage the account during the early stages with the understanding that he will later hand it over to the local salespeople to manage. The sales manager can reward the salesperson for getting such a major account by ensuring that he gets paid a higher commission for whatever business he brings to the company.

Empathy

Empathy is the ability to sense the feelings of others. A sales manager must have empathy for his sales force. He must understand the concerns and apprehensions of the salespersons and find ways to address these concerns. If the sales manager takes a personal interest in the problems the salespersons face, it will go a long way in developing a loyalty in them towards the organization and in motivating them to perform better.

However, while being empathetic, the sales manager must never compromise on organizational objectives and when it becomes necessary to take a tough decision like firing someone, he should not hesitate to do so. The emphasis should always be on improving the bottom line of the company and the sales manager must constantly encourage his sales force to take action.

Eye for talent

To be able to lead a sales force, a sales manager should have an eye for talent. This trait is especially important when it comes to hiring people. While hiring, the sales manager should be able to identify the right person for the job. If he hires unsuitable individuals as salespersons, it may result in loss to the company in terms of sales volume as such individuals could lack personal selling skills and would, therefore, fail to attract customers. Their poor selling skills may even result in the company losing existing customers.

Needs and Motives

The needs and motives of a sales manager influence the development of leadership qualities in him. For example, a sales manager who has esteem needs strives to attain power and recognition by displaying leadership qualities. On the other hand, a sales manager whose needs are confined to physiological, safety and social needs fails to display leadership traits since he is yet to satisfy his basic needs. Moreover, not all managers make good leaders. This is probably because not all individuals have the same needs.

Bases of Power

Sales managers can exert an influence on their subordinates by means of the power they wield over them. They can have five types of power -- expert, referent, legitimate, reward, and coercive power.

Expert power

Expert power originates from the expertise of the person in a position of authority. The expertise may be the result of knowledge, information, or skills in a particular area. Thus, expert power cannot be delegated. In a sales manager-salesperson relationship, expert power originates from the knowledge and information held by the sales manager in the field of selling, and the selling and presentation skills he possesses. His knowledge, information and skills influence the salesperson to respect him as a leader and follow his instructions.

Referent power

Referent power originates from the attraction that one person has to another. The basis of this attraction may be friendship, a desire to identify with a successful, famous or reputed personality, or feelings of shared identity. In a sales manager-salesperson relationship, a sales manager may have referent power over the salespersons in his team due to his supersalesman image. The salespersons may want to emulate his success and thus yield to referent power.

Legitimate power

Legitimate power arises when the position held by a person gives him the right to influence others and command obedience from them. In a sales manager-salesperson relationship, the sales manager, by virtue of his position in the organization, has the legitimate power to command the salespersons and to make them change their behavior when necessary. Legitimate power is based on societal and institutional acceptance of the relationship and roles played by the two parties.

Reward power

A person may have reward power over another due to his authority to confer rewards on the other. For example, a sales manager, has the power to evaluate the performance of the salespersons and reward them accordingly as he is in a position of authority. This results in his having a reward power over the salespeople.

Coercive power

Coercive power originates due to an individual's perception that another person has the right to confer a reward or punishment on him. This makes the individual yield to that person's influence. Thus, coercive power has a negative connotation. The top management in a sales organization has a coercive power over all the salespersons working in the organization.

Past Experience

The past experience of a sales manager prepares him to deal with similar situations and similar individuals in a specific manner. For example, a sales manager may have used an authoritarian approach to successfully tackle a rather headstrong and problematic salesperson in the past. When confronted with another salesperson with similar personality traits, the sales manager tends to use the same approach to deal with him too.

Just as there are characteristics that are instrumental in making a sales manager effective as a leader, there are also some traits that a leader should not have. These are described in Exhibit 15.3.

LEADERSHIP STYLES OF SALES MANAGERS

Most studies of leadership styles in sales management assume that all sales managers adopt the same style towards all subordinates and that every style brings out a characteristic response in the salesperson. In general, leadership styles have been studied on the basis of the following three factors:

1. Who is involved in the decision making
2. Manner in which sales goals are achieved, and
3. How the salespersons are compensated, rewarded, or punished

Moreover, the leadership styles of sales managers can be studied from a traditional as well as a modern perspective.

Traditional Leadership Styles

The traditional approaches to studying leadership styles have related the leadership style of a manager (?) to the extent of decision-making he allows his subordinates. Based on the extent to which a leader allows his subordinates to be involved in decision-making, there are five leadership styles – autocratic, bureaucratic, consultative, democratic, and laissez-faire.

Exhibit 15.3

What not to be as a Leader

When salespeople relate their experiences with sales managers they have worked for in the past, they may have several horror tales to narrate along with the success stories. And invariably, the sales managers that they found so ineffective as leaders would have had certain common traits.

Visionless leader – A sales manager who lacks vision, one who doesn't feel the need to set goals for himself or for his team of salespeople, is a visionless leader. Such a leader has the tendency to constantly change his instructions to team members.

Egotist – A sales manager who is an egotist takes the credit for every achievement of the team. He claims every deal made as his own achievement even though, in reality, he may have had very little to do with making it materialize.

Blamer – This type of sales manager offers very little help to his salespeople in terms of suggestions and advice but is quick to pinpoint faults or mistakes and blame them for a lost deal.

Number cruncher – The sales manager who is a number cruncher is not bothered about the long-term growth of his salespeople; he is only concerned about achieving sales targets and earning his commission.

Desk-jockey – This type of sales manager expects his salespeople to work late hours while he himself follows a 9-to-5 work schedule. Moreover, this type of sales manager doesn't step out into the field and prefers to work from the comfort of his office.

Old pal – A sales manager of this type adopts a soft approach towards salespeople who are his favorites. He turns a blind eye to their poor performance, creating resentment and dissatisfaction among the rest of the sales force.

Adapted from Barry J. Farber, "What Kind of Manager Are You?" Sales & Marketing Management, March 1995, Volume 147, Issue 3, 28-30.

Autocratic style

A sales manager who follows an autocratic style of leadership gives orders and expects his subordinates to obey them. Being in a position of power, he instructs the salespersons on every aspect of the job – what is to be done, how it is to be done, who will do it, when it is to be done, and so on. An autocratic sales manager uses his position in the organization to show his authority and enforce discipline and control over his subordinates. Such a leadership style is suitable if the salespersons are new and lack experience or when they have to be disciplined. However, it is unsuitable when the salespersons are experienced and knowledgeable.

Bureaucratic style

In the bureaucratic style of leadership, the sales manager abides by the rules, policies, and procedures of the organization and expects the salespersons also to do the same. Although he is not responsible for framing the rules, policies, and procedures, he enforces them strictly. For example, a sales manager who makes it mandatory for salespersons to follow a certain manner of reporting just because the policy says so, is said to be a bureaucratic leader.

Consultative style

A sales manager who follows a consultative style of leadership consults his subordinates before making a decision. He invites the views and suggestions of the salespersons working under him and takes the final decision after considering all the viewpoints. For example, a sales manager who has a consultative leadership style involves the salespersons in designing a new compensation plan. This not only

Exhibit 15.4

Participative Leadership to Gain the Support of Employees

Herb Kelleher, founder of Southwest Airlines, is known to be a great leader whose leadership and management skills helped the company grow by leaps and bounds over the years. Kelleher exhibited a great sense of trust in his employees, something that became the hallmark of his leadership style. He encouraged employees to take their own decisions as well as help their colleagues do so. He believed that leadership was not the preserve of a single person but a style of functioning that must be practiced by every single person at all organizational levels.

As a supportive and participative leader, Herb showed great concern for employees' professional and personal needs. He consulted employees before making professional decisions because he felt that employees who had actually dealt with a situation were often in a better position than the top level management to decide what was the best thing to do. Consciously acting more as a friend than a boss, Herb always tried to set an example for others in the company.

Source: ICFAI Center for Management Research

motivates the salespersons to perform better but also brings out a variety of viewpoints that will help design a more effective compensation system. The consultative style of leadership is also termed as participative or supportive leadership. Exhibit 15.4 describes the participative leadership style of Herb Kelleher, CEO of Southwest Airlines, which motivated his employees to perform better.

This type of leadership behavior is suitable when the sales force is harmonious in nature and willing to accept the manager's decision as final. However, a consultative leadership style is not suitable when the salespersons are new, inexperienced, and are not working harmoniously.

Democratic style

The democratic leadership style is similar to the consultative leadership style. A sales manager who follows a democratic style, invites the participation of his subordinates in making decisions. However, unlike in the consultative style of leadership where the sales manager makes the final decision based on his judgment, the sales manager with a democratic leadership style makes the final decision based on consensus or majority vote. For example, all the salespersons may be asked to vote on a proposal to increase the sales targets of every salesperson by 10%. Based on the majority view, the sales manager then decides whether or not to increase the sales targets of the salespersons. A democratic leadership style is suitable when the sales force is small and concentrated at one location and when the sales manager has plenty of time at his disposal to take a decision. This style is unsuitable when the sales force is large and scattered over a wide geographic area and when a quick decision is necessary. It is also unsuitable when the salespersons are inexperienced.

Laissez-faire leadership

A sales manager who has a laissez-faire leadership style sets goals for the salespersons but gives them total freedom to manage their accounts. A laissez-faire sales manager also allows salespersons to make their own decisions. In this form of leadership, there is least supervision, direction, and control by the sales manager. This type of leadership style is suitable when a sales manager has independent representatives working under him.

Modern Leadership Styles

However, rather than adopt any of the traditional approaches of leadership, most sales organizations today are characterized by modern styles of leadership such as transactional or transformational leadership, and situational leadership.

Transactional leadership

The transactional style of leadership is the most common form of leadership behavior found in most sales organizations. In this leadership style, the sales manager-salesperson interaction is more of an exchange process. There is an implied agreement that the sales manager will reward the salesperson if he succeeds in attaining a certain level of performance.

Transactional leadership has three components: i) contingent rewards, ii) management-by-exception, and iii) follower's level of experience.

A transactional leader, who uses contingent rewards as the basis to lead the sales force, reaches a formal agreement with the salesperson regarding what needs to be done to earn a reward. The reward is thus contingent on the salesperson's performance and may be in the form of praise, pay hike, bonus, etc. A sales manager, who leads by management-by-exception, passively observes the salesperson's performance from a distance and becomes actively involved only when he finds a negative deviation in the performance. The third component of transactional leadership – follower's level of experience – is based on the fact that in the case of new and inexperienced salespersons, the sales manager must set objectives and instruct the salespersons on how to achieve them. However, if the salespeople are experienced and independent representatives, the sales manager can leave them to manage their accounts on their own.

Transformational leadership

Unlike transactional leaders, who identify the current needs of salespersons and promise to satisfy them on the salesperson's achieving the desired sales performance, a transformational leader identifies the latent needs in the salesperson. These needs may be of a higher order and may be dormant in the salesperson. A transformational leader then transforms the salesperson's latent needs into current needs and motivates him to achieve them. Thus, a transformational leader magnifies the strength of the salesperson's needs, desires, and wants and motivates him to such an extent that the latter surpasses himself in achieving these objectives.

Mary Kay of Mary Kay Cosmetics is an example of a transformational leader. She recognized the latent need for self-esteem and recognition in her salespeople and motivated them to satisfy this need by achieving top sales. The pink colored Cadillac that she gifted to every successful salesperson was her style of rewarding them by satisfying their latent need of self-esteem.

Charisma, inspirational motivation, intellectual stimulation, and individualized consideration characterize transformational leadership. Charisma comprises a magnetic personality along with other traits such as risk-taking ability, assertiveness, a high level of confidence, persistence, determination, and courage that make subordinates or followers respect, trust, and admire the leader.. The charisma of a sales manager influences the salespersons in his team to share his sense of vision and mission. By their expectations, charismatic sales managers are able to successfully instill confidence, optimism, and self-esteem in the salespeople.

A sales manager with a transformational style of leadership provides inspirational motivation to his salespersons by conveying to them the high expectations he has of them and motivating them to improve themselves and take on new challenges. The sales manager uses symbols, language, and images to project the future he has envisaged for his followers and inspires them to continuously improve their performance in order to meet his expectations and make the vision come true.

A transformational leader also tries to intellectually stimulate his followers by encouraging them to think creatively. Such a sales manager encourages his salespersons to look for new ways to approach a problem. He cautions the salespeople not to blindly accept assumptions but to question their validity. Using intellectual stimulation, a sales manager with a transformational leadership style encourages the salespersons to use their intuition to identify the needs, motives, and problem areas of the prospects. This type of sales manager devises innovative prospecting and selling methods for his salespersons. He also contributes toward maintaining organizational stability by devising new methods of recruiting and controlling sales force turnover. For example, some companies such as Hershey Chocolates, based in Seattle in the US, follow a proactive rather than a reactive approach to recruiting. The regional sales manager of the company prefers to recruit before there is an opening in the company. In his view, rather than considering unsolicited sales applicants as an interruption, companies should consider them as an opportunity to source people with initiative and inner drive.

A transformational leader anticipates the future needs of the company and takes precautionary steps to prevent later problems. Thomas Watson, one of the chairmen at IBM, known for his ability to encourage constructive thinking among his subordinates, is considered one of the most intellectually stimulating leaders of the 20th century. He ensured that the word "Think" pervaded the organization (in every room, on every desk, on every page of a sales presentation) and ultimately made it the corporate symbol of IBM. He considered success to be the result of the thinking process and made all efforts to tap this rare quality in his employees.

A transformational leader shows individual consideration for his subordinates or followers. A sales manager who has a transformational leadership style gives more importance to the individual needs of the salespersons than to administrative matters and policies. He gives personal attention to each salesperson and devises learning and development opportunities for each one of them. In doing so, he helps allay their fears, anxieties, and apprehensions. A sales manager who shows individuals consideration, practices management-by-walking-around which enables him to learn about the individual needs of the salespeople. The sales manager thus acts as a mentor or coach to the salespersons. Mary Kay Ash of Mary Kay Cosmetics was known to be a model mentor. She always had a trainee sales manager with her in the field to observe and learn from her or to be observed by her and given suggestions for improvement.

It has been found that salespersons working for sales managers with a transformational leadership style feel more satisfied, committed, and less stressed than those who work for transactional leaders. This is because in the transactional leadership style, making the rewards contingent on the salesperson's performance increases the pressure on the salesperson to increase his sales performance.

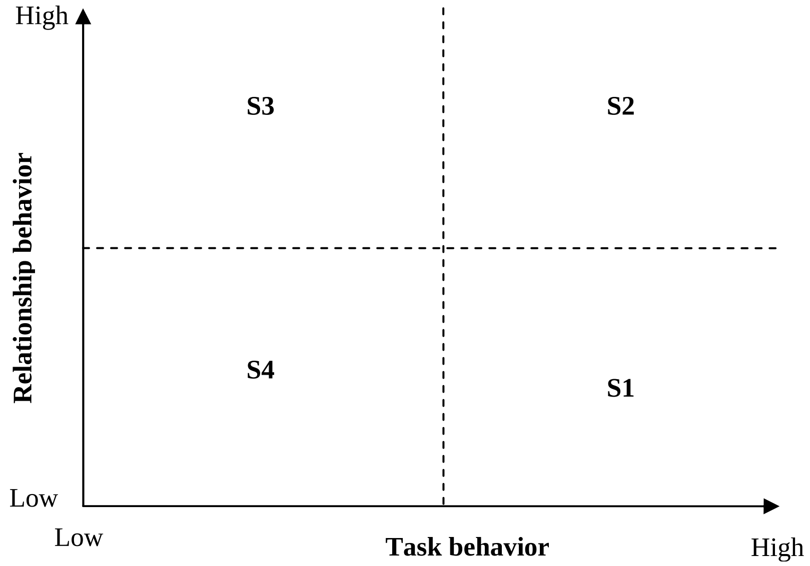
Situational leadership model

The situational leadership model is one of the most popularly accepted models with which to understand the leadership behavior of sales managers and it has been widely accepted as a training device in Fortune 500 companies such as Caterpillar, IBM, Xerox, Mobil Oil, and BankAmerica.

The Situational Leadership Model is one amongst the various contingency theories of leadership. Apart from this model, other theories include the path goal theory (proposed by House), normative decision theory (proposed by Vroom, Yetton, and Jago), and contingency leadership theory (proposed by Fiedler). All these theories propose that the leadership style of a manager is contingent upon the situation he faces.

The situational leadership model (as shown in Figure 15.1) describes the leadership style along two dimensions – task behavior and relationship behavior. According to this model, there are four leadership styles – S1 (high task behavior, low relationship behavior), S2 (high task behavior, high relationship behavior), S3 (low task behavior, high relationship behavior) and S4 (low task behavior, low relationship behavior). The

Figure 15.1: Situational Leadership Model



Adapted from Butler, John K., Jr. and Richard M. Reese, "Leadership Style and Sales Performance: A Test of the Situational Leadership Model," *Journal of Personal Selling & Sales Management**, Summer 1991, Volume 11, Number 3, 37-46.*

model proposes that a manager should adopt an appropriate leadership style based on the maturity of the subordinates which, in turn, is described as the willingness and the ability of the subordinates to focus their behavior on the task or objective. According to later researchers, it is the readiness of the subordinates and not their maturity that determines the leadership style of the manager.

SKILLS ESSENTIAL FOR A LEADER

To be effective as a leader, a sales manager should possess certain soft skills or people-focused skills. These include the skills of delegation, communication, team-building, administrative, and interpersonal skills.

Delegation Skills

It is impossible for any individual to single-handedly carry out all the activities involved in a project. A sales manager too will find it a Herculean task to manage all the activities involved in selling. To be an effective leader, he has to learn to delegate responsibility to his subordinates. The decisions as to what activities to delegate and whom to delegate them to depend on the level of trust the sales manager has in his subordinates. Delegating tasks helps a leader avoid taking on more than he can handle. It also helps to enhance the morale and commitment of the subordinates by providing them with challenging tasks and increasing their responsibilities.

Communication Skills

To be effective as a leader, a sales manager should possess good communication skills. He should be able to clearly communicate to the sales force about what the market trends and organizational expectations are. A sales manager should be able to

Exhibit 15.5

Be a Good Listener to be Effective as a Leader

Not every sales manager is fortunate enough to have brilliantly performing salespersons in his team. Likewise, not every salesperson is fortunate enough to work for a sales manager who is also an effective leader. To be an effective leader, a sales manager should possess good communication skills, which include talking, listening, and comprehending skills. Listening skills play an important role in helping a sales manager gain the trust and loyalty of his subordinates.

Exit interviews in organizations have revealed that the sales manager's lack of ability to listen to his sales people have led to the sales people growing frustrated and leaving the organization. The leader in the sales manager will tend to stagnate if he lacks the ability to listen to feedback and criticism from his superiors, peers, and subordinates. To be effective, a sales manager should constantly be on the look-out for input, obtain feedback, and act upon it to improve his performance as a leader.

Generally, there are three primary barriers that prevent a sales manager from listening to others. These barriers are the sales manager's ego, fear, and impatience.

An egocentric sales manager tends to be under the false impression that he knows everything and doesn't need to listen to anyone. However, to be an effective leader and to make a positive contribution to society and the organization, he has to learn to keep his ego under control and place organizational interests above his own.

The fear of being embarrassed or the fear of losing control prevents some sales managers from listening to others, especially if the ideas of others contradict their own. Therefore, it is necessary for a sales manager to remember that obtaining the best ideas is more important than proving oneself right.

Impatience is yet another trait that prevents a sales manager from being an effective listener. A sales manager who shows impatience on being approached by his subordinates fails to gain the trust and respect of his subordinates. So, a sales manager should set aside a specific time to listen to the problems and suggestions offered by his salespersons. This will not only enhance the morale of the salespersons but will also improve the leadership qualities of the sales manager himself.

Adapted from "Good Leaders Slow Down and Listen," Sell!ing, February 2001, 4.

provide his salespersons with effective feedback and point out the areas where they need to improve. His communication skills should include not only his ability to convey things but also his ability to listen to his subordinates. A sales manager should listen to his salespeople when they come to him with their problems and queries. Effective listening skills help sales managers prevent problems from assuming gigantic proportions. Exhibit 15.5 describes the barriers that prevent a sales manager from being an effective listener. Communication should be an ongoing process. Sales managers should continuously communicate with their subordinates in order to devise new selling strategies to beat the competition.

The communication skills of a sales manager are put to test when he is required to make presentations and provide company information during campus recruitments, to prepare business plans to present to the senior management in the organization and when he has to conduct sales meetings during which he addresses a large gathering of sales representatives. A sales manager with poor communication skills fails to gain the respect of his subordinates and the attention of the top management.

The listening skills of a sales manager should be used not only to listen to his superiors, peers, and subordinates but to listen to customers as well. John Chambers, senior vice-president, Worldwide Sales and Operations, Cisco, made good use of his listening skills to listen to customers. This strategy helped Cisco to a great extent. For example, in 1993, when a network manager at Boeing Corporation told him that Local Area Network (LAN) switches offered huge potential in future, and that Boeing was contemplating a shift to these switches, Chambers decided to focus on this new product despite an earlier attempt to produce LAN switches at Cisco having proved unsuccessful. So, Chambers decided to acquire a few companies that manufactured these switches. Cisco acquired Crescendo Communications and Kalpana (a US-based company manufacturing low-end Ethernet switches) for $95 million and $200 million respectively. This marked the beginning of Cisco's entry into the switches market, estimated to be worth $100 million in early 1994.

Team-building Skills

It is the responsibility of a sales manager to ensure that the salespersons under his supervision work as a team. Teamwork becomes all the more important when the salespersons are engaged in team selling. So, a sales manager should have good team building skills to be able to make his subordinates perform to their maximum potential.

Administrative Skills

A sales manager must possess administrative skills to ensure sales force effectiveness and efficiency. He should be able to manage his sales team effectively, irrespective of whether the sales force is concentrated or dispersed geographically. The sales manager should also have disciplinary skills to enforce discipline among his subordinates and control deviations in behavior.

Interpersonal Skills

To be an effective leader, a sales manager must have good interpersonal skills. A sales manager is required to interact with a wide variety of people. Within the company, he has to interact with the top management, his peers, and his subordinates. He also needs to constantly interact with various groups of people outside the company such as prospects, customers, suppliers, and those segments of the public who want information about the company. So the sales manager has to have good interpersonal skills to be able to project a positive image of the company and of the sales force.

SUMMARY

Leadership is a process wherein one person influences others to accomplish a mission, task, or an objective. A weak leader heading an organization tends to demotivate others in the organization. Effective leaders, on the other hand, enhance the morale of their subordinates and followers and lead the organization towards success and growth. Thus, effective leadership is not optional but a prerequisite for success of an organization.

There are several characteristics that make a sales manager an effective leader of his sales team. These include the personal characteristics or traits of the sales manager, his needs and motives, the bases of his power as well as his past experience. The personal characteristics of a sales manager that make him an effective leader include clarity, consistency, urgency, assertiveness, ego drive, ego strength, risk taking ability, innovativeness, empathy, and an eye for talent. Also, the need and motives of the manager determine how successful he will be as a leader. The bases of power that a sales manager is equipped with determine his ability to lead the sales force. There are five bases of power available to a sales manager -- expert, referent, legitimate, reward, and coercive power. Past experience of the sales manager is also one of the characteristics that influence his leadership behavior.

The leadership styles displayed by various sales managers can be broadly classified into traditional and modern styles of leadership. The traditional leadership styles include autocratic, bureaucratic, consultative, democratic, and laissez-faire leadership. Modern leadership styles include transactional or transformational leadership, and situational leadership. Transactional leadership is based on contingent rewards, management-by-exception and follower's level of experience. Transformational leadership is characterized by charisma, inspirational motivation, intellectual stimulation, and individualized consideration. The situational leadership model, a widely accepted style of leadership, describes leadership along two dimensions -- task behavior and relationship behavior. Accordingly, the model describes four leadership styles, namely, high task behavior-low relationship behavior, high task behavior-high relationship behavior, low task behavior-high relationship behavior and low task behavior-low relationship behavior.

To be effective as a leader, a sales manager should possess certain soft skills or people-focused skills. These include the skills of delegation, communication, team-building, administrative, and interpersonal skills.

Chapter 16

Evaluating Sales Force Performance

In this chapter we will discuss:

- Sales force performance
- Determinants of sales force performance
- Performance evaluation
- Information sources for evaluation
- Criteria for the evaluation of sales force performance
- Establishing of performance standards
- Methods of sales force evaluation
- Monitoring and reviewing of sales force performance

Sales managers oversee activities like setting sales and profit targets, formulating sales related marketing policies, designing personal selling strategies, and integrating the sales organization with the company's other functions. In short, they design and develop the sales organization and oversee the implementation of the sales program to get the desired results. However, in discharging these responsibilities, sales managers tend to spend a lot of time in trying to achieve the planned results and end up overlooking a significant function in the sales management process – that of measuring and evaluating the effectiveness of the sale force's performance. Organizations have limited resources, and it is the sales manager's responsibility to utilize them in such a way so as to achieve a fair balance between costs and profits in order to reach the overall organizational goals. The sales force is one such resource that must be utilized effectively.

In this chapter, we will discuss the concept of sales force performance and the factors that influence the performance. We will also discuss the purpose of, and sources, processes and methods used in the evaluation of the performance of sales personnel in an organization. Both sales force performance and evaluation are generally undertaken as a part of the sales audit, which in turn, is a component of the marketing audit process.

SALES FORCE PERFORMANCE

Faced with the changing global environment, varying customer needs, and increasing competition, organizations are seeking new ways to improve their performance. Since sales force performance has a direct bearing on the overall performance of organizations, they are relying more and more on the sales force to maintain their performance levels. No other factor has a greater impact on the bottom-line of organizations than the effective performance of their sales force. Clarifying the link between sales force behavior and the sales objectives has led to performance improvements in many organizations. Not surprisingly then, organizations are seeking ways to improve sales force performance. New methods of sales force training, human resource policies, and a greater awareness of the elements that influence their working environment have led to significant improvement and a better understanding of the concept of sales force performance. It is essential that sales managers be aware of the factors that influence the performance of the sales personnel. This awareness will have a great influence on the approach and process that they will adopt in evaluating the sales force.

DETERMINANTS OF SALES FORCE PERFORMANCE

The changing dynamics of the market place, increasing competition, the slowing down of the industry or segment growth, and declining profits have increased the pressure on the sales force to perform effectively and achieve the set objectives. Many studies have attempted to identify the factors that influence sales force performance. Yet, no conclusive evidence has been gathered to determine the different specific factors, their inter-relationships, and their effect on sales force performance. Awareness about the factors that determine sales force performance can help the sales manager and sales personnel adapt better to present business conditions.

Internal Factors

These factors are dependent on the individual salesperson. Sales performance is directly linked to the make-up of individuals, and so differs from person to person. Some of the internal factors that influence the performance of sales personnel are personal motivation, level of skills acquired, and personality characteristics.

Motivation: This is the most important internal factor that influences a salesperson's performance. An individual may have the required aptitude, knowledge, and skill to perform. Yet he may perform poorly due to lack of motivation. Performance measurement and evaluation methods have a strong bearing on the motivation levels and sales force morale. If a salesperson's personal goals are in alignment with the organizational goals, the chances of the individual being highly motivated are very high.

Skill level: The skill level of sales personnel has an impact on their performance in the organization. An individual's skill level is his proficiency in a particular area. Sales personnel are required to have a good skill-set, which includes public speaking, ability to establish relationships with customers, and effective communication and interpersonal skills. The skills-set required by a salesperson depends on factors like the industry he operates in, the products he sells, and other selling activities that he has to perform. For example, the ability to gather and analyze customer information and suggest products that fulfill those needs at the earliest is an essential skill for a salesperson involved in selling technology-based products.

Job satisfaction: When an employee is satisfied at work, his performance tends to improve. Compensation is one of the important factors that determine job satisfaction for all employees, including the sales force. Organizations that have a well-established compensation system, which is linked to performance, have satisfied employees. Interest in the particular job activity and its alignment with their career objectives also influences the extent of job satisfaction of sales personnel.

Role perception: The performance of the sales force is influenced by how the sales personnel perceive their role in the organization. The extent of their awareness about the activities and responsibilities of the job, the needs of customers, the types of products the company offers, and how it meets customers' requirements help to provide salespersons with a clear perception of their roles.

Personal factors: Personal factors include all internal individual aspects related to sales force performance, except those that come under aptitude, skill level, role perception and motivation. Thus personal factors include those like age, sex, weight, height, appearance, marital status, education, and number of dependents. Studies conducted over the years have been unable to identify a direct relationship between sales force performance and some of these personal factors, but some definitive conclusions have been made concerning the influence of age and education on performance. Studies have shown that, at the beginning of their career, sales personnel prefer to sell high margin products and that, with age and experience, they tend to shift towards selling lower margin products in order to achieve sales targets. Sales performance also increases with age and experience and usually tapers off after the salesperson has worked for more than 18 years.

Ego Drive: Sales personnel who take the closing of each sale as a personal challenge and experience a sense of victory when they make a sale, have a high ego drive. They usually perform better than sales personnel with a lower ego drive. For those with a high ego drive, achieving sales targets becomes a personal affair in terms of self-worth or reputation and this pushes them towards improving their sales performance.

Empathy: The salesperson must be able understand the way the buyer feels. Simply stated, empathy means stepping into the customer's shoes. A salesperson who is more empathetic, has a better chance of identifying a customer's needs and developing a cordial long-term relationship with him. An aggressive salesperson, on the other hand, may be so preoccupied with selling the product that he may be blind to the customer's needs. So, sales personnel with better empathy show better sales performance.

External Factors

The external factors that influence sales force performance can be divided into environmental and organizational variables. The different functions in sales management also exert a strong influence on the performance of the sales personnel.

Environmental Factors: The external environment factors like the terrain of the territory, economic and demographic factors can have a profound influence on sales force performance. It can influence their output, sales volumes, number of sales orders, number of calls made per day, and the expenses incurred during selling activities.

Organizational Factors: The internal environment of the organization and its culture also influence sales force performance. Organizations that streamline communication and workflow processes to facilitate interaction between sales personnel, can improve sales force performance. Even the compensation system that a particular organization uses can influence the performance of the sales personnel and the sales manager. It has been observed that most employees usually underestimate their superior's pay and overestimate the pay of colleagues and subordinates. This attitude can have a negative impact on sales performance. Lack of awareness of the payment system is another factor that can have a negative impact on the performance and job satisfaction of the sales personnel. So compensation plans must be transparent, so that sales personnel are aware of any changes made in them. The sales personnel should also be made aware of the compensation of superiors, colleagues, and subordinates. Internal organizational factors are easily measurable and can explain the variations in sales force performance better than personal factors.

Sales Management Functions: These include aspects like sales force planning, forecasting, territory management, compensation, and control. The organizational structure, job descriptions, and sales force structure also play a crucial role in influencing the performance of the sales force.

Sales managers must keep in mind that no single factor or combination of factors can clearly help in predicting the performance of sales personnel. Most factors, except aptitude and personal traits, can be substantially modified through training and effective company procedures and policies. Therefore, this gives credibility to the concept that a good salesperson is made, rather than born with the gift of selling.

Sales managers in most organizations determine the factors that affect sales force performances in their organization, depending on the job profiles of the sales personnel and their personal experience. So, there is no common set of factors that can be considered as having an equal influence over the performance of the sales force across different industries.

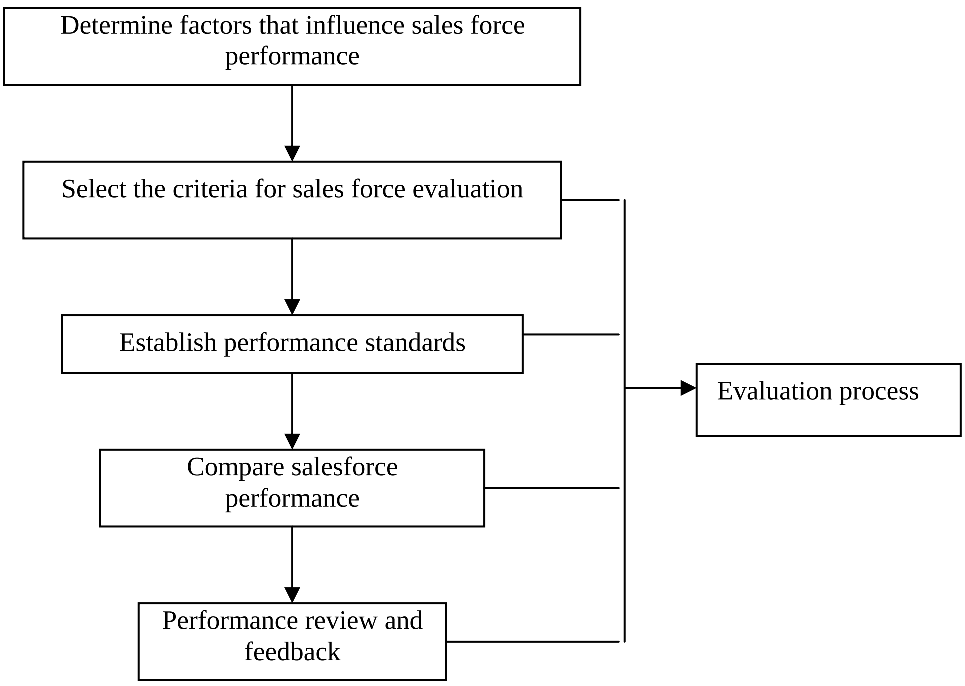
PERFORMANCE EVALUATION

Performance evaluation is an important process for supervisors and employees. It is a tool that can enhance the way in which an organization is managed. It allows employees to be recognized for good performance and provides recommendations for further improvement. When done properly, it strengthens the relationship between the sales manager and sales personnel, increases the flow of communication between the sales force and management, highlights present expectations from the management, and appraises past performance. Increasing competition, costs of selling, and greater dependence on the sales force for maintaining profitability, have led to performance evaluation becoming a critical function for the sales manager. Simply stated, evaluation involves comparing the objectives given to the sales force with the actual results achieved at the end of a particular time-period. The method of evaluation varies from company to company. An effective performance evaluation helps in achieving the desired sales objectives and in controlling the excess costs incurred by inefficient selling practices.

Another important use of performance evaluation is to provide feedback to sales personnel and sales managers about any inherent weaknesses in the selling approach and process. If the performance evaluation system is not properly designed, it cannot correctly convey to the sales personnel what the management expects from them in terms of desired behavior and activities. This may also affect the morale of the sales force and give rise to role conflicts that may eventually lead to sales force attrition. But over the years, sales force evaluation has become more complicated due to the increasing emphasis on non-core activities such as relationship-building and customer satisfaction, which cannot easily be identified or measured using the existing evaluation methods.

The basic steps that need to be taken in carrying out the evaluation process are shown in Figure 16.1. The first step is to determine the factors that affect the performance of the sales force in the organization. The next step is to select the criteria which will be used to evaluate the performance. Step three involves establishing performance standards against which the sales force performance can be compared. Step four involves monitoring actual performance while the last step is reviewing and providing feedback to the sales personnel.

Figure 16.1: Salesforce Evaluation Process



Purpose and Reasons

The purpose of evaluation is to monitor the performance of the sales personnel and ensure that it is in alignment with corporate goals and objectives. Evaluation also helps a manager to measure the efficiency of sales force activities and keep track of the progress made by the sale force towards the fulfillment of objectives. The results of performance evaluation influence decisions relating to compensation, promotion, and transfer of sales personnel. Organizations use performance evaluation results to rate the performance of sales personnel and reward those who perform well. In order to make an accurate assessment of the performance of sales personnel, the sales manager must have a clear understanding of their duties and job descriptions. Without relevant information, it is difficult him to accurately measure their performance.

Performance evaluation helps to fulfill certain objectives. It acts a tool to help appreciate good performance; it also helps discuss shortcomings openly and establish methods for overcoming each shortcoming; it helps to review or update job descriptions, clarify job expectations, and set standards of performance. A performance evaluation process must continually guide the sales manager and the sales force and help enhance the superior-subordinate relationship. Some of the reasons for performance evaluation are described below.

To be aware of company objectives: Organizational objectives have a profound influence on the performance of sales personnel. The sales manager should be aware of these objectives and of their relationship with daily sales activities. This will help him direct the sales force. Some organizational objectives that have an influence on sales force performance, are:

1) Increasing the focus on new products, where the organization provides the necessary support to sales personnel to increase the product's market penetration and improve market share.
2) Reducing the time spent on non-selling activities. Here the sales personnel have to focus attention and resources on primary selling activities and cut down on time spent on report preparation and paperwork formalities.
3) Retaining the existing customer base. The sales force must lay greater emphasis on building long-term relationships with existing customers.
4) Providing training facilities so that sales personnel become more competent within a shorter time period.
5) Providing focus on value-added activities and formulating compensation plans that ensure retention of talented sales personnel.

All these objectives influence the emphasis that the sales personnel lay on the different selling activities.

To improve motivation and skills: Performance evaluation can help in motivating sales personnel, thereby leading to an improvement in productivity. A performance evaluation system that is fair, directed towards organizational objectives, that lays down clear performance-based criteria, and provides proper feedback in terms of quantitative and qualitative factors helps in improving the motivation levels of sales personnel.

To appraise past performance: Performance evaluation helps the sales manager appraise a salesperson's past performance. By comparing his present performance with performance standards, he can identify the difference in performance levels. The progress made by the sales personnel in various selling activities can also be monitored. This helps the sales manager identify training needs and areas in which the salesperson needs to develop more.

To develop a sales plan to increase future sales: Performance evaluation helps the sales manager evaluate the different selling and non-selling activities that a salesperson undertakes. This knowledge aids him in developing sales plans that will improve the performance of the salesperson. The sales manager can draw up training and development programs that will address any weaknesses of his salespeople. This will help them increase their sales volumes.

Who Should Evaluate

The effectiveness and accuracy of the evaluation process depends on the evaluator as well. In most organizations, it is the immediate supervisor or sales manager who usually evaluates sales personnel. The immediate supervisor is the best person to evaluate the sales personnel. His proximity to them and his own previous experience of selling, makes him more empathetic to the issues involved in selling. The sales manager usually undertakes the complete evaluation process, including giving recommendations for promotion and salary hikes. Sometimes the territory manager and the regional manager also evaluate the sales personnel.

When to Evaluate

The timing of the performance evaluation plays a crucial role in keeping sales plans on course. Performance evaluation periods vary from organization to organization. It may be on a weekly, monthly, quarterly, half-yearly, or annual basis. However, the routine monitoring of selling activities cannot be considered as a performance appraisal procedure; only systematic and formal procedures aimed at measuring the performance of the employees come under an evaluation plan. The frequency of evaluation depends on the type of sales plan developed. For example, the period of evaluation is longer for complex sales plans. The variation in evaluation time may also be due to economic costs and the feasibility of conducting an appraisal. The variations in the period given to sales personnel to respond to and take corrective steps based on the previous evaluation, also influence the timing of evaluation in a organization. Despite these conditions, performance evaluation has to be conducted as frequently as possible to identify and communicate variations in performance to sales personnel at the earliest.

Performance evaluation must be conducted in a systematic manner and the duration must be based on the job profile of the salesperson. The time-period for the evaluation must be communicated well in advance to enable the sales personnel to organize and plan their activities. Exhibit 16.1 describes a common performance appraisal form that is used to evaluate the sales force performance.

INFORMATION SOURCES FOR EVALUATION

The collection and analysis of relevant information play an important role in helping the sales manager understand the factors that influence performance and develop the criteria to be used for performance evaluation. The source of information influences the criteria that the manager selects to measure sales force performance. If the sales manager is aware of the strengths and weaknesses of different sources of information, it will lead to a better development of criteria for evaluation and improve the efficiency and accuracy of the entire process. Organizations must formally establish a proper process for the collection of information so that performance evaluation can be done efficiently and accurately. The major sources of information that a sales manager can use are:

Company records: These are the main source of data by which sales managers evaluate the sales personnel. Company records are used mainly as a source of information for developing quantitative output criteria, which are used to compare sales force performance. Sales invoices, accounting records, and customer orders are a part of the company records. With the advent of information systems, it has become easier for organizations to collect, analyze, and dissipate relevant information to sales managers with minimal effort. They also save on time and costs. Company records help analyze quantitative factors like sales volumes, sales order to call ratio, profitability, selling expenses, and so on.

Exhibit 16.1

Employee Appraisal Form

Date: _______________

Name of Employee: ___________________

Completed By: ____________________

A. Most successful job accomplishments since last performance period:

1. ____
2. ____
3. ____
4. ____

B. Key strengths of employee:

1. ____
2. ____
3. ____
4. ____

C. Problems since last performance appraisal:

1. ____
2. ____
3. ____
4. ____

D. Key areas that need improvement:

1. ____
2. ____
3. ____
4. ____

E. Teamwork ability:

1. ____
2. ____
3. ____
4. ____

F. What warnings, if any, should be given to employee?

1. ____
2. ____
3. ____
4. ____

G. How would you rate the employee on the following:

	Excellent	Above satisfactory	Satisfactory	Average	Below average	Unsatisfactory
Attitude						
Initiative						
Dependability						
Work quality						
Work quantity						
Knowledge of job						
Team Play						
Organization Ability						
Judgement						
Responsibility						

H. Any other observations:

Source: "Employee Appraisal Form" <u>*<http://www.allbusiness.com/forms/asp/231850p.asp>.*</u>

Reports from salespersons: Sales personnel send data in the form of daily, weekly, monthly, activity, expense, and call reports. These reports act as a source of information for the sales manager. The disadvantage with this source is that the accuracy and validity of the information depends on how punctual and ethical the salesperson is.

Customers: Customers are a valuable source of information for sales managers. They help to make up the inadequacy associated with the reports of salespersons. A manager can get to know the results or impact of the overall sales efforts by sourcing the required information from customers through customer surveys or informal discussions with them. Though customers are the ideal source of information for sales force evaluation, they may sometimes favor those sales personnel who provide additional benefits to them. However, the benefits offered may not be favorable to the organization.

Manager's field visit: The sales manager usually spends time in the field directly supervising the sales personnel. Field supervision not only helps him to gain a first-hand understanding of the activities of the sales personnel and give the required training and coaching, but also provides him with valuable information on qualitative aspects like their communication skills, interpersonal skills, technical product knowledge, and personality traits (adaptability, empathy, sociability, etc.,).

Manager's personal insights: The personal insights of a sales manager are largely restricted by personal experience in a similar job as his sales personnel. Training and development programs and discussions with peers and superiors also act as a valuable source of information.

Other sources: Sales managers also make use of other external sources of information like distributors, informal and formal personal contacts, published and electronic sources, and evaluation criteria and sources used in other organizations for evaluation purposes.

Exhibit 16.2

360-degree Feedback as a Performance Management Tool

The 360-degree feedback was first developed as a tool for team building and management training. However, its use has grown steadily over the years, and many organizations now use it as a performance management tool. The logic behind the 360-degree feedback is that peers and subordinates have a better understanding of an individual's behavior than a superior does, because they observe him in circumstances that the superior does not. The tool is based on the premise that the better the understanding, the greater is the ability to analyze and improve the performance of the individual. The 360-degree feedback is a performance evaluation method, which makes use of information given by a salesperson's superiors, colleagues, distributors, and even customers to take decisions on compensation and promotion. It is also known as a multi-source, a multi-rater, or a full-circle feedback. This method is especially useful in evaluating sales personnel, because they are mostly in the field away from the headquarters, and the sales manager does not have the means to sufficiently supervise them. The disadvantage of this method is that it is very difficult for sales personnel to handle themselves when they come to know what others think of them. Also, it is awkward to know that a subordinate will be giving an opinion on their performance.

So, unless the program is communicated properly and implemented for a certain length of time and sales personnel are made familiar with it, the 360-degree may do more harm than good. It may lead to a decrease in sales performance or an increase in sales force turnover.

Adapted from Edward Prewitt, "Should You Use 360 degree Feedback for Performance Reviews?" Harvard Management Update, February 1999, Volume 4, Issue 2, 8-9.

The above sources of information influence the sales managers while determining the quantitative and qualitative criteria for sales force performance. It has been observed that sales managers rely more on certain sources of information while determining the criteria. Company records, field sales reports of sales personnel, and feedback from customers are the primary sources of information used to determine quantitative criteria while personal observations of the sales manager when interacting with the salesperson, field sales visits, and customer feedback are the key sources of information in determining quantitative criteria. Earlier, information gathered from peers and subordinates was rarely preferred, but that is changing now. Many organizations have started making use of the comments given by peers, personnel from other management functions, and subordinates for performance evaluation. This method of gathering information is done through the 360-degree feedback. Exhibit 16.2 gives an overview of this process of performance evaluation.

CRITERIA FOR THE EVALUATION OF SALES FORCE PERFORMANCE

The performance of the sales personnel can be considered and evaluated in terms of behavior and outcome-based components. The behavior component includes evaluating all the activities, plans, and strategies carried out by the sales personnel while fulfilling their job responsibilities in terms of selling activities. Here the focus is on what the sales personnel do and not on the results they achieve. It is also called the qualitative criteria for sales force evaluation. Sales planning, technical knowledge, adaptiveness, sales support, sales presentations, teamwork, territory management, and personal traits are all qualitative criteria for evaluation. The results obtained as a consequence of sales force efforts and skills come under the outcome-based or quantitative component of sales force evaluation. Sales volume, market share, customer retention, sales orders, gross profit from new customers and number of calls per day are some of the criteria that come under the quantitative component. Both these components have a significant influence on the performance of the sales personnel and form the basis on which the sales manager can evaluate them. Significant differences have been observed between the qualitative and quantitative components of highly effective and less effective sales organizations. The criteria for measuring sales force performance should be derived from and closely related to the job description of the sales personnel.

Qualitative

As mentioned earlier, qualitative measures include the personal competencies or behavior of sales personnel that are inherent in and unique to each individual. It includes distinct aspects like planning skills, teamwork, aptitude and attitude, product knowledge, ethical behavior, time management, communication skills, report preparation, and technical skills. These qualitative measures are usually obtained after the evaluator/sales manager fills up a rating scale. Qualitative measures of performance are usually used as a support for quantitative measures, due to their subjective nature. Lack of a distinct measurability may lead to ambiguity in understanding for the sales personnel and the possibility of personal bias during evaluation on the part of the sales manager. There is also a possibility of a conflict arising between the sales personnel and sales manager due to a difference of opinion about a factor like motivation or aptitude. In spite of these limitations, many organizations nowadays prefer to use qualitative factors while conducting sales force performance evaluation. Their preferences regarding the measures to be used keep changing over the years. The preference for planning skills, knowledge of company policies, and time management has reduced whereas the preference for communication skills, ethical behavior, and team orientation has increased in most organizations.

Sales skills: Sales skills are one of the most important factors that have an influence on sales force performance. Selling skills relate to the extent to which the salesperson has learned the tasks that are needed for a particular sales job. The sales skills of a salesperson can be divided into three sections -- technical skills, interpersonal skills and salesmanship skills. Technical skills involve skills to operate an engineering product, knowledge of the company, awareness of competitors' products and operations, and so on. Interpersonal skills include the ability to cope in a particular selling situation, to persuade customers, or to be empathetic. They also include verbal and non-verbal skills. Salesmanship skills include the ability to identify and select prospects, the skill to make sales presentations, service prospects, and develop long-term relationships with customers.

The ability of a salesperson to adapt to a particular selling situation helps in improving his sales performance. The level and combination of skills required for a particular sales job can be decided based on the sales manager's personal experience and an analysis of the job description and profile. The skills required vary with the type of products sold, the region of operation, the strategy adopted as part of the sales plan, and so on.

Territory management: This factor can also be used as a criterion for performance evaluation and it carries more weight for geographically based sales personnel. The sales manager can consider several aspects in evaluating sales personnel using this criterion. It may include the number of prospects, total customer base being serviced, level of competition, the routing and scheduling plan of the salesperson, territory terrain, total time spent on making sales calls, and knowledge of key decision-makers in major accounts. The sales manager can consider all these factors under the criteria for territory management when evaluating the sales force performance.

Personality traits: The sales manager has to list the ideal traits that are needed for a particular type of sales job. Only after this is done can the sales force be evaluated. Most of the personality traits are psychological in origin and it is difficult for a sales manager to evaluate the sales force by administering and evaluating psychological tests. However, personality traits for motivation, competitiveness, role ambiguity, and conflict can be identified. For example, a salesperson's degree of instrumentality influences motivation levels. Instrumentality signifies the extent to which a person is individualistic in performing the selling activities. Sales personnel with a high level of instrumentality are more aggressive, independent, and have a greater tendency to complete the assigned tasks than those who have a low level of instrumentality. The sales manager must be able to identify the required level of instrumentality needed for a particular job in order to effectively evaluate the sales force. The level of competitiveness is another individual factor that describes the inherent desire of an individual to win over others. Adaptability, locus of control, ego drive etc., are some of the other important traits that influence sales force performance.

Quantitative

Quantitative criteria, being objective in nature, are used most widely in measuring sales force performance. These measures of performance are easier to implement than qualitative criteria and can be standardized. Quantitative measures can be further segregated in terms of input and output measures.. Input measures include aspects like the average number of sales calls made per day, ratio of sales cost to sales and the number of reports submitted by the salespersons. Output measures include aspects like sales volume, sales orders, and number of new accounts. Evaluating the salespersons' efforts in terms of the process of selling (input measures) will show what they did during selling. Evaluating the output measures will show how they achieved the results. A sales manager can also combine the input and output measures for sales force evaluation. He can determine the reasons for a particular output of salespersons by taking into account their input measures. Consumer goods marketers are more likely to use output measures like sales volumes and number of advertising displays in supermarkets and retail outlets than industrial marketers.

Sales volume: Sales volume is the most widely used measure in organizations to evaluate sales force performance. Sales volume is not restricted to just measuring the total sales of the sales personnel in terms of money; there are many other variations as well. This measure may include sales volume in rupees/dollars, sales volume by customer, sales volume per order, sales volume to previous year's sales, sales volume per product or product line, sales volume per call, sales volume by quota, or sales volume in units. Use of sales volume by quota and sales volume by units has reduced, and the use of output measures like sales volume per customer have gained predominance.

Average calls per day: This is another quantitative measure that can be used to evaluate sales force performance. The sales manager monitors this aspect through the daily reports sent by the sales personnel. However, this measure is not preferred nowadays because of the lack of both accuracy and the means of determining the credibility of the daily reports. Sales personnel may fake the total number of calls to get a good performance result.

Sales orders: Sales orders are also used as a measure for sales force performance. There are many variations in this measure too. Sales managers may use the sales order per call ratio (commonly termed batting average), net sales orders per repeat order, the average size of a sales order, or the number of sales orders gained or canceled to measure sales force performance.

Ratio of selling costs to sales: Sales managers use this measure to control the costs in terms of the selling expenses incurred for a particular sales volume. This measure has gained importance due to the emphasis by the top management on corporate profitability. Reducing selling costs can help in the achievement of this objective. The selling cost to sales ratio varies for sales personnel due to differences in territory potential, customer distribution, and territory size. The sales manager must establish different expense ratios for the sales personnel based on the prevalent factors. Otherwise, the possibility of inequity in performance evaluation is possible. Industrial organizations give more preference to this measure in sales force evaluation than consumer product companies.

Gross profit obtained from new customers: This measure is usually linked to the profit quotas set by sales managers. It helps in gauging profit as a percentage of sales. Gross profit is obtained by reducing the cost price of the products from the total sales volume obtained by a salesperson. This measure is useful when an organization launches a new product or enters new territories to increase the customer base.

The emphasis given to qualitative and quantitative factors by various organizations differs depending on their size, operating industry, etc. Sales managers must try to establish criteria that reflect the entire range of the salesperson's selling activities.

ESTABLISHING PERFORMANCE STANDARDS

After establishing the criteria based on which the sales force will be evaluated, the sales manager has to formulate standards with which the performance of the sales personnel can be compared. Comparison with performance standards enables the manager to know how the sales personnel are doing vis-à-vis their job description and expected activities. They act as a benchmark to evaluate sales force activities and also as a guide for sales personnel to plan their activities. Performance standards also help sales personnel know the level of performance they are expected to achieve, and how to achieve it. Performance standards that are specific and easily measurable help in easily determining whether established objectives are being achieved.

Establishing performance standards is one of the most difficult steps in the performance evaluation process. The performance standards can be prepared by the sales managers singly or in consultation with sales personnel who have a similar job profile. A standard list that is generally prepared for every job description may also be used. The most important issue in this regard is the number of standards that are to be used to measure sales force performance. Sales managers in most organizations frequently depend on sales quotas as the single-most important performance standard. But it must be remembered that the sales force performance is dependent on a number of internal and external factors, as discussed earlier. This dependency makes it necessary for sales managers to adopt multiple standards for performance measurement. The difficulty in this approach though, is the complexity in giving appropriate weights to each parameter to enable comparison. The selection of the standards is also influenced by the sources of information the sales manager uses. Another difficulty in using a common set of performance standards arises because of the variations in the sales territory potential, product portfolio, account sizes, competitive conditions, and types of customers. Companies that have a large sales force have to use a common set of performance standards because it is difficult to develop performance measures tailored to individual salespersons.

The sales manager must keep in mind the relationship between the input and output measures while setting performance standards. Combined standards like sales volume/expenses, gross margin/order, and orders/calls can improve the ability and accuracy of performance evaluation by reducing the discrepancy in comparing sales force results with standards.

Performance standards can be classified into four major areas. Organizations can use all the four types of performance standards or any combination of these. They are quantity standards, quality standards, time-based standards, and cost-based standards.

Quantity Standards: These standards include all aspects that can be measured directly without any complex calculations. They include the number of sales calls per day, the number of orders, the number of sales presentations, and number of lunches hosted for a customer. Quantity standards are the easiest to set and the most convenient to compare with the results of the sales force.

Quality Standards: These standards are subjective in nature and are measured by interpretation. They include aspects like teamwork, adaptability, ethical behavior, ability to gather information, and so on. For example, a sales manager can measure the information gathering ability of a salesperson by comparing the number of sales calls of his that yielded information for preparing a sales proposal to the number of sales calls that did not yield any information.

Time-based Standards: All aspects involved in the selling activity that can be measured relative to the factor of time can be considered under time-based standards. The time taken between identifying the customer need and preparing a sales proposal, the time between a customer inquiry and the sales call, the time between a customer's complaint and solving the problem, the time between getting the order and collecting the sales amount, etc., are some aspects that can be measured with the help of time-based standards.

Cost-based Standards: All the selling activities that are linked to organizational expenses and profitability can be measured under cost-based standards. These include the ratio of selling costs to sales, gross profit margin obtained from new customers, expenses incurred per order, and the number of gifts or entertainment expenses.

Most organizations prefer to use multiple measures or performance standards to evaluate sales force performance. The most widely used quantitative performance standards are: sales volume based on quota, sales volume in comparison to previous year's sales, and net profits. The global environment and competition have led to cost-based standards assuming importance in many organizations. This is because of the difficulty organizations have in maintaining profitability. Time-based standards are preferred in the service industry and by organizations that focus on customer satisfaction and customer relationship management.

METHODS OF SALES FORCE EVALUATION

Several methods of performance evaluation have been developed based on research studies conducted over the years. However, no single method has been accepted as the most accurate for evaluating the sales force. Cotham and Cravens, in 1969, suggested using the standard deviation to minimize the variations caused by measuring sales performance using multiple measures. This method helped to compare performances of sales personnel operating in different selling situations. In 1972, Cravens, Woodruff, and Stamper developed an evaluation model that helped predict the performance of sales personnel in a given territory and evaluate them on the basis of total sales volumes, in terms of the number of units sold. Jackson and Aldag propounded the Management by Objectives (MBO) method for evaluating the sales force in 1974. Cocanaugher and Ivancevich developed a behaviorally anchored rating scale (BARS) system of evaluation in 1978, for the sales force. In 1982, Behrman and Perrault developed a self-report performance scale as a method to evaluate the sales force.

Most methods of performance evaluation are based on either personality traits or are behavior-based and results-based. In the personality trait method, the observable aspects of salesperson behavior like adaptability, dependability, or sociability are used to measure performance. This method is not accurate since it considers only the personal characteristics and not the factors that influence sales force productivity. In the behavior-based method, the sales manager observes certain key work behaviors and measures them against the possible outcomes in terms of a seven-point scale. Sales force behavior is rated in degrees from least desirable to most desirable. Results-based methods of measuring sales force performance have gained popularity due to the use of objectives that are easily measurable. Management by objectives is the most widely used performance evaluation method under the result-based method.

We will study some of the methods of evaluating the sales force in detail.

Essays

This is the simplest of all the methods of sales force evaluation. In this method, the sales manager describes the performance of the salesperson in a few paragraphs. He mentions details like individual potential, strengths, weaknesses, and other relevant matters in the essay. The basis for using this method is the assumption that a written or word-of-mouth statement is as reliable as any other formal evaluation method. Organizations make use of essay appraisal from former employers or colleagues while recruiting sales personnel. The problem with this method is that there is no standardized pattern for the essay. Different managers use different approaches to writing their evaluation and a different way of interpreting and rating the characteristics required for a particular job. Due to this difference, each essay may highlight only certain characteristics of a salesperson and this creates a difficulty in comparing the profiles during the evaluation process, especially during the time of promotion. In addition, there is a possibility of bias due to the absence of concrete factors of evaluation.

Exhibit 16.3

Behavior Observation Scale (BOS)

In order to minimize the demerits associated with the traditional rating scales, industrial psychologists developed a better method to evaluate sales force performance called the 'Behavior Observation Scale' (BOS). This method considers those behaviors and activities of sales personnel that significantly influence individual performance. All the behaviors that are similar in the job context are grouped together under a single dimension. For example, certain behaviors can be grouped under the dimension 'customer relationships'. Around ten such dimensions are generally rated to measure the performance of a salesperson. After the dimensions for a particular job type are established, they are given in a random order to a group of specialists to rate the dimensions again. If the rating is similar to the rating given previously, the dimensional rating for that particular job-type is fixed. A five-point Likert scale is used for each of the ten dimensions. This evaluation form is given to the respective sales managers to rate each crucial behavior for all the dimensions, based on their observations.

There are certain disadvantages with this method of measuring sales force performance.

1. The sales manager has to keep observing the sales personnel for the entire period of evaluation. This is difficult because the sales personnel are always on the move in their territories.
2. It is difficult to identify and interpret a particular behavior to fit one of the dimensions in the appraisal form.
3. BOS consumes lot of executive time and organizational costs because different dimensions have to be established for different types of jobs.
4. BOS overlooks the end results or fulfillment of objectives and concentrates only on the means used to achieve the objectives. This is not an accurate basis for measuring the sales performance.

Adapted from Jan.P Muczyk and Myron Gable, "Managing Sales Performance Through a Comprehensive Performance Appraisal System," Journal of Personal Selling & Sales Management, May 1987, Volume 7, Issue 1, 41-52.

Rating Scales

In this method of performance evaluation, which is the most widely used, the sales manager identifies certain specific criteria for a particular type of job. The criteria may be based on personality traits, and behavioral factors, or they may be performance related. The sales personnel are evaluated based on the extent to which they exhibit the desired behavior or the extent to which they meet the desired performance criteria. The advantage of this method is that it helps identify areas where the salesperson has to improve or maintain the desired levels of performance. The disadvantage of this method is that the most recent behavior of the sales force is considered without looking at the salesperson's behavior for a period of time (say, on a quarterly or annual basis). Another disadvantage is the difficulty that arises in preparing behavioral charts that are reliable enough to measure the salesperson's performance. There is also the possibility of the evaluator not understanding what the performance criteria or ratings mean.

Forced Choice Method

Forced-choice rating is a method of rating that helps in comparing sales personnel by creating standards for measuring sales force performance. In this method, the sales manager is asked to go through groups of statements and select those that best explain the individual. Usually, within a group, both or all statements are either positive or negative. The rater is forced to choose what describes the salesperson best from a group of all positive or all negative statements. Each statement is given weights that the evaluator is not aware of. The form is evaluated by the personnel department and the salesperson with the maximum score is rated the highest. The advantage of this method is that it helps remove rater bias. The disadvantage is that it is not useful during the performance appraisal interview. It is not easy to prepare standard forms because of the variations in the job profiles of the sales personnel. Also the costs of preparation are very high.

Another method of performance evaluation is the Behavior Observation Scale (BOS), which overcomes most of the disadvantages associated with rating scales. Exhibit 16.3 describes this method.

Ranking

This method of performance evaluation is useful when the sales personnel in the entire sales force working in different areas have to be compared. All the sales personnel are placed in order, beginning with the top performer. This is useful where essays, rating scales, or appraisal forms are not. Ranking is preferred when sales personnel from different operating areas have to be evaluated for promotion or for increase in compensation. In such conditions, a subjective approach rather than an objective one based on numbers is needed to evaluate sales force performance. Alternation ranking and paired comparison ranking are the most commonly used ranking methods.

In alternation ranking, the sales personnel are listed randomly on the left-hand side of the evaluation sheet. The names are selected based on the criteria chosen for ranking. For example, the sales manager chooses the best salesperson from the list (if the ranking is done to increase the compensation) and writes the name on the top-right hand corner. The name of the least valued salesperson is placed on the bottom right-hand corner. Now the sales manager alternatively keeps writing the names until the list is complete. The new list is the ranking profile of the sales personnel for increase in compensation. In Paired Comparison ranking, the list of sales personnel is written on the left-hand side of the appraisal sheet. Now based on the criteria selected, each salesperson is compared with the rest in the list. For each comparison, a tally is given. The salesperson with the highest tally is ranked number one and the salesperson with the lowest is ranked last. Another method of ranking is the multiple ranking method where the list of sales personnel are ranked by more than a single individual and the average is taken. Alternation ranking and Paired Comparison ranking are preferred when ranking sales personnel for salary increases.

The disadvantage of ranking is the difficulty in deciding the criteria based on which the sales personnel are to be ranked. Another disadvantage is the possibility of overemphasis on a particular criterion like behavior or personality traits to rank the sales personnel.

Rankings are widely used to evaluate the sales force. At GE, supervisors identify the top 20 percent and the bottom 10 percent of the sales force by ranking them. The top 20% are well rewarded while the bottom 10% are usually fired. However, rankings have created problems for organizations also. For instance, in Ford Corporation, some employees sued the company stating that the A, B, and C grade rankings given by the superiors discriminated against older employees and that the criteria for differentiating between B and C grades were not objective and lacked clarity. Microsoft also faced similar lawsuits from its employees.

New Methods of Evaluation

Organizations have been trying to develop new methods for evaluating sales force performance in order to overcome the limitations associated with the traditional methods. Some of the newer methods of sales force evaluation include critical incident appraisal, management by objectives, work standards approach and assessment centers. The 360-degree performance evaluation is also one of the new methods of evaluation. Certain methods of evaluation use historical personnel and accounting data to advocate a long-run approach to evaluating the sales force, while other methods like multivariate analysis and multiple regression analysis make use of quantitative methods.

1) Critical Incident Appraisal: In a critical incident appraisal, the sales manager keeps note of the positive and negative behaviors of the sales personnel. During the time of performance evaluation, he discusses the actual behaviors with the salesperson instead of debating on the personal traits and their interpretations. The disadvantage of this method is that the sales manager has to maintain a record of the salesperson's behavior constantly, and this takes up a lot of time. The costs in spending so much time in monitoring the sales personnel are also not feasible.

2) Work-Standards Method: This method is used primarily to improve the productivity of the sales personnel. The sales manager prepares a comprehensive list of all the activities and job duties that the salesperson must perform. The manager then monitors and evaluates the salesperson on the basis of this list. Since the activities may vary from salesperson to salesperson, it is difficult to compare and evaluate them on a common base.

3) Management by Objectives (MBO): This method is different from the traditional methods because it is tied to results and not based on the personality or behavior traits of the sales force. MBO has been widely used by organizations due to its focus on end results. In this method, sales personnel are evaluated on the basis of how well they attain the given objectives. These objectives, which are specific and measurable, are generally prepared at the time of sales planning.

The sales manager formulates them based on the corporate and strategic marketing plan after discussions with the sales personnel. The objectives are set with mutual consent for a fixed period of time. Usually the objectives and acceptance are put in writing in the form of a statement. After the objectives are set, the salesperson chalks out strategies and plans to achieve each of them. The sales manager regularly monitors the implementation of the action plans and programs. Periodic review is done to study the progress made and to identify any deviations from the original plan. At the end of the stipulated time, the sales personnel are evaluated based on the extent to which the fixed objectives have been attained. Rewards are generally attached to fulfillment of the objectives. The above process is repeated once the sales force is evaluated and new objectives are set.

The disadvantage of this method of evaluation is the lack of a logical framework to decide on the standard of objectives and the criteria to be used to measure them. This method also overlooks the factors that influence the achievement of the objectives. With increasing changes in customer tastes and demands, companies have begun to focus on factors other than selling, like customer satisfaction and relationship. To measure these aspects, it is necessary to get to know the means of achieving these objectives. This has led to MBO losing its importance in performance evaluation systems in many organizations. Exhibit 16.4 describes some of the problems that arise while implementing MBO.

4) Behaviorally Anchored Rating Scale (BARS): This is one of the recent approaches in performance evaluation. BARS is a combination of a critical incident method and a graphical rating scale which helps in increasing the accuracy of sales force evaluation by emphasizing objective measures rather than subjective ones. In this method, the most suitable behavior needed in carrying out a particular type of job is identified and anchored on a rating scale. The sales manager has to select a behavior that is most similar to the behavior profile on the rating scale.

Developing BARS involves: a) putting together a list of the most appropriate behaviors needed to be successful in a particular job; b) grouping similar behaviors into 5-10 behavioral sets or dimensions by those aware of the job, like sales managers.

Exhibit 16.4

Limitations of Management by Objectives

MBO involves objectives being set for the sales personnel by the sales manager through mutual agreement,, performance targets being set, performance being periodically reviewed, the results being discussed at the end of the stipulated period, and corrective action being taken. However, routine problems that are not predicted at the time of setting objectives can arise during the implementation of MBO.

- MBO does not take into account the influence of personal, organizational, and environmental factors while achieving the set objectives. The influence of other management functions is also not considered.
- In the present competitive environment, sales personnel have to be very flexible in carrying out their selling activities. This is because of the shifting emphasis on different areas of selling caused by constant changes in the sales plan to stay ahead of competitors. But the job description, in spite of being detailed, does not incorporate such a degree of flexibility in this method.
- The time taken to prepare objectives is not sufficient to take into consideration the possibility of setting objectives that can help in integrating the different functions. This finally leads to the method being unable to contribute to improving teamwork and organizational control.
- Another problem with MBO is that the superior, who has to play the role of the judge in identifying the reasons for success or failure, measures the performance himself. Most managers dislike giving comments or judgments on the worth of an individual and may resort to a lenient evaluation.
- Certain important aspects cannot be considered while setting objectives due to their lack of measurability. For example, a sales manager cannot set a measurable objective such as increasing customer satisfaction by 10%. Activities like the selling approach, ethical behavior, and product service together influence the customer satisfaction.

Adapted from Harry Levinson, "Management by Whose Objectives?" Harvard Business Review, January 2003, Volume 81,Issue 1, 107-116

For example, all the behaviors contributing to customer satisfaction are grouped under a single behavior dimension; c) giving the list of appropriate behaviors or critical incidents to experts who regroup them. Only those dimensions that are similar to the grouping made in the earlier step by sales managers are retained; d) asking the expert group to scale the dimensions on the basis of their degree of influence on the success of the job; e) preparing the final rating scale by selecting some of the most relevant behaviors under each dimension.

The advantages of BARS are: it is very objective and accurate in measurement and helps to develop clear standards; it gives proper feedback to sales personnel about inconsistent behavior; it gives the feedback in clearer terms than traditional evaluation methods. The disadvantages are its higher cost and the greater extent of time taken. Sometimes it is difficult for the sales manager to identify behaviors that are most similar to those given in the list of dimensions.

5) Family of Measures (FOM) as a method of sales force performance evaluation:

FOM is a new tool developed to track employee performance in an organization. It differs from the traditional evaluation methods in that it helps measure the progress made by a salesperson or group individually, and not by giving ratings. The method is useful to measure individual as well as group performance. FOM does not compare the results obtained with those for other members of the sales force; it compares the results with the previous results over a time period. The method is a continuous evaluation process and the results are not linked to the sales force pay. FOM is flexible in approach because it allows sales personnel to assign weights to each area based on the difficulty of work and the experience of the salesperson.

This method evaluates sales personnel on a monthly basis in five major areas and gives the performance to-date for the month as well as for earlier periods. These areas are quality aspects, quantity aspects, timely service, actual time spent in selling activities, and customer satisfaction achieved. The quantity aspects include the number of transactions done. Quality aspects include measuring performance based on communication, accuracy, and product knowledge. Customer satisfaction is measured through the results of a customer survey.

Family of Measures is used to develop the performance of the sales personnel on a continuous basis by identifying weak areas and improving on them with the help of special training and coaching given by sales managers. The company gives special recognition to those employees who have shown significant improvement in their performance.

A performance evaluation method must be able to facilitate rewarding the best performer appropriately, identifying the individuals eligible for promotion or those whose services have to be terminated, identifying the training needs and help needed in human resource planning, and providing appropriate feedback. The appraisal must be able to create a set of preferable dimensions for different job types so that new people can be easily hired whenever a need arises by comparing profiles with the fixed dimensions.

Exhibit 16.5

Choice of Evaluation Method

Every method of evaluation has certain advantages and disadvantages. Selecting the most appropriate one based on the performance evaluation objectives is necessary to ensure that the sales force evaluation program is successfully executed. Different objectives require different evaluation methods.

- If the objective of sales force evaluation is to identify sales personnel who require coaching, counseling, or motivation, it is better to use the goal-setting or work-standards method of evaluation.
- The critical incident method is suitable when the objective of evaluation is to motivate managers to take a greater interest in the activities of their subordinates.
- Management by objectives is the best method to motivate sales personnel. It is also useful when it is necessary to provide constant feedback to the sales force.
- In organizations where quantitative objectives are absent, the critical incidents method can be used to communicate the performance criteria and results to the sales force.
- If the objective is to evaluate sales personnel for a promotion, the forced choice rating method can be the most effective if developed properly. Evaluation techniques like alternation ranking and paired comparison are also used to reduce the scope of personal bias on the part of the sales manager and yield effective ranking lists.
- Rating scales and essays are the best methods when the objective is to identify the training needs and areas of development of the sales personnel.

Adapted from Winston Oberg, "Make Performance Appraisal Relevant," Harvard Business Review, January/February 1972, Volume 50, Issue 1, 61-67.

Exhibit 16.6

Monitoring Sales at Marico

Marico Industries Limited, a fast moving consumer goods (FMCG) manufacturer, has installed a software model at a cost of Rs 16 crore. The two installed software systems are Marico Industries Network (MiNet) and Marico Industries Distributor Application Software (MIDAS), which operate on basic ERP software called R3 and an Advanced Planner and Optimizer (APO) software. The new system helps Marico keep abreast of the selling activities of its distributors, stockists, and sales force. At any given time, the company can track what is being sold in any corner of the country. The system helps the sales representatives provide information on orders and send requisitions for credits and supplies. It also has a section called the business information warehouse, which helps sales personnel to provide useful market information with ease. The system has enabled the company to concentrate on increasing sales and maintaining stock positions. It has become a useful source of information for sales managers to measure the various sales activities in terms of the quantitative, cost and time-based performance standards. Overall, the system has helped the company to undertake a more accurate and equitable approach to sales force performance evaluation.

Adapted from Austin Lobo, "On Track," Business India, September 02, 2002.

No single method of performance appraisal can act as an accurate base for sales force evaluation and fulfill the above requirements. Each method has its own advantages and disadvantages. So sales managers have to use a combination of these methods to evaluate the sales force. For example, sales personnel engaged in missionary selling can be evaluated by using BOS and the Forced Choice Rating method. Irrespective of the costs, time, and incompleteness of the different methods of sales force performance, the activity is very important and cannot be ignored.

Exhibit 16.5 describes the basis for selecting a particular evaluation method.

MONITORING AND REVIEWING SALES FORCE PERFORMANCE

The performance of sales personnel has to be monitored at regular intervals to ensure that they are not deviating from their assigned duties and responsibilities. Monitoring also helps sales managers keep track of the progress made by the sales force toward established objectives. The sales force performance can be monitored with the help of sales reports, invoices, order forms, accounting records, and direct interaction. Continuous monitoring helps the sales manager to easily make the necessary adjustments from time to time without undertaking a major reorganization of the organizational structure, processes, and policies. Input-based measures require considerable monitoring and directing than output-based measures. Sales automation products and web-based technologies have made performance monitoring less cumbersome by making the relevant information available on time at significantly lower costs. Exhibit 16.6 gives a brief description of how Marico Industries has implemented a new software model to monitor sales through distributors, retailers, and the sales force.

The final step in the performance evaluation process, after monitoring sales force performance, is to review the performance of the sales personnel by conducting an evaluation interview. This helps the sales manager communicate to the sales personnel the differences between their actual performance and the performance standards. A one-to-one review helps provide feedback and allows sales personnel to discuss aspects for improvement, clarify doubts, and help in the overall development of the individual. Most organizations conduct performance review once a year. This is not sufficient in the present competitive scenario where the review must be conducted at regular intervals without any bias towards any salesperson. At PepsiCo, the review process is linked to corporate strategy. The company makes use of a timetable to

Exhibit 16.7

Common Drawbacks Cited In Formal Appraisal Programs

Organizations are making continuous efforts to develop performance appraisal systems that are free of the common pitfalls. An awareness of the common problems that sales managers and sales personnel face during the performance evaluation process can help one watch out for these problems at the time of sales force evaluation.

- The concept of a sales manager evaluating his subordinate like a judge can hamper the participative style of management adopted by organizations. It also creates a superior-subordinate relationship that may act as a deterrent for a sales manager during training and coaching activities.
- Performance appraisals may vary with different sales personnel. Some managers may be very tough when evaluating sales personnel, whereas some may be lenient. This variation hampers the standardization of the appraisal process.
- Due to the increasing size of the sales force and greater responsibilities on the sales manager, it is not possible to supervise the sales force regularly. The lack of regular supervision can affect the accuracy of performance appraisal, since the manager is not fully aware of the selling activities and working conditions of the salesperson.
- Appraisal programs must not be treated as a substitute for training and development programs where improving the sales force performance is concerned.
- Communicating a poor performance report is difficult and may backfire. Instead of acting as a stimulant to improve performance, the appraisal may de-motivate the sales people, especially those with low self-esteem.
- Some performance systems may lose their efficiency due to personal bias and the wrong evaluating criteria adopted by the evaluator.
- Even though the objectives and evaluation criteria and methods are defined clearly, the final task of judging the actions of the sales personnel is subjective and not consistent.
- The performance criteria vary for sales personnel in different types of sales force structures. In such situations, it is difficult to compare and rate sales personnel for the whole organization.
- In organizations where compensation is based on performance, there is a possibility of sales personnel who show positive behavior consistent with organizational expectations, not getting the deserved pay increase. At the same time, those who achieved results with inconsistent behavior are rewarded.
- Despite having a well-established performance evaluation system there is no framework for guaranteeing that sales managers provide regular feedback to the sales force. An absence of a periodic feedback can lead to a loss of morale and the failure to carry out the required correction in the necessary areas.

Adapted from Winston Oberg, "Make Performance Appraisal Relevant," Harvard Business Review, January/February 1972, Volume 50, Issue 1, 61-67 and Harry Levinson, "Appraisal of What Performance?" Harvard Business Review, July/August 1976, Volume 54, Issue 4, 30-38.

integrate the corporate strategy with the performance appraisal. The corporate plan for the coming year is prepared in November and December of the previous year and the appraisal takes place in January/February. Performance evaluation is done keeping in view the requirements of the future based on the corporate plan.

Sales managers and sales personnel in organizations face several problems in the implementation of successful performance appraisal programs. The common drawbacks of appraisal are described in Exhibit 16.7.

SUMMARY

One of the most important responsibilities of sales managers is to evaluate the performance of the sales personnel. The performance appraisal period can become one of those times that a salesperson dreads, unless the appraisal is effectively conducted. Ineffective performance appraisal tends to become a time-consuming and unpleasant activity for the sales manager as well as the sales personnel.

The factors affecting sales peoples' performance are many. Some of these are beyond the control of the individual, while some can be modified. Aspects like motivation, skill-set, job satisfaction, role perception, personal factors like age, sex, height, etc; the ego drive, and empathy towards the customers are inherent in the individual salesperson. Environmental and organizational factors, along with the different functions of sales management come under external factors. It is difficult for the sales manager to predict the influence of the external factors on the performance of the sales force.

To measure performance, it is necessary for the sales manager to put in place a performance evaluation procedure. A proper evaluation process ensures that the organization is well managed. It also provides the sales personnel with information on their performance and gives recommendations for further improvement. Performance evaluation can also help in improving the relationships between the sales force and superiors by minimizing suspicion and improving interaction. The performance evaluation process generally involves five steps. The first step is to determine the factors that affect the performance of the sales force. The next step involves the selection of criteria that will be used to evaluate the performance. Step three involves establishing performance standards that can be used as a basis to compare the performance of the sales force. Step four involves monitoring actual performance. The last step is to review and provide feedback to the sales personnel.

The purpose of conducting performance evaluation is to crosscheck whether the sales force activities are in alignment with organizational objectives. It also helps monitor the sales force activities and provide remedial action, if required. Performance evaluation also helps to prepare a future action plan for the sales personnel and fulfill the organizational objectives. It exerts an influence on the mode of compensation, fixing of sales quotas, and decisions on the transfer or removal of the salesperson from the organization. In most organizations, it is the immediate superior or the sales manager who conducts the performance appraisal. Sometimes a team of people including the personnel manager and the department head, along with the sales manager, appraise the sales personnel. The timing of appraisal also varies for different organizations. It depends on the complexity of the sales plan, the costs involved, and the current objectives of the organization. Periodic performance appraisal is necessary to identify any discrepancies in the overall sales plan and correct them.

The sales manager or the concerned person involved in appraising the sales force can take the help of quantitative or qualitative criteria. These are also termed the behavior and outcome components. Qualitative criteria include sales skills, territory management skills, personality traits, etc. The quantitative factors include the sales volume, average calls per day, sales orders, etc. Quantitative criteria are those aspects that measure the sales performance in terms of the end results whereas qualitative criteria involve all those activities that the sale person does to achieve the end results.

The sales manager must ensure that the performance standards are set to compare and evaluate the actual performance of the sales force. The standards vary from industry to industry and are different for different job profiles. Performance standards come under quantitative standards, qualitative standards, time-based standards, or cost-based standards. All the sales force activities can be segregated into one of these four categories and compared with the base standard.

Many methods of performance evaluation have been developed over the years. Yet, there is no single method that can be considered ideal for all organizations. Some of the commonly used methods are essays, rating scales, rankings, management by objectives and behaviorally-anchored rating scales. Several modern methods like critical incident appraisal, work-standards method, family of measures, etc., have been developed to suit variations and other requirements. Finally, regular monitoring and review of the sales force activities is also necessary to ensure that the organizational activities are aligned to the sales plan.

Part IV
Distribution Management

Chapter 17

Marketing Logistics

In this chapter we will discuss:

- Logistics and its importance
- Functions in logistics management
- Importance of communication in logistics
- Technology in logistics
- Streamlining the logistics process
- Strategic issues in logistics management
- Local and global challenges in logistics management

Of all the living things on earth, ants are known to be the most hardworking. All of us would have seen ants scurrying along, one behind the other, transporting food from wherever they find it, to their dwelling places. Any obstruction in the path does not deter these little creatures from moving forward. They quickly locate the most efficient path around the obstruction and once again resume their journey. Just as these little creatures transport things that they need from where they are available to their destination or place of storage, in the business world too, goods and products are transported from the place of manufacture to the place where they are required.

In the highly competitive business environment of today, companies find it difficult to maintain their competitive advantage over others only by developing innovative strategies pertaining to the product, price, place, or promotion. Though they have tried out various methods to build a competitive advantage for themselves like making changes in the product design, pricing the product differently, and even trying to reduce the cycle time for the product to reach the retailer's shelves from the manufacturing location, they have realized that competitors can easily duplicate these efforts. Thus, the emphasis of all companies today is to build a sustainable competitive advantage. And logistics provides a means by which they can do just that.

In this chapter on *Marketing Logistics*, we will examine the various aspects pertaining to logistics management. We begin the chapter with a discussion on the importance of logistics in the current business environment. This will be followed by a description of the various functions in logistics management and the use of technology in logistics. The chapter will then discuss the importance of streamlining the logistics process and the strategic issues involved in logistics management. We end the chapter with a discussion on the local and global challenges in logistics management.

LOGISTICS AND ITS IMPORTANCE

The origin of the term 'Logistics' has been traced to the Latin word *logugea,* which means a lodge or hut. Logistics is often erroneously thought to be a purely military term due to its initial association with the military. In fact, the creation of the post of a *Marechal General des Logis* in the French Army in 1670 is the first recorded instance of the use of the term in a military organization. Webster's dictionary too defines logistics as "the branch of military science having to do with procuring, maintaining, and transporting material, personnel, and facilities." History is witness to the fact that the most successful war campaigns have been the ones in which the winning side was equipped with a superior logistics network. An efficient logistics network was instrumental in quickly and efficiently transporting supplies, materials, equipment, and troops to the site of action. Operation Desert Storm in which the US army was successful in efficiently moving its troops and tanks to the site of action during the Gulf War in 1991, is a good example of how a superior logistics network contributes to a winning military campaign.

In business too, logistics plays a similar role as in the military. It is a complex process by which companies transport products, parts, and materials from the place where they are manufactured to the place where they are required. Companies across the world are increasingly realizing the importance of attaining a competitive edge over their competitors by efficient logistics management.

Liberalization of markets across the world has led to an increasing number of companies expanding their business by setting up manufacturing and marketing facilities in various parts of the world. The high growth potential in the liberalized economies of the Asia-Pacific region has encouraged transportation and logistics companies such as Federal Express (FedEx), DHL, United Parcel Service (UPS), and TNT, to think of expansion plans. The tremendous scope for growth, exceeding 20% per year, in these economies has also led to third party logistics providers expanding their operations in these regions. Notable among third party logistics providers are Maersk, Exel, Kuehne & Nagel, Tibbett and Britten, Schneider Logistics, and TNT.

The overriding importance being given to logistics in various businesses can be attributed to the following reasons:

1. Companies now have a wider choice of alternatives available to them to maintain cost and service standards. These alternatives may be in the form of shipping products through containerization, using mini computers and sophisticated satellite communication systems to track shipments, or transporting them by air to ensure speedy delivery of the products. All these alternatives have a cost attached. This has made it essential for companies to ensure that they maintain an efficient logistics management system so that they can gain an advantage over their competitors.
2. The location of retail outlets is based on proximity to the market. During periods of energy shortages, transportation costs become the primary concern of companies. These costs play a crucial role in the companies' plant and warehouse location decisions. Thus, during periods of energy shortage, having their own logistics system helps companies minimize transportation costs and benefits them in the long term.
3. The growing complexity of product lines and the increasing shortage of raw materials are forcing companies to focus on logistics management to ensure constant and steady supply of raw material to manufacturing locations.
4. Yet another reason for companies to increase their focus on logistics is the belief that an effective system of computerized inventory control will help them tide over any crisis that may arise on account of swings in business cycles, changes in interest rates, increase in cost of labor, etc.

These reasons have led to companies in various industries laying increasing emphasis on logistics and logistics management.

FUNCTIONS IN LOGISTICS MANAGEMENT

Logistics is a complex process, involving several functions. These include procurement or purchasing, inward transport, receiving, warehousing, stock control, order picking, materials handling, outward transport, physical distribution management, recycling, and returns & waste disposal functions.

Procurement /Purchasing

Procurement is the process of buying goods and services for the user department based on order specifications given by that department. Procurement begins with sending the purchase order to the supplier. The procurement function involves various activities such as identifying new suppliers, qualifying the suppliers, negotiating terms and conditions of supply, organizing delivery of orders, arranging for insurance, finalizing the mode of payment, and sending the purchase order to the supplier. This function is considered to be a support function in logistics. It also involves monitoring the performance of the suppliers for adherence to quality standards as the quality of inputs in the form of parts supplied by the suppliers, affects the quality of the final product. This, in turn, has an impact on both customer satisfaction and the revenue of the company. Thus, the effectiveness of the procurement function plays a crucial role in determining the company's competitive advantage.

Inward Transport

Inward transport is the function in the logistics process in which parts and components are moved for storage in warehouses before they are transported to the places where they are required. Since the direction of movement of the goods is inward (toward the logistics service provider), the function is known as inward transport.

Receiving

Receiving is the function in which the material is received at the warehouse for storage. When parts and components are received at the warehouse, they have to be checked with the purchase order, inspected for damage, sorted, and stacked according to the date of arrival.

Warehousing

Warehousing is the function in the logistics process in which the material received for dispatch is stored for various durations of time. The warehousing function serves as an efficient way to balance the demand and supply of goods. It supports the post-production processes of manufacturers by providing space for storing the produced goods prior to sale. For example, products such as electricity bulbs need to be tested to ensure that they work for the duration specified on the package. So after they roll off the production line and before they are dispatched to wholesalers and retail outlets, the products are stacked in warehouses while they undergo quality control tests to ensure that they meet the prescribed quality standards. During the warehousing period, if any defect is observed in the products being tested, the manufacturer can recall the entire batch from the warehouse. Products such as wine and canned food are other examples of products that require long storage before sale. Wines age with time and fetch the manufacturer a better price if sold after a long period after they are produced. Similarly, in the case of canned food, storing the cans in warehouses helps the manufacturer to ensure that there is no bacterial growth and that the food is safe for human consumption.

Over a period of time, significant changes have taken place in the warehousing function as a result of changes in both the business environment and the demands of customers. Although it was predicted that the warehousing function would become obsolete as a result of just-in-time production, quick response time, continuous flow distribution, and direct store delivery, it continues to thrive as a dynamic function. Exhibit 17.1 describes some of the trends that are likely in the warehousing function in the 21st century.

Stock Control

Stock control in logistics is the function that involves keeping track of the amount of stock present in the inventory. The stock control manager is responsible for stock taking and stock checking, receipt of the stock at the warehouse, and inspection of the stock to check for loss or damage during transit. Efficient stock control ensures the smooth operation of the logistics process.

Order Picking

Order picking is the function of picking or retrieving products stored in the warehouse from their respective storage locations to cater to customer orders. Since order picking comprises almost 60% of the labor activities in the warehouse, it is considered to be one of the most labor-intensive activities in the warehouse.

Exhibit 17.1

Warehousing Trends in the 21st Century

Significant changes have taken place in the warehousing function over the past several years. Some of the trends that are likely in the warehousing function in the 21st century are:

Customer focus – Companies today are aware that customers seek value at low cost with high functionality. They also realize that warehouses form an important chain in the value-added services they offer to their customers. Therefore, they focus on providing quality service to their customers in the form of ensuring on-time shipments of the products. In their attempts to retain customers, companies view special requirements of customers as opportunities to satisfy them.

Consolidation in the warehousing function – Companies are increasingly feeling the need to have fewer distribution points due to the benefits that accrue from sourcing from fewer suppliers. In sourcing from fewer suppliers, they tend to build rewarding partnerships through joint planning, information sharing, and by entering into mutually beneficial agreements. Further, having fewer distribution points leads to increased levels of customer service and economies of scale through reductions in costs due to inventory, labor, space, and equipment. Therefore, consolidation is taking place in the warehousing function due to attrition in companies or due to mergers as a result of strategic decision-making. The aim of all this consolidation is to have fewer operations with greater scope and more efficiency.

Value-added services – Warehousing functions have undergone a sea change from what they were in the past. Warehousing companies now offer value-added services in the form of customized packaging, special labeling, delivery of merchandise to retail customers in a store-ready form, etc. These functions were previously handled by the retail customers and not by the supplier. However, with more and more activities moving upstream, it would not be surprising if what is being considered as a value-added service today becomes a standard operating procedure in the future.

Paucity of space – Warehouses will experience a scarcity of space due to the increasing need to package the product for more markets. Thus, more storage locations will be required to carry out various warehousing activities. Inadequate planning can lead to the available warehouse space being misallocated and adversely impacting the efficiency and services of warehouses.

Increased use of information technology – In the 21st century, warehousing functions will see the increased use of sophisticated information technology in the form of bar coding, which, in turn, is likely to be soon replaced by the radio frequency identification software.

Reverse logistics –There is a growing awareness among companies of the benefits of using recyclable and reusable products. Besides, the increasing regulatory pressures on them to produce recyclable products in order to reduce landfill waste, the opportunity to lower costs by reusing packaging material, and the potential to improve customer relations by reclaiming damaged products have led to the increasing focus on reverse logistics. Reverse logistics includes the entire set of activities from receiving the returned goods and crediting the customer for return of the product, determining the product status (whether it calls for resale, repair, remanufacture, or has to be consigned to scrap), and packaging the product such that recyclable and reusable material is delivered to the manufacturer. As more and more material enters warehouses as part of returned goods, there is an increasing need for them to efficiently plan out cost-effective methods to handle the freight, receipts, claim processing, credit notification and disposal of the goods, and the labor associated with it.

Paperless warehouses – Warehouses in the future will operate in a paperless manner with all transactions taking place electronically with the help of electronic data interchange and bar coding technology. This will eliminate the scope for human error in routine warehousing activities, and improve the accuracy and efficiency of data entry, picking, and product and location identification. Electronic transactions of warehousing activities will also reduce labor and training requirements in warehouses. However, adequate care will need to be taken while selecting and implementing paperless systems in warehouses because of the likely impact of these systems on the productivity, flexibility, and growth of warehouses.

Third party warehousing – With more and more companies beginning to focus on their core competencies and the growing need to leverage capital, there is now an increased demand for third party warehousing services, not just by the small companies, but by the medium-sized ones as well. Third party warehousing has advantages over internal warehousing in that it helps reduce capital asset and labor force requirement, reduces overall distribution costs, leading to improvements in technology and customer service.

Shrinking orders – Companies are experiencing an increasing need for reduction in order size and order frequency on account of many factors such as elimination of on-site retail warehouses, customers' access to better information, and increased sophistication in technology. With online shopping slowly picking up, companies can expect to survive in business only if they are willing to ship one product at a time, since quite often this happens to be their only order quantity. There is such an increase in competition that companies have to be ready to grab every opportunity that comes their way just to prevent the customer from switching to a competitor. Thus, shrinking orders have become a reality and the sooner this reality is accepted, the better it will be for companies involved in warehousing activities.

Need for a more skilled workforce – With the increasing use of technology in warehouses, it will become increasingly difficult for warehouse personnel to carry out the various tasks involved on the basis of their traditional skills. The personnel will require a higher level of expertise and technical skills, especially computer skills. Warehouse personnel in the 21st century will need to identify, select, pack, and ship the right product to the right customer. For this, they will need to have adequate knowledge about the product, customer, and company standards. Thus, warehouses in the 21st century will require a workforce with multiple skills and will need to cross-train their personnel in all warehousing job functions.

Adapted from Thompson Brockmann, "21 Warehousing Trends in the 21st Century," IIE Solutions, July 1999, Volume 31, Issue 7, 36-40.

Logistic service providers seeking to increase the efficiency of their order picking function try to minimize the expected order picking time - that is, the time consumed in the various components of order picking. In all, there are four components of the expected order picking time. These include travel time, processing time, administrative time, and waiting time.

In warehouses, products are stored in containers, which are stacked on top of each other, with aisles or passageways between columns of containers. Travel time is the time the worker takes to travel within the aisle and across aisles in the warehouse to locate the order. Processing time is the time the worker spends in various tasks at the location point of the order and includes tasks such as searching for the order, extracting it from the various others that are present at the same location, and then documenting the order. Administrative time is the time the worker spends at the start and finish of an order picking tour. It includes the time spent on administrative and start-up tasks. Examples of start-up tasks include collecting a pick device such as a pick up cart or trolley, and obtaining the list of orders to be picked from the storage locations. Waiting time is the time between the completion of one order picking tour and the start of the next.

Materials Handling

Materials handling is the function that involves the movement of materials required for operations. The movement may take place from the receiving area to the storage location, from the storage location to the dispatch location, etc. Materials handling mainly involves loading, unloading, and storage of material. Efficient materials handling ensures that material is transported without delay or damage. It ensures the constant flow of material and its availability when needed. Efficiency in materials handling helps in reduction of operations cost, effective utilization of men, material, and storage space, effective stock management and control, and effective rotation of the stock, ultimately resulting in reducing material wastage.

Outward Transport

Outward transport is the function of dispatching material to meet the user requirements. It involves activities such as matching the material with the order requisition, and checking the material for packaging and any damage.

Physical Distribution Management

This function in logistics management involves all those activities that help in the delivery of the finished goods to the customers. Physical distribution management involves the design and administration of systems that will help regulate the flow of materials and finished goods from the warehouses to the customer.

Recycling, Returns, and Waste Disposal

This function comprises the reverse logistics process. While the logistics process moves materials and goods from the manufacturer to the customer, reverse logistics is the process in which the materials and goods move from the customer back to the manufacturer. This may happen in four situations – one, when the goods comprise material or parts of material that can be recycled to produce the same product (for example, paper, glass, polythene bags, etc.); two, when the products are defective and have to be returned to the company; three, when the product is transported in packaging or containers that are returned to the manufacturer to use for sending a fresh batch of products (for example, Bibo water cans, Coca-Cola, Pepsi bottles, etc); and four, when the waste generated from the product has to be effectively disposed of by the manufacturer or a third party firm to prevent it from causing harm to the environment.

IMPORTANCE OF COMMUNICATION IN LOGISTICS

With businesses moving from a production-driven or manufacturing-oriented economy to a service-driven economy, there has been a concurrent shift in the emphasis of companies from transportation to communication. Speed, service, and decisiveness have become the basis for competition amongst various companies. Businesses are forced to take up measures that facilitate speed and decisiveness in order to ensure their survival in the new economy. The increasing demand for a shorter cycle time and reduced costs have made companies focus more and more on improving their communication process. Communication becomes all the more important in a vital function such as logistics management because it conveys the actual status of goods and products to the various groups of people involved in logistics. It helps logistics service providers to improve their service by keeping a closer watch on inventory management and to take the necessary steps to avoid losing customers.

Satellite technology has assumed a key role in facilitating logistics service providers to establish communication links with their customers as well as with the various elements that make up the logistics chain of processes. The speed of service delivery and quality of service have become major factors in deciding the competitiveness of these companies. For example, when a customer places an online order for a product, say a microwave oven, he expects the oven to be delivered at his doorstep as quickly as possible. The speed with which one logistics company transports the product from the manufacturing or warehouse location to the point of delivery helps it gain a competitive advantage over its competitors. Customers also want to remain updated on the status of the delivery during the transit of the product. Logistics companies are taking the help of satellite technology to provide this information to customers. The use of satellite technology and sophisticated hand-held devices by the drivers of UPS helps customers obtain real time information about the shipment of the product. These hand-held devices, known as Delivery Information Acquisition Devices (DIAD), make it easy for the drivers of the UPS cargo vehicles to record and upload the latest information regarding the status of the shipment delivery onto the UPS network. They also help the driver remain in constant contact with the company and be instantly updated on information regarding changes in pickup schedules, traffic patterns, etc.

TECHNOLOGY IN LOGISTICS

Technology has become a key factor by which logistics companies are gaining a competitive advantage over other players in the industry. Advances in technology in the form of WAP phones, personal digital assistants (PDAs), etc., allow customers of logistics companies to keep track of the shipment's progress along the logistics chain of processes.

Logistics companies rely on various types of technology such as electronic data interchange, artificial intelligence, expert systems, communication technology, and bar coding and scanning to improve the quality of their service.

Electronic Data Interchange (EDI)

Electronic data interchange is the exchange of routine business information between distantly located computers. The exchange of information takes place in a standardized electronic format through the use of networks such as the Internet. Unlike in e-mail where the exchange takes place between two persons, the exchange of information here takes place between computer applications. Also, unlike e-mail which facilitates the exchange of only textual messages, EDI facilitates the exchange of structured business messages such as invoice forms, purchase orders, etc.

There are several benefits associated with the EDI form of information exchange. It eliminates the traditional manner of exchanging business information by mailing of printed business forms. So it reduces paperwork, minimizes costs, improves the response time of organizations, and increases their efficiency and effectiveness. Also, EDI requires only a one-time input of data, with the EDI system taking care of the rest of the procedure. Thus, fewer inputs are required, resulting in fewer errors, faster data transfer, and better streamlining of business processes.

Electronic data interchange is the technology that underlies the just-in-time processes of companies such as Wal-Mart and FedEx. For example, Wal-Mart uses EDI to have a just-in-time arrangement with its suppliers that helps the retailing giant avoid problems of cash flow management, storage costs from warehousing, and losses due to spoilage, theft, and obsolescence. Similarly, FedEx uses EDI to track its various shipments during their transport though its network of land, air, and ocean-based carriers. The technology enables the company to communicate with its customers, regulatory agencies, as well as the various carriers within its network. It also allows the customers to track down the status of their shipment.

Artificial Intelligence

Artificial Intelligence (AI) is automated intelligence. It reproduces human intelligence in an automated or machine form. It refers to the ability of a machine to process data and respond with human-like intelligence. Artificial Intelligence systems can carry out all those activities that involve human intelligence such as understanding language, learning, reasoning, problem-solving, etc.

Artificial Intelligence is the technology that underlies the process of logistics scheduling. Logistics and materials handling processes offer many situations for the implementation of artificial intelligence systems. Some of these include management assessment or audit, inventory planning and control, purchasing analysis, production planning and scheduling, freight rate negotiation, transportation routing and scheduling, and management information systems.

Expert Systems

An expert system can be defined as an artificially intelligent computer program that makes use of the knowledge and problem solving logic of human experts to solve problems at an expert level. Expert systems can be applied to logistics management to solve operational and strategic level problems in all functional areas of logistics. They aid in decision-making, strategic planning, and fusing information gathered from diverse sources. In this way, they help companies gain a competitive advantage over others.

Expert systems have certain advantages over conventional decision support tools used in logistics management. They can process both qualitative as well as quantitative information. They can process even partial information and come up with a solution much faster and at a much lower cost than logistics decision support tools. The display of expert problem solving logic by expert systems in logistics management allows logistics managers to improve their decision-making abilities. Further, expert systems provide solutions that can be transferred, duplicated, and documented. Thus, the use of expert systems in logistics management allows companies to apply expert logistics knowledge uniformly throughout the firm.

Authorizer's Assistant is an example of an expert system at American Express Co., the New York-based company, which transformed itself from a freight and valuables forwarding business to a financial services company.

Communication Technology

The communication technology that the logistics service providers use plays an important role in helping them achieve a competitive advantage over others in the industry. What makes the quality of information support a vital aspect in achieving a competitive edge is the need for logistics service providers to have a tighter control over their operations. With faster response time being the demand of customers nowadays, logistics service providers seek efficient information and communication systems that are directly linked to the physical flow of goods. Having such a communication system will allow them to forecast, plan, organize, and monitor the operational processes involved in the logistics function and prepare them to handle any disruptions that might occur in the flow of goods.

Logistics service providers use various methods to communicate with the various elements in the logistics chain of functions and with their customers. These methods include satellite communication using WAP enabled phones, pagers, handheld devices such as Delivery Information Acquisition Devices (DIAD), radio frequency identification (RFID) technology, specially designed package delivery vehicles, and global communication and computer systems.

Some logistics service providers use advanced wireless communications in their operations. For example, UPS uses wireless technology for communication between its fleet operators and drivers. UPS's highway rigs are equipped with global positioning systems, which help the company to pinpoint the vehicle's position via satellite. Even in case of a vehicle breakdown, the global positioning systems installed in the highway rigs help the company to exactly identify the location of the stranded vehicle. The company can then send another vehicle to the location if a priority pick-

Exhibit 17.2

Use of Communication Technology at UPS

The global logistics service provider, United Parcel Service (UPS), links together its distribution sites in various countries by means of its network, UPSnet. UPSnet uses a dedicated satellite and miles and miles of communication lines to streamline electronic information pertaining to international package processing and delivery.

Every UPS driver is equipped with a Delivery Information Acquisition Device (DIAD). He has to carry this small hand-held device with him while making deliveries of the shipments. The device allows him to record the latest delivery information and upload it onto the UPS network. In the case of UPS, along with delivery information, the DIADs also transmit a digital picture of the recipient's signature, thereby providing the customers with real-time information about the status of their shipment. The use of DIADs allows the drivers to remain connected with the headquarters to receive important messages, as well as to know about traffic patterns, changes in pick-up schedules, etc.

Further, the company's website, UPS.com, offers its customers the facility to track information about their packages in transit. The measures that the company has taken in the area of communication management have helped it to soar above its competitors, to become a logistics service provider of global repute.

Adapted from "Embracing Technology," United Parcel Service of America, Inc., <http://www.ups.com/content/hn/en/about/history/1999.html>

up is to be made. The global positioning systems also help the company to inform the police of the exact location of its vehicle in the event of hijacking of its rig. Exhibit 17.2 describes how UPS uses Delivery Information Acquisition Devices (DIAD) to help its drivers communicate delivery information to the UPS network.

Bar Coding and Scanning

Bar codes are a series of black and white stripes printed on labels glued to items, and provide a unique identification to these items. Bar codes work on auto data capturing technology, which is based on reflective optics. The black and white stripes in bar codes absorb and reflect light rays in various intensities, and thus help identify the product.

Bar codes require a scanner for reading the code. The bar code scanner reads the bar code on labels and converts the black and white stripes into a series of letters and numbers. These are then passed on to a computer.

Although bar coding began first in the grocery industry, there is now no industry that is untouched by it. Wherever we go, whether to a supermarket, library, or a greeting card store, bar coding seems to have pervaded every business, even to the extent of replacing the traditional method of pricing goods and products.

There are several benefits of using bar codes for product identification. For example, in logistics management, bar codes help track shipments of packages in warehouses. Bar coding results in improved data accuracy, consistency, improved efficiency, and improved inventory and asset management.

Data accuracy – Bar coding leads to a significant reduction of human error in data entry. It is possible to achieve 99% data accuracy by scanning bar codes instead of manually entering numbers. Thus, bar coding ensures data credibility in organizations and with organizations laying more and more emphasis on 100% accuracy in operations, it is assuming an important role in helping organizations achieve this objective.

Consistency – Following a standardized method of bar coding symbologies and labeling ensures that the capture and relay of product information is universally consistent -- that is, the information conveyed by the bar code is understood and accepted across the world.

Improved efficiency – Bar coding helps personnel to carry out tasks much faster and with greater accuracy. Thus, it improves the efficiency of personnel in organizations. Further, by converting manual tasks into electronic processes, it eliminates the possibility of human error.

Improved inventory and asset management – Labels containing specific information about the product are affixed on the product, container, or pallet at the end of the manufacturing process. Scanning the labels provides the shipping department with information regarding the exact inventory from which the product originated, as well as the exact date and time at which the products left the warehouse. These labels contain both human-legible information and bar code information. While human-legible information describes the product characteristics, packaged quantity, name of the manufacturer and that of the customer, if it is known, the bar code information provides internal information such as production line number, serial number, quality control information, etc.

Bar coding is expected to be soon replaced by radio frequency identification software devices. These devices depend on the use of radio frequency signals to identify items. This technology can be used in warehouses to automatically identify and locate items during picking.

STREAMLINING THE LOGISTICS PROCESS

The year 1990 was characterized by intense activity in the logistics arena. The re-engineering that occurred in the logistics pipeline during this period, the growing popularity of the concept of supply chain management, and efficient customer response led to great deal of excitement in logistics firms. Streamlining the logistics process became necessary in order to maintain the efficiency of the logistics management function.

Companies began to realize the immense savings that could result from an efficient logistics network. Logistics also played a vital role in the success of companies, making it all the more important for them to focus on developing an efficient logistics network. In order to increase the efficiency of the logistics process, streamlining it became essential. Exhibit 17.3 describes how Schneider Logistics, a wholly-owned subsidiary of Schneider National Inc., was able to help its customer, General Motors Service Parts Organization, save close to $3 to $4 million a year by streamlining its logistics process.

In an effort to streamline the logistics process, it should be designed backwards from the end-user to the manufacturer. There should be free and open communication among the logistics partners and communication should flow both ways. Further, the role of every partner in the logistics process should be clearly defined. The logistics process should be transparent in order to avoid bottlenecks and problems in the flow of materials and information. However, this does not mean that one does not have to prepare for contingencies. Rather, the potential for exceptions, problems, and contingencies should be recognized and measures to counter them, built into the process.

A streamlined logistics process is one that is designed from both a strategic and a tactical viewpoint. The strategic design states the purpose and the plan of the logistics process. It also identifies the various players and demarcates their roles and responsibilities. The tactical design then determines the details of the various stages that will help the logistics process function efficiently.

Exhibit 17.3

Streamlined Process of Schneider Logistics

Wisconsin-based Schneider Logistics, a leading international logistics provider, provides its customers, mainly Global 2000 companies, with supply chain management solutions in the form of technology, supply chain engineering, and outsourced logistics services. It offers its customers the benefits of reduced inventory and distribution costs, and improved customer service and helps them derive strategic value from their supply chains.

Schneider Logistics delivers auto parts manufactured by Michigan-based General Motors Service Parts Organization, GMSPO (General Motors' parts manufacturing division) to auto dealers and processing centers located across Michigan and Toledo, Ohio.

In October 2003, Schneider Logistics entered into a multi-year, single-source agreement with Penske Logistics and XTRA Lease, a St. Louis based trailer equipment lessor. Under the agreement, Penske Logistics would provide truck carrier services to Schneider Logistics, while XTRA Lease would provide Schneider Logistics with 1000 dry van trailers for the multi-year period along with an additional 200 trailers in the initial period. As part of the agreement, Schneider Logistics could also take on 500 rental trailers from XTRA Lease and this number could be gradually reduced as the logistics provider attained efficiency.

Prior to this agreement, Schneider Logistics was using approximately 1700 trailers provided by 10 different carriers to serve the GMSPO account. However, the single-source agreement will allow Schneider Logistics to significantly cut down the fleet size of trailers to 1000 in three years. This reduction in the number of vendors will bring in significant savings to GMSPO, close to the tune of $3-$4 million each year. Thus, it will allow Schneider Logistics to further improve the outstanding service it provides to the GMSPO account.

Adapted from "XTRA Lease Chosen to Provide 1,200 Trailers in Unique 3PL Alliance," XTRA Lease, <http://www.xtralease.com/PressReleases/press41.asp> and "Schneider Logistics Streamlines GM Transportation Sourcing," Commercial Carrier Journal, January 2004, 40.

Logistics managers should address the following points while streamlining the logistics process:

i. The importance of the logistics management process varies in different industries. Logistics managers should, therefore, take into consideration the costs involved in terms of transportation costs, and information technology or inventory costs, while determining the design and operation of the logistics process.

ii. It is essential for logistics managers to understand the needs and requirements of every partner in the logistics process. This helps them to forecast the needs of their partners in the logistics function, to ensure that the right products are positioned at the right warehouse at the right time, and that complete and full orders are delivered on time. Internal communication and teamwork makes this possible.

iii. Every customer expects complete, accurate, and on-time delivery of his order. Logistics managers should ensure that the delivery of orders takes place to the customer's satisfaction. This will help in making the customer view the company as a reliable and valued supplier. In order to attain this goal, logistics managers must take steps to reduce the cycle time of the logistics process. Reducing the cycle time will make the company agile and more responsive to customer needs. Logistics managers must also take steps to communicate the logistics process within the company, both in a general sense as well as in a logistics specific way, to key customers. This will allow them to ensure that these customers are aware of what, why, and how things are done in the logistics process. In order to ensure complete, accurate, and on-time delivery to customers, logistics managers also need to analyze the efficiency of their distribution network in terms of location of their warehouses and whether the locations are appropriate to enhance the effectiveness of the logistics process.

iv. Streamlining the logistics process requires that logistics managers communicate to the suppliers as to what and how things are done in the logistics process and the firm's expectations of them. Logistics managers can take measures to understand the suppliers' processes and coordinate with them to devise ways to improve the effectiveness of their (suppliers') processes. Thus, it is essential that they do not disregard suppliers' needs in their efforts to optimize the logistics process.

v. Considering the lead-time required for international sourcing and transport of materials and the impact of these on the firm's inventory, it becomes essential for logistics managers to know about the suppliers' operations and the cycle time for the logistics process. The large distances and lead-times required for international sourcing make it necessary for logistics managers to ensure that there are always some materials flowing through the pipeline, or in transit. This also helps them overcome the surplus and gaps in inventory availability and replenishment. Further, logistics managers need to know about the shipping schedules and to adopt a multi-modal approach toward flow of materials. That is, rather than concentrating on only one mode of transport, an alternative mode of transport can also be used to avoid surplus and gaps in availability of material.

vi. Streamlining the logistics process also calls for reducing the number of suppliers. This not only reduces the complexity in the logistics process but also offers the benefits of consolidated volumes and leveraging.

STRATEGIC ISSUES IN LOGISTICS MANAGEMENT

In business, a strategy guides organizational activities and operations toward the achievement of organizational goals. Logistics has begun to change the way companies are doing business. Not only are they under increasing pressure from other players in the supply chain but they also have to meet the demands of customers for efficient service. Therefore, in order to efficiently manage their supply chain capabilities, businesses are realizing the need to focus on their logistics strategy as well as on the need to integrate information technology and advanced logistical approaches into their business operations.

The operations and activities of logistical firms play a critical role in the movement of materials from the manufacturer to the end consumer. The logistics strategy examines logistical operations and activities and provides logistical firms with a sense of unity, direction, and purpose. It determines the purpose of their operations and activities in terms of their long-term objectives, planning, and resource allocation priorities. The logistics strategy helps firms involved in the business to attain a competitive advantage over others by helping them to promptly respond to the opportunities and threats in the business environment.

A firm's logistics strategy involves complex decisions pertaining to the structural aspects and infrastructural aspects of logistics firms. Structural decisions pertain to the structural features of logistical firms such as logistics process technology, operations process technology, facilities network, and vertical integration of the supply chain. Infrastructural decisions, on the other hand, pertain to the nonstructural aspects of logistical firms such as the policies, procedures, and control systems. Further, structural decisions have a long-term impact and are irreversible in nature while infrastructural decisions are of a tactical nature.

LOCAL AND GLOBAL CHALLENGES IN LOGISTICAL MANAGEMENT

Logistics is essentially a process of managing inventory with the aim of achieving customer satisfaction. Customer satisfaction is what differentiates a successful company from others. Customers today demand not only quality products, but also speed and quality of service. Logistics is the function that helps companies in attaining growth by bringing about cost reduction for them as well as by helping them attain customer satisfaction.

Challenges faced by logistical firms may be both local and global in scale, depending on whether the company is operating locally or has a global reach.

Local Challenges

The aim of all firms involved in logistics management is to achieve customer satisfaction. And in their attempts to satisfy the customer, logistical firms are becoming increasingly aware of the challenges that face them. Some of the challenges are discussed here.

Integration of logistics activities

Most operations in logistical firms are carried out in a segregated manner. The logistics process involves the activities of various personnel such as the order entry manager, warehouse manager, traffic manager, claims manager, etc. Most often, these personnel carry out their work in isolation. Customer satisfaction being the goal, companies involved in logistics should ensure that these various personnel work together, with each one of them being aware of the totality of the logistics function. Logistical efficiency thus requires integration of the various activities associated with the logistics process.

Lack of qualified personnel

Moreover, the personnel involved in logistics management today lack the skills required to handle the breadth of the business. Not only is there a dearth of expertise in managerial positions but firms are also facing inadequacy of efficient line and staff labor. Companies in future will require specialized expertise in each of these aspects. Thus, qualified human resource is one of the challenges that logistical firms face.

Global Challenges

Logistics firms operating on a global scale face many more challenges than those operating locally. The global logistics challenges are primarily in terms of four D’s – demand, distance, documentation, and diversity. Global logistics firms have to cater to greater demand, serve greater distances, ensure more extensive documentation, and take into consideration greater diversity in terms of culture as well as requirements. These and other global challenges faced by logistics firms are listed as follows:

Distance

Since global logistics involves distribution of materials across countries, it involves greater distances to be covered. This, in turn, means longer pipelines, greater lead-time and more inventory. Since the materials that need to be transported amount to large volumes, it calls for better logistics management by logistics managers.

Modes of transport

While domestic logistics involves transport by means of road or rail, distribution of materials across countries requires entirely different modes of transport. Global logistics involves transport on surface (water) and by air. This, in turn, requires the logistics managers to be equipped with an entirely different set of knowledge and skills in order to understand the intricacies involved in conference and non-conference rates, containers, ports, schedules, and sailings.

Documentation

Transport by surface and by air requires extensive documentation as well as knowledge of the likely hurdles in import and export customs clearance. In order to meet this challenge, logistics managers have to either develop the expertise in-house or obtain it from a third party or intermediaries.

Coordination of intermediaries

In global logistics, several intermediaries are involved in the process of transport of materials. These may include transportation companies, warehousing firms, customs personnel, and even banks. The involvement of so many intermediaries in intercontinental movement of material makes the process even more complicated and gives rise to the possibility of more delay points. Thus, logistics managers need to ensure greater coordination and communication and exercise greater monitoring than is required for domestic logistics.

Cultural differences

The cultural differences across countries have an impact on the design and implementation of logistics management. Language is the most important of cultural differences and poses a problem in global logistics with respect to communication, both within, as well as beyond the company. The need to develop product labels, advertisements, and product manuals in the local language of the country leads to product proliferation, making inventory management difficult.

Government/Political differences

Differences in regulatory constraints are a natural consequence of the global movement of materials. Therefore, global logistics managers need to be aware of the local rules and the regulations, customs, duties and taxes of the country to which they are transporting the materials. Due to the effect of these aspects on the design and administration of the logistics system, it becomes absolutely essential for logistics managers to be familiar with these aspects.

Globalization of firms

With the increasing globalization of firms across the world, logistics managers are faced with the challenge of having to widen their scale of operations to match the globalization efforts of the manufacturing firms. In order to achieve customer satisfaction, logistics firms now have to ensure that they meet the time, place, and availability demands of customers globally.

Flexibility and speed

Customers across the world are demanding speed and flexibility in delivery of products. In order to cater to this need, logistics firms have to streamline their internal processes, modify their policies, and integrate their ordering and order fulfillment processes. Further, logistics managers also have to keep track of the changing trends in business, such as the increasing scope of e-commerce, and cater to the rapid turnaround expectations of customers who make small quantity online purchases.

Supply chain integration

Logistics firms today are finding it increasingly necessary to integrate their operations internally as well as externally. Internally, the firms seek to integrate along horizontal processes, whereas externally, integration with the suppliers and customers has become necessary. This integration can be achieved by the implementation of technology such as Enterprise Resource Planning and through collaborative initiatives.

Green logistics

While traditional logistics seeks to organize activities for forward distribution, the rising concern over environmental protection and the manufacturing objective of minimal impact on the environment has led to the manufacture of recyclable and reusable products. These environmental considerations have, in turn, given rise to the concept of 'Green Logistics', also known as reverse logistics, reverse distribution, or reverse-flow logistics. Green logistics involves the transport of waste generated from manufactured products and the movement of used materials back to the manufacturer. Thus, logistics managers have to exercise the same amount of care to plan the reverse flow of products -- from the consumer end to the disposal end -- as they do in forward distribution.

SUMMARY

Companies today are finding it extremely difficult to maintain their competitive advantage over others purely on the basis of innovative strategies pertaining to the product, price, place, or promotion. Since competitors can easily imitate each of these competitive advantages, the emphasis on building a sustainable competitive advantage has made companies focus their attention on logistics, which provides such a means for companies to successfully differentiate themselves from competing firms. Logistics is a complex process by which companies transport products, parts, and materials from the place where they are manufactured to the place where they are required. There are several reasons for the overriding importance being given to logistics by businesses across the world. These reasons include wider availability of alternatives to maintain cost and service standards, need for location of retail outlets closer to the market, the growing complexity of product lines, the increasing shortage of raw materials, and the perceived need for an effective system of computerized inventory control.

Logistics is a complex process and involves several functions such as procurement or purchasing, inward transport, receiving, warehousing, stock control, order picking, materials handling, outward transport, physical distribution management, recycling, and returns & waste disposal functions.

Effective logistics management requires that the actual status of goods and services be communicated in real-time to the various groups of people involved in the logistics process. This helps logistics service providers to improve their service by keeping a closer watch on inventory and taking the steps necessary to avoid losing customers. Communication using satellite technology and sophisticated devices makes it possible for the various players involved in the logistics chain of processes to remain in constant communication with one another and with the end customer. Technology is playing a key role in communication as well as in other processes in the logistics function and helping logistics firms to attain a competitive advantage. The various types of technology being implemented in logistics activities include Electronic Data Interchange, artificial intelligence, expert systems, communication technology in the form of satellite and wireless communication, and bar coding and scanning.

It is necessary to streamline the logistics process to maintain the efficiency of the logistics network. In addition to integrating information technology and advanced logistical approaches into their business operations, businesses are beginning to realize the need to focus on their logistics strategy in order to efficiently maintain their supply chain capabilities. A logistics strategy examines logistical operations and activities and provides logistical firms with a sense of unity, direction, and purpose. It helps firms involved in the business to attain a competitive advantage over others by allowing them to promptly respond to the opportunities and threats in the business environment.

In their efforts at logistical management, firms face several challenges, which may be local or global in their scope. While the need for integration of logistics activities and lack of qualified personnel are the primary challenges faced in logistics management at the local level, the global challenges include challenges arising due to greater distance, modes of transport, documentation, coordination of intermediaries, cultural and political differences, globalization, need for flexibility and speed, need to integrate supply chain activities, and challenges due to emphasis of companies on green logistics.

Chapter 18

Marketing Channels

In this chapter we will discuss:

- Evolution of marketing channels
- Channel members and their roles
- Channel functions
- Designing marketing channels
- Channel flows and costs

Way back in 1934, a Moscow University Professor, G.F. Gause, known as the father of Mathematical Biology, conducted an experiment on protozoa (minute single cell organisms) of the same genus by putting two of them together in a bottle containing an adequate supply of nutrients. The experiment found that only one of the protozoa survived, despite the availability of ample amount of food. Based on his findings, Gause propounded the *Principle of Competitive Exclusion,* which stated that no two species that lead identical lives can coexist.

Competition has begun and evolved with life. With resources being limited, competition among similar species has led to the vanquishing of one species by another and the extinction of species, the notable examples being the dinosaurs. To survive, every species needs to have an inherent advantage over others of the same genus.

The law of nature is applicable in the business world too. Businesses that survive are those that displace their competitors. To do this, businesses need a unique and distinct advantage that differentiates them from competitors. Businesses can use the following distinguishing features – place, price, product, promotion or customer service – to gain a competitive advantage.

First, businesses have to be successful in controlling manufacturing costs and in coping with competitive pricing. They then have to look at innovative practices and methods to make their goods and services available to end users at lower prices and better quality. To achieve this, marketing channels are very important. Businesses are concentrating more and more on enhancing channel performance.

In this chapter, we will examine various aspects pertaining to marketing channels. Beginning with a description of how marketing channels evolved, we will go on to discuss channel members and their roles. This will be followed by a description of various channel functions and the dimensions involved in designing marketing channels. The chapter will end with a discussion on channel flows and costs involved in different types of channel flows.

EVOLUTION OF MARKETING CHANNELS

Behind every product or service that reaches consumers, there are marketing channels in the background, which play a significant role. A marketing channel is a set of interdependent individuals and organizations involved in the process of making a product or service available to the end-user for use or consumption. Also known as distribution channels, these have evolved over time. The evolution has been influenced by market forces, which bring about institutional change, reallocation of functions and changes in relationships among channel intermediaries. These complex forces reshape marketing channels and play a dominant role in their growth. Both customers and competitors stimulate competition.

In other words, the evolution of marketing channels has taken place in tandem with businesses' response to environmental forces. Exhibit 18.1 describes the various evolution stages in the PC industry.

As businesses passed through the distinct phases of the production era, the sales era, the marketing era and the human or relationship marketing era, marketing channels too evolved from being production-oriented to being customer-centric in nature. The evolution of marketing channels in each of these distinct phases of business evolution is described in the following paragraphs.

Exhibit 18.1

Evolution of Marketing Channels in the PC Industry

The personal computer (PC) has evolved to the point where most educated households own a PC. Nowadays, PCs are more widely used in business than calculators were during the latter half of the 20th century.

The introduction of PCs in the market began with the marque brands -- business models that were developed and used by primary manufacturing firms. In the first phase of channel evolution in the PC industry, manufacturer's either sold the product themselves or owned retail stores that exclusively sold their products. This paved the way for a different type of ownership, in which an independent distributor/retailer was allowed to distribute one of the marque brands[1] under certain conditions. The manufacturers controlled the right to sell certain products. Product differentiation and development of products that would give the manufacturer a competitive advantage in a fast changing marketplace were the focus in the first phase of channel evolution. The second phase of channel evolution was marked by the development of a strategy that ensured efficient and quick delivery to end- users. As margins were still high, manufacturers were in a position to afford wider distribution levels.

The third phase was aimed at product homogeneity. This trend was driven by component branding. For instance, IBM initially used the "Intel Inside" logo to differentiate its products. However, it did not take measures to prevent the use of the logo by its competitors. The result was that even a low-end competitor could gain market credibility by advertising that it used the Intel chip. This opened up the field to many low cost assembled systems. At the same time, the introduction of unbranded computers and their acceptance by the end-users began to challenge the marque brands' position.

Price protection played a major role in the PC distribution channel. During the first three stages of evolution, the industry followed a push inventory policy and a 'make-to-stock' manufacturing policy. Manufacturers forecast sales and then made the product. If the forecasts were inaccurate, manufacturers were forced to reduce the price of their PCs in the market. The effect of the price cut had to be borne by manufacturers rather than by downstream channel partners.

The fourth phase in channel evolution in the PC industry saw the introduction of a new business model. This model, pioneered by Dell Computers, promoted direct business. According to this, computers were made-to-order and delivered to the customer in a quick response mode (seven days or less were taken for both manufacture and delivery). Price protection became less important because of the reduced order-delivery cycle. Further, since all machines were made-to-order, there was no need to forecast. As the product had to be manufactured within a certain time after receiving the order, industry standardization of components and selection of suppliers assumed importance. The new model also operated with less inventory than required in the phase-two or phase-three model and gained immediate acceptance by customers. The direct business model enabled customers to buy a PC from their homes.

Adapted from James L. Ginter, Bernard J. La Londe, "Using Channel Functions as the Building Blocks for Strategic Channel Design," Fisher College of Business, 15 November 1999, Ohio State University, 10-08-04, 1-30 <http://fisher.osu.edu/supplychain/pdf_files/IMMPaper.119.pdf>

The Production Era

The late 19th and early 20th centuries were characterized by technological advancements in the fields of agriculture, transportation and communication. Improved plant and machinery provided businesses with the technical capacity to produce goods in large quantities. Moreover, the demand for goods matched their supply. That is, markets had the capacity to absorb produced goods. These factors led

[1] Mark (Brand Mark) or Marque is the combination of symbol, design, use of colour or font, which is the primary means of visually identifying and activating an association with a particular product or service

businesses primarily focusing on production. Managements laid more emphasis on production volumes, capacity expansion and improvement of plant efficiency.

As businesses evolved, a simultaneous transformation took place in the marketing channel. The role of the sales person underwent a transformation. Earlier, the job of a sales person was not highly regarded. In fact, some people even considered sales a profession without prestige. Businesses too did not give sales importance and held the view that the sales department would automatically sell whatever was manufactured. The salesperson was viewed as a congenial and friendly representative of the company, who could create goodwill for it. Of course, this part of the concept is still in vogue today, where it is the salesperson, who is deemed primarily responsible for customer satisfaction. Selling was considered an art, rather than a specialised field requiring skill and knowledge. Sales management meant that there was tight control and supervision over those involved in selling.

The Sales Era

The sales era began in the 1920s, when industrialization and economic prosperity were at their peak. Many dominant factors affected businesses during this period. Continuous improvements in technology and labour efficiency drove production levels to new heights. The mass production that began in the previous era continued in this sales era. However, this period did not witness a commensurate growth in demand for the goods that were manufactured. In the sales era, markets were characterized by 'consumption saturation' and failed to generate the required demand at a time when industrial production was at its height. Economic prosperity turned to economic recession (The Great Depression) and worsened the demand situation by the late 1920s. To sum up, the sales era was marked by consumption saturation and economic recession. Businesses responded to the challenge of low demand by developing mass distribution systems that could be used to support huge production volumes.

The sales era also witnessed an elevation of the sales position in the eyes of managements. It was realized that selling involved much more than creation of goodwill and required a lot more than convincing skills and minimum knowledge. This increased the responsibilities of the sales manager from supervision and control of the sales force to recruiting and selecting effective individuals to form the sales force. The term 'scientific salesmanship' came into use to describe the application of management and behavioural science principles to the selling process. Managements' company-oriented outlook was evident from the expectations they had from sales personnel. Businesses expected sales persons to generate high-volume sales for the company.

The Marketing Era

The 1950s witnessed recovery from economic recession. There was further technological advancement and erosion of industrial boundaries. The technological advancements that took place during the Second World War resulted in new manufacturing processes that glossed over industrial boundaries. For instance, the steel industry began to face competition from the plastic industry as plastic items began to replace those made of steel. Similarly, the glass industry faced tough competition from paper-based products. This era was marked by the emergence of more educated and sophisticated consumers and growing concern among companies about rising costs and price constraints. The biggest problem faced by businesses was the abundance of goods in the market coupled with the customers' limited potential for consumption. Businesses realized the need to determine the changing tastes of consumers and to cater to these to survive and succeed. Businesses also had to be wary of market changes and address them. This gave rise to the marketing concept.

The sales person's role was therefore redefined in the marketing era. He or she was thought of as an essential link between the seller and the prospective buyer. The salesperson was required to play the role of a problem-solver, an educator and an empathizer. He or she was required to utilize selling skills to solve the customers' problems, educate them on the ideas contained in the sales proposal and recognize and understand customer needs. The responsibilities included planning, forecasting, setting goals and market development. On the whole, the salesperson was required to manage a market.

With this redefining, the need arose to restructure the role of the sales manager too. The sales manager was freed from the responsibilities of planning, monitoring and controlling the daily sales activities of the sales force. The sales manager began to get more involved with strategic planning, accompanied with a shift in focus from sales volumes to profitability of the company.

Relationship Marketing Era

The present day highly competitive marketplace has forced businesses to first determine the needs and wants of users and then produce goods and services that fulfill these needs. The success of goods and services, and of the company itself, depends on customers.

So, businesses worldwide are focusing on customers – existing and potential – and adopting strategies to attract and retain them. One such measure is relationship marketing, which involves the creation of customer loyalty by using an appropriate combination of product, pricing, promotion, distribution and service. Relationship marketing is based on the premise that customers need constant attention. It involves understanding customer needs, offering them the relevant product at the appropriate time, having an interactive two-way flow of communication with customers and engaging in a long-term mutually benefiting relationship with them.

A business that focuses on relationship marketing aims to establish a long-term relationship with its customers and serve them over time. It anticipates future needs of customers and attempts to meet these needs. Relationship marketing is a complex selling process.

CHANNEL MEMBERS AND THEIR ROLES

The key constituents of a marketing channel are manufacturers, intermediaries and end users. The term 'manufacturer' refers to the producer of the good or service that is being sold. Manufacturers possess and own the merchandise till it leaves the production site and reaches the next member in the distribution channel. They negotiate with buyers on sales and merchandising terms.

Apart from manufacturers, middlemen form an important element in the marketing channel. They execute some marketing functions more efficiently than producers do. Depending on their role in the distribution process, middlemen can be classified as merchants, agents and facilitating intermediaries. Merchants differ from agents in that the former own the title to the merchandise, while agents do not own the title but negotiate it.

Facilitating intermediaries do not involve themselves with the transfer of title but only act as facilitators. Examples are warehouses, advertising agencies, research agencies etc. Merchants and agents can be further sub-divided into retailers and wholesalers. Retailing includes both store as well as non-store retailing. Common store retailers are discount stores, departmental stores and so on. Non-store retailing involves selling through one to one marketing such as door-to-door sales, mailers etc.

Exhibit 18.2

HLL's Innovative Distribution Model

Given the fact that the urban saturation is becoming an important factor for companies, aggressive initiatives to capture the rural market have become imperative for companies like HLL. FMCG giants like HLL have realized the need to strengthen their rural base.

To reach this aim, Hindustan Lever Ltd. initiated Project Shakti in 2001 as a distribution channel to ensure the company's penetration and growth in rural markets. The project was piloted in Peddakaparthy village in Nalgonda district of Andhra Pradesh. HLL chose women from rural Self Help Groups (SHGs) for its new distribution model. These women acted as direct-to-home distributors of HLL products, giving HLL an opportunity to target unexplored areas. HLL's ambitious vision of creating 11,000 Shakti entrepreneurs, covering one lakh villages and touching the lives of 100 million rural consumers by 2010, formed the basis for the project. The objective of the project was to enhance the income-generating capacity of underprivileged rural women by providing them sustainable micro-enterprise opportunities. It also aimed at improving rural living standards through health and hygiene awareness programmes.

The Channel: A woman selected as a Shakti entrepreneur has stocks of HLL products delivered to her at her doorstep by a HLL rural distributor. She sells them to retailers and directly to consumers in the village. Each Shakti entrepreneur serves about 6-10 villages with a population ranging between 1,000-2,000 people. The units that are packaged for rural markets are small in size, making it affordable for low income groups to purchase them.

The Selection: The women chosen to act as Shakti entrepreneurs are provided three months training and guidance by the company. The finance required for the business is provided by the SHG. After the training, the entrepreneurs begin selling.

The Fruits:

Though the results have been slow, a 15% increment in sales of HLL products has been witnessed in rural markets. These markets account for 50% of the sale of HLL products in Andhra Pradesh.

Having successfully implemented Project Shakti in Andhra Pradesh, HLL extended it to the villages of Madhya Pradesh, Karnataka and Gujarat.

The project created a win-win partnership between HLL, its rural sellers and consumers, some of whom now depend on the organization for their livelihood. It built a self-sustaining cycle of growth for all those involved.

Adapted from "Reaching Out – Community Development," HLL, <http://www.hll.com/HLL_Flash/reachingout/communitydev.html#writeup> and Vinay Kamath, "Where HLL's Shakti Comes From," The Hindu Business Line, 29 May 2003, <www.blonnet.com/catalyst/ 2003/05/29/stories/2003052900020100.htm>

Wholesalers can also be categorized into agents and merchant wholesalers. Agents can be either manufacturing agents, sales agents or brokers. Each of these follows a different method of distribution of merchandise to the end user. A manufacturing agent has less control over pricing goods or services compared to a sales agent.

The merchant wholesaler plays a major role in the distribution system. Depending on the extent of services provided, merchant wholesalers can be further divided into service wholesalers and limited function wholesalers. Service wholesalers perform almost all wholesale functions including delivery, credit, storage and distribution. Limited function wholesalers carry out a few specific wholesaling functions and specialize in them. End users are also members of marketing channels as they receive the merchandise from the other members and are the final consumers. Exhibit 18.2 describes an innovative distribution model launched by Hindustan Lever Limited (HLL) in rural India using rural women from Self Help Groups as channel members.

Roles of Channel Members

Channel members or channel intermediaries perform various roles in their capacity as a medium of distribution of goods and services. Some roles performed by channel members are described below:

1. Facilitate the search process of buyers and sellers: Channel members or channel intermediaries facilitate the search process of buyers and sellers and help reduce uncertainty in them. By making products and services available to end users, channel members lower uncertainty among end users regarding product or service availability. In the absence of channel intermediaries, manufacturers too would be unclear about how to reach target markets. Therefore, the presence of channel members spares end users from the cumbersome routine of having to locate manufacturers and buying from them. Likewise, the manufacturer is spared the additional activity of having to reach target customers. For example, in the insurance industry, insurance agents, who sell insurance products of various companies, serve as channel members. In the role of channel member, an insurance agent brings the insurer (the producer) closer to the customer, and at the same time, reduces the uncertainty in customers and makes them aware of available products and insurance policies.

2. Sorting: Channel members perform the role of sorting where they try to eliminate the differences in the assortment of goods and services offered by the company. Discrepancies occur in this process due to differences in the pattern of manufacturer supply and customer demand. Manufacturers produce large volume of goods in limited variety, while consumers often seek a wide variety of goods in limited quantity. Sorting by the channel intermediaries involves activities such as sorting out, accumulation, allocation and assorting. In the first, intermediaries break down heterogeneous supplies of goods received from various manufacturers. Arrangement of fruits according to size and quality is an illustration. Accumulation is the opposite of sorting out. Channel intermediaries procure goods from various manufacturers and club together or assemble goods that are similar to form a homogenous supply. One-stop stores are examples of channel members who aggregate goods produced by various sellers at a single location. Allocation refers to the process of breaking up similar supplies into smaller lots. For example, wholesalers break up a homogenous supply of goods and sell small lots to retailers. The latter further break up the lots into smaller quantities to sell to customers. Assorting refers to the process of putting together various products in the form of a package for the purpose of reselling.

3. Making transactions routine: Typical activities in a transaction involve ordering of goods or services, fulfilling orders and paying for goods and services purchased or availed. Both the buyer and the seller must accept the terms and conditions of the sales transaction. Channel members help in making transactions routine through standardization and automation. Standardization means setting a standard pattern for performing routine activities. For example, standardization of activities such as placing orders, lot size, payment, etc helps increase efficiency in performance. Likewise, automation of processes such as reordering, etc helps prevent errors. Thus, channel members contribute toward increasing efficiency and minimizing distribution costs.

4. Contractual efficiency: In a marketing channel, several relationships result from transactions or exchanges that occur between various channel members. A transaction in a distribution channel involves the product flow from the manufacturer to the wholesaler to the retailer and finally to the customer i.e. Manufacturer—Wholesaler—Retailer—Customer. At the same time, money might flow through the channel in the reverse direction i.e. Customer—Retailer—Wholesaler--Manufacturer. Channel intermediaries have to optimize the number of exchange relationships required to complete a transaction. If each channel member has to interact with all other channel members, then the number of relationships would be huge. The presence of intermediaries reduces this number and makes the process simpler. However, adding intermediaries beyond a certain point might result in inefficiency as the law of diminishing returns will set in.

CHANNEL FUNCTIONS

Channel functions involve all the activities by means of which products flow from manufacturer to end users. During the flow, the materials that go into the making of the product are transformed from basic raw material into the final product. Channel functions play an important role in determining channel structure. As the product moves through different stages in the marketing channel, various members in the channel perform various functions.

The most common functions of a marketing channel can be broadly categorized into exchange, supply or logistics and facilitating. Buying and selling are part of the exchange function. The logistics function includes transportation and storage, while facilitating includes standardization and grading, financing, risk bearing and providing market information.

The functions performed by a marketing channel are described in detail below.

Facilitating the Strategic Aim of Channel Members: Marketing channels facilitate the strategic aim of channel members and help them attain goals. For instance, in a "bancassurance" arrangement, banks serve as marketing channels for insurance companies. In this role, banks sell insurance products to their customers and help insurance companies fulfil their strategic aim of increasing market share.

Fulfilling the Interaction Process: Marketing channels coordinate the ordering systems, delivery timing and merchandising and help fulfil the interaction process with the customer. Distribution is a complex process involving several members and their activities. Marketing channels, by coordinating all aspects of the distribution process, facilitate the smooth flow of products and goods from producers to consumers.

Market Coverage and Product Availability: A marketing channel has to ensure market coverage and the availability of the products. The marketing channel does this by contacting existing and potential customers. It also provides customers support services in the form of credit, delivery and technical advice at prices affordable to customers and profitable to companies. The number of channels required to ensure adequate market coverage depends on factors like market potential, the manufacturer's market share, frequency of purchase of the product, technical knowledge required to sell the product and extent of product differentiation.

Market Development: Apart from making goods and services available to existing and potential customers and providing support services, the channels also contribute towards expanding the manufacturer's market share by soliciting new business from customers. New customer accounts solicited by the channel intermediary add to the company's market share.

Technical support: The extensive use of computers in almost every sphere of society has made the world highly dependent on technology. This dependence has made it mandatory for marketing channels to offer customers the needed technical support in addition to selling the product. Many end users will need require technical information on how to use a product. Technical support is required for optimal product performance, usage and the important task of maintenance. Technical support is required more for technologically sophisticated products. Hence, marketing channels should ensure adequate technical support to end users.

Market information: Marketing channels can be a valuable source of market information. As they directly interact with customers, they play a pivotal role in providing valuable data on customer preferences. However, analysts feel that marketing channels are yet to reach the desired level of performance in providing market information. Most channel members, despite having Electronic Data Processing systems in place, do not have complete and current data required for market analysis and planning.

Inventory management: One critical factor that affects customer service and manufacturers' profitability is the inventory levels maintained by marketing channels. The channels have to maintain a certain level of inventory to be able to meet customer demands. This level should be such that liquidity and profitability of the inventory holder are balanced. Excess inventory might lead to blocking of funds, which in turn will affect the marketing channel's profitability. At the same time, inadequate inventory might lead to delayed delivery of products and anger customers. Businesses are now depending on information systems to efficiently manage inventories. Chapter 23 discusses channel information systems in more detail.

Risk taking: If the manufacturer were to himself undertake the responsibility of distributing finished products, there would be exposure to risks such as spoilage of goods in transit or storage, physical damage to goods, misplaced items and product obsolescence. Such risks can result in manufacturers not realizing the full benefits of selling products. Marketing channels, by taking on the responsibility of distribution to customers, reduce manufacturers' risks.

DESIGNING MARKETING CHANNELS

The long-term commitment of a business towards the market affects its choice of marketing channels. The design of a marketing channel is influenced by factors like technological advancement, changing demographics and competition. There are several dimensions to choosing a channel design, which include:

- The channel length -- the number of intermediaries between the producer and the customers.
- Channel breadth -- the number of outlets available to customers.
- The costs involved in selecting a particular channel.

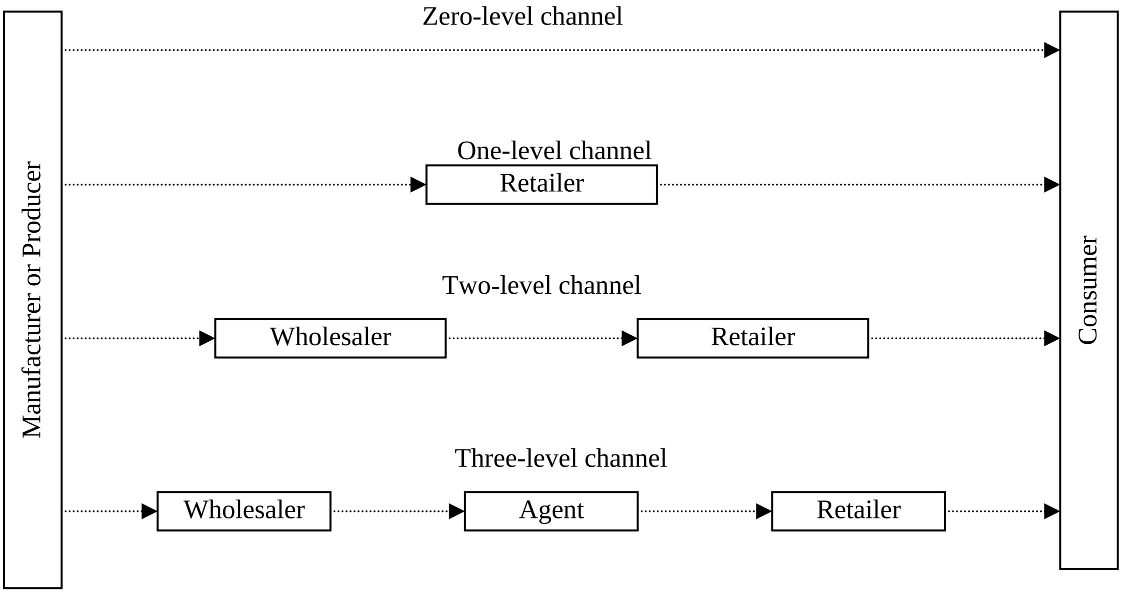
A channel design decision is made taking into consideration the channel structure, channel intensity and the type of intermediaries used at each level. While channel structure refers to the number of levels of channel intermediaries (distributor, wholesaler, retailer), channel intensity refers to the total number of channel intermediaries required at each level. The type of intermediaries at each level may include manufacturer's sales force, manufacturer's representatives or industrial distributors.

Channel Structure

The channel structure adopted by a company depends on the number of intermediaries it uses to distribute its products to end users. These intermediaries give rise to channel levels.

The length of a channel, described above, differs from consumer markets to industrial markets. The possible channel levels are zero level, one level, two levels and three levels.

Figure 18.1 Channel Levels in Consumer Markets



In a zero level channel, the manufacturer directly sells to the end customer through door-to-door selling, telemarketing and so on. Companies like Eureka Forbes and Amway reach their customers through direct selling. These companies use a zero level channel to make their products get to customers' hands.

In a one level channel, the manufacturer distributes the products directly to the retailer, who in turn, sells them to end -users. A single channel intermediary – the retailer – exists between the manufacturer and customers. One level marketing channels are mostly used by automobile manufacturers and petroleum companies. For example, Maruti Udyog Limited (MUL) directly supplies its cars to dealers, who sell them to customers. Showroom dealers serve as the single channel intermediary for MUL. In the case of petroleum companies like Bharat Petroleum Corporation Limited, Hindustan Petroleum Corporation Limited, etc, the company supplies fuel to dealers, who then sell it to consumers.

In a two level channel, there are two channel intermediaries present between the manufacturer and the customer. These are the wholesaler and the retailer. The manufacturer sells the goods to the wholesaler, who sells them to the retailer. The retailer then sells the goods to consumers. A typical two- level marketing channel is that used by manufacturers of fast moving consumer goods such as Hindustan Lever Limited, Dabur, Bajaj, Godrej, etc.

A three level channel is characterized by the presence of three channel intermediaries between the manufacturer and the customer. The three channel intermediaries in a three level marketing channel are the wholesaler, the agent and the retailer. An agent mediates between the wholesaler and the retailer. These channels are commonly found in the pharmaceutical industry. In this industry, medical representatives act as agents of pharmaceutical companies and persuade retail drug stores to purchase from the manufacturer, drugs manufactured by their company. Figure 18.1 shows a diagrammatic representation of the various channel levels in consumer markets.

In a zero level channel in industrial markets, producers directly sell products to industrial customers. In a one level channel, manufacturers sell the products to industrial distributors who sell them to industrial customers. With an increase in the channel level, the number of intermediaries too goes up.

Products usually flow between channel levels in a forward direction. But, of late, the reverse flow of products has also started to gain prominence. Reverse flow takes place in two circumstances -- one, when the manufacturer opts for product recycling and second, when there is product recall. Many manufacturers have realized the significance of environment friendly manufacturing and have opted for recycling. In recycle management, products flow in a reverse direction from end user to the manufacturer. The reverse flow is generated when the products are returned to the manufacturer after use by the consumer. Examples of such products include soft drinks and mineral water containers and paper products.

A product recall situation arises when a manufacturer requests its customers or distributors to return its products in exchange for a refund, replacement, or return of the product after carrying out necessary modifications or repairs. . Several manufacturers have resorted to this owing to defective quality of products released in the market. Examples of noteworthy product recalls are that of the anti-pyretic Tylenol capsules by Johnson & Johnson (1982), Firestone tyres (2000) and Dell Computer’s notebook computer batteries (2000) and the liquid antacid Gelusil by Pfizer (in 2004).

Channel Intensity

Channel intensity refers to the number of intermediaries present in a distribution or marketing channel. The degree of market exposure sought by the company for its products or services an important consideration while formulating channel policy and determining the number of intermediaries to be used. Depending on the number of intermediaries and the degree of market exposure sought at each level, manufacturers can choose between intensive, exclusive or selective distribution. Let us discuss this.

Intensive distribution

Customers consider the time and place utility while making purchase decisions. Taking this into view, producers of convenience products stock their goods in as many outlets as possible. This is termed intensive distribution. Place utility plays a significant role in selling convenience products. Producers of such products like pens, confectionery, soaps, detergents and cigarettes try to maintain a stock of their products at every possible retail outlet to generate maximum exposure and make it convenient for customers. An intensive distribution policy is driven by the belief that every exposure to a customer is an opportunity to buy, and that the image of the outlet occupies less prominence in the customer’s mind compared to the utility offered by the product.

Exclusive distribution

Producers of some products limit the number of intermediaries handling their product to deliver maximum service quality to customers. They try to develop a superior brand image for their product in the process. This is known as exclusive distribution and is often used in conjunction with exclusive dealing. In exclusive distribution, the manufacturer grants exclusive rights to some dealers, allowing them to distribute its products only in a certain geographical area. In an exclusive dealing arrangement, the manufacturer requires that the dealer should not carry competing lines. Car manufacturers usually have exclusive dealing arrangements with their dealers. In both exclusive distribution and exclusive dealing, it is the manufacturer’s responsibility to ensure that the distributor is able to provide appropriate repair, service and warranty handling facilities. Exclusive distribution allows manufacturer greater control over intermediaries in the areas of price, credit and promotion. In turn, they get greater loyalty and more determined selling of their products by the channel intermediary.

Exhibit 18.3

Chocolate Retailers Fail to Abide with Storage Norms

The recent controversy involving the recall of worm- infested Dairy Milk Chocolates manufactured by Cadbury's India Limited has brought to the forefront the total disregard paid to storage norms by retailers in the country. And it's not just retailers who seem to be at fault. Experts who conducted a study following the controversy found that in India, there are no storage norms laid down by the Government, which would make it mandatory for retailers to follow them. Moreover, it was also found that companies manufacturing chocolates in India were equally vague in their instructions to their stockists and retailers on product storage.

Undoubtedly, it is the chocolate manufacturers' responsibility to make channel intermediaries aware of how a product needs to be transported and stored. However, in India, few manufacturers seem concerned about this aspect. Chocolates should be transported under controlled temperature conditions for them to retain their quality. Further, they need to be stored under a specific temperature to retain taste and consistency. In India, chocolates are transported in cartons and stored in glass cabinets. This fails to provide the necessary cool setting, especially with temperatures in the country reaching up to 45 degrees Celsius in summer. Among the chocolate manufacturers, Amul is the only one, which specifies that its chocolates have to be stored in a dry place at plus 15-degree Centigrade. Despite being a multinational company, Cadbury's is vague in its instructions to retailers on storage norms. In its instructions, the interpretation of which can vary, Cadbury's only specifies that its chocolates need to be stored in a cool, dry and hygienic place. What is meant by cool is not made clear by the company. Yet another multinational company, Nestlé, gives no instruction in this regard to its retailers.

Adapted from P. T. Jyothi Datta, "The Chocolate Story: No Clear Norms on Storage," The Hindu Business Line, 14 October 2003.

Selective distribution

The selection distribution policy falls between the extremes of intensive and exclusive distribution. Selective distribution is adopted when the manufacturer lacks the resources to adequately influence the policies of all intermediaries who can carry a particular product. Instead of diluting the marketing effort by distributing products across a wide range of possible outlets, the manufacturer concentrates on the most promising outlets. In selective distribution, the manufacturer distributes products only to specific retailers selected on the basis of defined criteria.

To fulfil the manufacturer's selective distribution requirements, channel intermediaries require specialized resources to store and market the products effectively. For example, intermediaries distributing frozen food products should have deep freeze facilities to keep the products in good condition. The deep freeze should be displayed prominently so that customers are convinced of the freshness of the product. The recent controversy involving the recall of Cadbury's Dairy Milk chocolates, which were found worm- infested, is an example of how essential it is for channel intermediaries to follow proper storage norms. Exhibit 18.3 describes how chocolate retailers in India disregard storage norms, resulting in disrepute to manufacturers when defective quality chocolates reach customers.

All retailers need specialized resources to meet the selective distribution requirements of manufacturers. In the particular case of pharmaceutical companies, manufacturers abide by certain ethical standards and ensure that they distribute their products only to intermediaries with capabilities to offer advice on the use and limitations of the product. Such products are therefore distributed to pharmacies alone.

The manufacturer also ought to be concerned about the brand image. This should prevent them from distributing their product to intermediaries who have doubtful records or capacities. Some intermediaries may resort to stocking products in discount outlets or displaying them in a functional way, to reduce overheads and the final price, regardless of the damage it causes to the product and its brand image. Therefore, selective distribution, to outlets with good facilities , resources and image, is the best means to create a favourable impression about the product in the customer's mind. An example is 'up market' brands of perfumes. Manufacturers of such brands distribute the product to select retailers, whose outlets will help enhance the luxurious image of the brand. Some manufacturers go to the extent of preventing retailers from selling their products on-line. For example, in 2001, Yves St Laurent Perfumes Company, France, a manufacturer of premium brands of perfume, modified its contract with its retailers to specify the conditions under which products could be sold on their (retailers') website. Retailers, who were selected previously for physical point of sales were allowed to sell perfumes online only if they satisfied certain conditions.

Types of Channel Intermediaries at Each Level

While designing a marketing channel, the type of channel intermediaries available at each level must be considered. . Businesses can choose any from three types of channel intermediaries – manufacturer's sales force, manufacturer's representatives and industrial distributors.

Manufacturer's representatives

Manufacturer's representatives, also known as manufacturer's sales representatives, account executives or sales engineers sell the manufacturer's products to wholesalers and retailers, other businesses and also to institutions such as hospitals, libraries and schools. Almost every manufacturer uses the services of these representatives to distribute products. Manufacturer's sales representatives may represent more than one manufacturer. For example, a sales representative in the pharmaceutical industry, who sells painkillers manufactured by one company, may sell syringes for another company and vaccines made by a third company. Manufacturer's sales representatives act as agents for manufacturers. They do not work for a base salary but instead receive a fixed portion of the sale as commission for their services. They operate within a specific geographical territory.

Manufacturer's sales force

Manufacturer's sales force comprises sales persons who are on the company's rolls. They receive a fixed salary. Although the first alternative --manufacturer's sales representatives -- is an optimal solution for companies that lack capital to invest in its own sales force, there are many companies which prefer a direct sales force. This is because of the inherent flaw in getting the services of manufacturer's sales representatives. These people usually represent several companies, have to sell all these products and therefore rarely develop product expertise. They cannot devote time to selling the product of one company. This becomes a hurdle for a company intending to increase its sales. A manufacturer's sales force, on the other hand, devotes its time and efforts entirely to selling that manufacturer's products and serves as a powerful tool for the company to increase profits.

Industrial distributors

Industrial distributors are independent firms consisting of sales and support personnel. They differ from manufacturer's representatives in that they take possession of the products they sell and have a partnership arrangement with the manufacturer. Manufacturer's representatives, in contrast, do not take possession of the manufacturer's products. A large portion of the sales in companies like Norton, Pfizer and 3M takes place through industrial distributors. Their use by a firm to distribute its products has its advantages. First, associating with an industrial distributor helps the manufacturing firm to gain access to specialized knowledge about the market, which would have been costly and time-consuming to get on its own. Also, association with the distributor's name and reputation helps the manufacturer overcome initial reluctance among customers about unknown suppliers.

However, there are disadvantages too. For instance, an industrial distributor may just stock the manufacturer's product and might not sell it as enthusiastically as the manufacturer's own sales force would have. Second, high profit margins of the industrial distributor might increase the price at which the product is offered to the customer, resulting in poor response. Third, the use of industrial distributors might distance the manufacturer from the customer.

CHANNEL FLOWS AND COSTS

Marketing channels ensure smooth flow of goods and services from manufacturers or producers to end users or customers. They reduce the gaps that arise in the flow of goods between channel members. The flow of products between producers, wholesalers, retailers, industrial and household consumers can be forward, backward or two-directional.

A marketing channel comprises a network of activities, which move through the channel in various directions and are aimed at satisfying consumer's needs and wants. It is not essential for all channel members to participate in all channel activities. Some channel members might specialize in the performance of certain channel activities and might not be involved in others. Channels can be restructured to eliminate members performing redundant channel activities.

Marketing channels are primarily characterized by eight basic flows, which influence the channel's performance. These are :

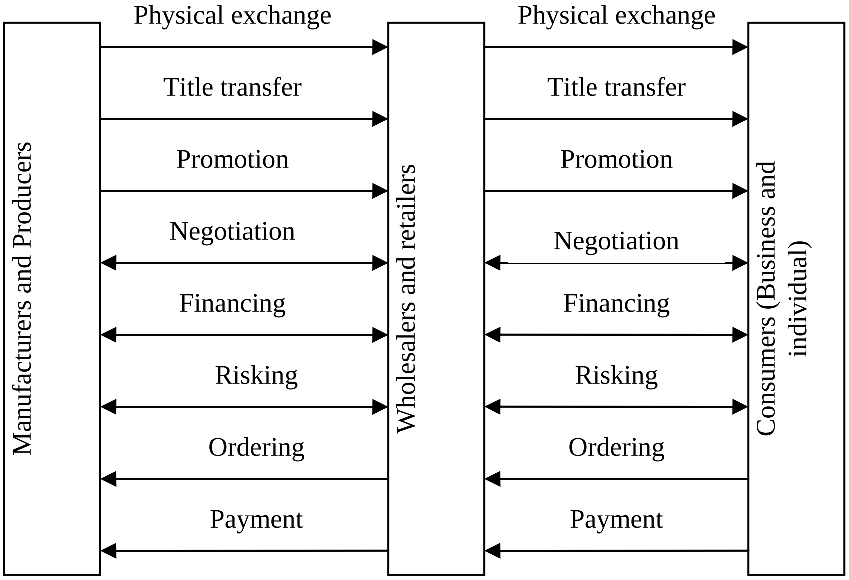
- Possession -- physical exchange of goods
- Ownership --transfer of title
- Promotion
- Negotiation
- Financing
- Risking
- Ordering
- Payment

Figure 18.2 gives a diagrammatic representation of the various types of flows in a marketing channel.

Possession: Possession represents the flow of goods from the producer to the final consumer through intermediares. The posession of goods gets transferred from the manufacturer to consumers. Possession flow consists of various activities pertaining to storage of goods and their transportation from one channel member to another. The costs involved are for storage and transportation.

Ownership: Ownership flow takes place when the title to the goods passes from one channel member to another during their passage from the manufacturer to the consumer. Usually, possession flow and ownership flow take place simultaneously, as goods move through the channel. The two flows are not always in the same direction.

Figure 18.2 Marketing Flows in Channels of Distribution



Source: Donald J. Bowersox and Edward E. Morash, "The Integration of Marketing Flows in Channels of Distribution," *European Journal of Marketing, 1989, Volume 23, Issue 2,58.*

For instance, in consignment selling[2], the product might be physically held by the seller but the title or ownership to the goods lies with the producer or manufacturer till the goods are sold. Ownership flow involves costs such as inventory costs for carrying the goods in inventory and opportunity costs incurred by investing in the goods.

Promotion: Promotional flows refer to activities that are aimed at making prospective buyers aware of the product features and to convert them into customers. These activities can be taken up by any channel intermediary and need not be confined to the producer or retailers. The costs involved in promotion flow are those incurred for personal selling, advertising, sales promotional, etc.

Negotiation: Negotiation flow occurs when terms of sale and after-sales relationships are discussed and agreed upon between channel members. The costs incurred are measured in terms of time spent on negotiation.

Financing: Financial flow usually takes place in a direction opposite to that of physical flow and involves payment for the goods received from previous channel members. Usually the seller grants some time to the buyer for making payment, even after the physical possession is transferred to the buyer. The costs incurred by the seller involve the loss of income that could have been earned by investing the money receivable, elsewhere. These costs can be incurred by any channel member or even by specialized external agencies like banks and credit card companies.

Risking: Risks flow from one channel member to the other along with the flow of goods. Risks can arise because of the perishable nature of the products or adverse price changes in the market. Costs involved are those associated with risk transfer, i.e., insurance, maintenance costs for perishable goods, warranties, repairs etc.

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[2] Consignment selling involves selling items owned by others. It involves collecting the items for sale from various clients, listing and selling them, and handing over the proceeds from the sale to the respective clients after deducting a certain fee for the seller's services.

Ordering and Payment: Ordering and payment flow involves activities pertaining to the purchase of goods and making payment. The costs associated with such flows are incurred for purchase of the products i.e. order processing costs, ordering costs, etc. Payment flows are associated with collection costs and costs due to bad debts. Advancements in technology can reduce costs associated with activities in the ordering and payment flow. For example, the installation of automatic reordering systems helps retailers cut down ordering costs significantly.

As each flow discussed above is associated with a cost, it becomes essential to reduce or eliminate flows that are repeatedly performed. Hence, knowledge of the service outputs required by end users helps the channel manager to efficiently manage channel performance.

SUMMARY

A marketing channel acts as a differentiating factor and provides businesses with a competitive advantage. Marketing channels comprise several individuals and interdependent organizations that facilitate the process of making a product or service available to end users. Marketing channels have evolved over time, from being production-oriented to customer- centric.. The evolution of marketing channels has primarily been a response to changes taking place in businesses due to the environment.

Channel members play a dominant role in moving products across the marketing channel. They facilitate the search process of buyers and sellers. They also perform the role of sorting, making transactions routine and contractual efficiency.

In addition, marketing channels perform several functions. These involves all activities that facilitate the flow of products from the manufacturer to the end user. As the product moves through different stages, different members in the distribution channel perform the functions of exchange, logistics and other supporting functions.

Designing an appropriate marketing channel is crucial to the success of a business. The channel design has to be meticulously planned taking into consideration the channel functions and other strategic business objectives. The most important elements in channel design are channel structure, channel intensity and the type of intermediaries at each level.

Marketing channels ensure the smooth flow of products between channel members. In the process, a marketing channel witnesses eight basic types of flows. These are flow of possession, ownership, promotion, negotiation, financial, risk, ordering and payment. Each flow is associated with certain costs. Therefore, it is necessary that marketing channels be designed to eliminate redundancy of flows.

Chapter 19

Channel Integration

In this chapter we will discuss:

- Importance of channel integration
- Vertical marketing systems
- Types of vertical marketing systems
- Benefits and costs of vertical marketing systems
- Horizontal marketing system
- Hybrid channel systems

Every year, trillions of dollars worth of goods produced make their way to the end consumers through a variety of channels. Channel members play a major role in distributing the goods and services of the manufacturers to the end-users. These channel members are considered channel partners when they integrate their activities with that of the manufacturer. The principal functions that channel members commonly perform are transfer of ownership of goods, negotiation of titles, and physical movement of products. Wholesalers, retailers, transporters, logistic providers, and distributor agents are channel members who undertake some of these functions. The marketing managers are responsible for taking decisions on the nature and type of channel members to use, the channel design, and the number and kind of channel members through whom the company should sell or buy. A distribution channel is described in terms of the length, breadth, number, and types of channel members.

In the early nineties, the traditional total systems concept of distribution was replaced by the concept of channel integration. Channel integration involves streamlining the distribution process in terms of physical and information efficiency by establishing channel partnerships and strategic alliances with channel members at all levels of the channel hierarchy. Companies have now begun to place greater emphasis on channel integration in order to reduce transaction costs, gain better control over the distribution process, and ensure a reasonable return on investment. Channel integration, where all the members work together as a single entity for their collective success, has become a source of competitive advantage for companies operating in mature markets.

This chapter discusses the importance of channel integration followed by a discussion on vertical marketing systems -- the types, benefits and costs. The chapter also discusses horizontal marketing systems and hybrid channel systems.

IMPORTANCE OF CHANNEL INTEGRATION

Intense competition has forced managers to analyze the different sales management functions in order to identify areas that can be harnessed to gain a competitive advantage. The successful agreements and alliances that companies have entered into with different channel members in recent times have made managers realize the potential of channel integration to reduce costs and improve productivity. Sharing resources and experiences through non-traditional distribution arrangements like channel integration enables companies to convert the customers' need for special services into an opportunity to make profits -- something that would not have been possible if the company were operating on its own.

Channel integration is of great significance not only to manufacturers but also to other channel members like retailers. It serves a host of functions in the present day competitive environment. These include maintaining minimum inventory levels, improving mutual relationships among channel members, reducing transaction costs, helping a company to manage its skills and resources better and also develop a competitive advantage over its rivals in different markets. Successful channel integration leads to at least a 10% increase in sales due to new business opportunities. Let us look at these aspects in detail.

1. Channel integration helps to bridge the gaps prevailing between production and consumption. These gaps may be quantity gaps, space gaps, time gaps, and variety gaps. 1) Quantity gap - Manufacturers produce in larger quantities than is possible for an individual consumer to buy. Channel integration provides a means of breaking bulk by dividing the product into smaller consignments for the final consumer. 2) Space gap – Manufacturing location is based on the feasibility to manufacturers in terms of raw materials availability, transport facility, etc.

Manufacturing location may not necessarily be the same as that of the customers. Distribution channels help bridge this 'space' between manufacturers and consumers. 3) Variety gap – Manufacturers produce a narrow range of products while consumers prefer to have a wide range of products to choose from. The channel members (retailers) in the integrated system source the products from different manufacturers to fulfill this need of customers by providing a wide range of products, with the required width and depth in each product category. 4) Time gap – Distribution channels schedule product delivery in such a manner that the time difference between manufacturing and purchase is small and the product reaches the consumer in the best condition. This can be done through point-of-sale systems and bar coding.

2. Channel integration streamlines the physical and information flow among channel members. The exchange of point-of-sale information between the supplier and wholesaler/retailer enables the supplier to manufacture at the level that exactly meets the actual demand for a product in the market. This prevents stock pile-up and duplication of services, which often increase costs by 15% to 20%, and ensures that the manufacturer and the intermediaries carry only the minimum required inventory.
3. Channel integration reduces the levels of opportunism generally associated with manufacturer-distributor relationships. It reduces the costs involved in transactions and leads to greater control of the overall distribution process.
4. In the case of exports, channel integration reduces the uncertainty, costs, and risks associated with legal agreements and partnerships between the manufacturer and other channel members like import agents or merchants.
5. Channel integration is an important component of a company's marketing channel strategy. The degree of integration can have a significant influence on the company's possibility of success or failure in an international market. The company can integrate forward to the retailer level to serve the customer or have an arrangement only till the distributor or wholesaler level.
6. It is a well-known fact that a single channel member cannot have the experience, resources, and skills to be proficient in and undertake all the channel functions. Channel integration enables the firm to better manage and optimize its limited skills and resources through horizontal or vertical integration along the channel. A symbiotic relationship is established where channel members who are proficient in different channel functions, link up to form an efficient distribution system that is mutually beneficial.
7. Integration also affects a company's competitive positioning and strategy in different markets. Control over the distribution channel reduces transaction costs and leads to better coordination across different markets. The company can use this as a competitive advantage to position itself better than its rivals in international markets. On an average, a successful integration of channels helps to reduce business opportunities lost (stock-outs or inability to respond to customer emergencies) by as much as 50% to 75%.
8. Integration is also useful since it can be used as a barrier to entry into the market for other competitors, as in Japan. In Japan, the distribution system is multi-layered and close-knit, involving a very high degree of loyalty among the various layers. In such conditions, it is difficult for a foreign operator to forge a relationship with the local channel members to sell their products.
9. An integrated distribution channel can be used in a differentiation strategy where a company or channel member in the integrated system can provide a superior product or service offering to the consumers. Channel integration can be used to deliver value to the consumer. Value-delivery and addition can be a source of sustainable competitive advantage to all the members of the channel system.

Value perceptions are different for different consumers. For example, some may perceive value in the kind of purchasing environment and experience, and others, in the product accessibility or level of customer service or support. The skill in successful channel integration lies in positioning the value offered in the most profitable manner.

10. Promotional campaigns can be coordinated between the manufacturer and the retailer based on the consumer demand and availability of the product. Otherwise, promotional timing may not be aligned with the manufacturing schedule and this may lead to a stock-out on account of increased demand.

Developments in technologies like information systems and integrated logistics management have given an impetus to companies to enter into cooperative agreements like channel integration. Volvo GM Heavy Truck Corporation is one company, which used logistics systems to help its dealers in the US to cater to emergency requests for critical components whenever one of its trucks broke down. It set up a warehouse in Memphis, which stocked the full line of truck parts. Under an agreement with FedEx Logistics Services, it arranged to deliver emergency requests from dealers for spares overnight. The arrangement also helped the company to reduce its inventory by 15% and to remove three of its warehouses. Channel integration has enabled companies and channel members to pool their resources together and provide a range of product offerings and services to customers.

Channel integration must not be interpreted as the integration of a single distribution channel from manufacturer to retailer for a product. An integrated channel actually involves a large number of companies in different supply channels. Channel integration can be undertaken for the industrial group as a whole. An industrial group may include different distribution channels and a number of manufacturers. An average industrial group includes around 50,000 outlets involving wholesalers, distributors, merchants, service centers, and around 10,000 small, medium, and large companies. Efficient integration of such a large group is possible only with the help of innovative information systems like bar codes, universal price code (UPC) numbers, and Electronic data interface (EDI). Network management and connectivity, education and training for all the employees concerned, sound technical plans and access to systems experts will also help in integrating such a large industrial group.

As we have just seen, there are various advantages of channel integration. But there are certain issues that may hinder effective channel integration and it is imperative that managers are aware of them. Exhibit 19.1 describes some of these issues.

With increasing competition, the need for establishing successful relationships between channel partners has become all the more important. A proper understanding of these issues can certainly help an organization meet its objectives of sustained profitability and market growth.

VERTICAL MARKETING SYSTEMS

Channel integration involves cooperation from various channel members and may not include ownership of the channel. In vertical marketing systems (VMS), one of the channel members owns the channel or exerts a substantial influence or control over the activities of the members along the channel. This ‘channel leader’ oversees the functions of channel members and ensures that everyone performs only those functions at which they are good.

A VMS consists of a manufacturer(s), distributor(s) and a retailer(s) pooling their individual strengths together to achieve operating economies or a competitive advantage. VMSs are a common mode of channel arrangement that companies use to overcome intense competition and changing market conditions.

Exhibit 19.1

Channel Integration Issues

Although channel integration is an effective way to gain a competitive advantage over the rivals, its success depends on the awareness and ability of channel members to resolve certain issues. Some of the primary issues in channel integration are given below.

- Channel members may be skeptical of the rewards of cooperation. This skepticism is all the more so because of the complexity of the conceptuality of channel integration and its differences with the traditional distribution system. Sometimes, profits are not based on the simple gross margin on sales but on the extent of cash flow and so on.
- Channel members may fear that they will lose their importance due to changes in the relationship arrangements. They may also be apprehensive about the probability of having to share resources and experiences with other channel members who are part of the integrated system. Companies have to give guarantees and assurances to help members overcome these fears.
- Ensuring equitable distribution of rewards or gains is a complex task. It is very difficult for a manager to have an accurate assessment of the extent to which the channel partners have pooled in their resources and leveraged their capabilities. So, an understanding of the position of all channel partners relative to each other is necessary if conflicts are to be avoided.
- The mode of payments to channel partners for sharing their resources is another important issue. Payment may be in the form of a fee-for-service arrangement where the channel member is paid a fixed amount for a particular task, which is determined initially. Microsoft makes use of this mode of payment to its channel partners. Functional allowance is another possible mode of payment. In this mode of payment, the manufacturer compensates the channel members for sharing their functional capabilities. Shell Chemical Corporation pays a functional allowance to GLS Corporation, its distributor, to develop market applications in its R&D facility, for Shell's synthetic rubber compound, Kraton.
- Getting the commitment of the senior management of the company to integrate the channels is crucial. Also there is a tendency among channel members to withhold information from one another due to lack of complete faith in each other. Inability to share important and relevant information can act as an impediment to successful channel integration.

Adapted from James A. Narus and James C. Anderson, "Rethinking Distribution: Adaptive Channels," Harvard Business Review, July/August 1996, Volume 74, Issue 4, 112-120 and Keith Blois, Susan Shaw and Sean Ennis, "Marketing-Channel Management," Oxford Textbook of Marketing , 2000, 245-270.

In traditional channel systems, channel members operate at arm's length and their objective is to maximize individual benefits. In VMSs, channel members work for a specified benefit common to the whole channel system. VMSs were developed with the objective of reducing recurring conflicts and achieving better channel cooperation and coordination. These are achieved through the use of channel plans and policies. Vertical marketing systems are most prevalent and successfully used in the food service industry. Companies like McDonald's and Wendy's have successfully streamlined production, distribution, and retailing into a single efficient system to succeed in the global market.

In a VMS, a channel member either owns other channel members, franchises the others, or influences other channel members to cooperate through the channel power vested with them. Based on these aspects, VMSs can be divided into corporate VMSs, administered VMSs, and contractual VMSs. We will discuss each of the three types in the following sections.

TYPES OF VERTICAL MARKETING SYSTEMS

There are many ways by which a company can develop a vertical marketing system. The different integration approaches vary in terms of the level of investment, profitability, extent of control, the need to reduce risks, and the bargaining power of the other channel members. The commonly used types of vertical channel systems are the administered type of system, the corporate system, and the contractual system

Corporate VMS

In a corporate VMS, one company owns and operates the other channel members at different channel levels. A company develops a corporate VMS, when it intends to produce nearly all of its internal requirements through the corporate VMS. A corporate system is preferred when – the company is confident that it can suitably protect its key processes or trade secrets; accuracy and high quality have to be maintained in the channel activities; the company wants to exercise maximum control on all the related activities; proper coordination and control give a strategic advantage. When the manufacturer owns or conducts operations at the wholesaler or retailer level, the vertical marketing system is said to be forward-integrated. When a retailer or wholesaler plans to operate or control the manufacturing aspects, a backward-integrated system develops.

Certain key variables influence the decision on whether a company should develop a corporate vertical marketing system or not. Some of these variables are described below.

The costs involved in operating the system: The possible profits must not be offset by the costs involved in operating the corporate system.

Price competition: The intensity of competition based on pricing influences the decision of a channel member on adopting a corporate VMS. In a corporate VMS, the cost of integrating channel functions may lead to a rise in the price of the end products. If the intensity of price competition between manufacturers of various products is high, the increase in price will lead to a significant loss of market share, offsetting the gains of adopting the corporate VMS.

Manufacturing capacities: Increasing the manufacturing capacities must not lead to significant resource constraints.

Value-addition: Vertical integration leads to a substantial increase in value-addition along the chain.

Availability of raw materials or channel partners: If there are no upstream or downstream channel members who can perform the required functions, the company can develop a corporate VMS.

Trade secrets: If the company uses exclusive processes or procedures that are not used by other companies in the industry, then a corporate VMS is preferred.

Product substitutability: If the product of the company is similar to that of competitors, corporate VMS is preferred.

Environmental uncertainty: If the economic, social, or technical environment is rapidly changing and competitor products are frequently introduced, the company would do better with a corporate VMS.

Coordination and team selling: If selling the product requires effective coordination and team selling efforts on the part of the company representatives and the distributor representatives, a corporate system is ideal.

Transaction size: If the order size per customer in a given territory is significant, the company must take advantage of the corporate VMS.

Performance of channel members: If it is difficult to measure the productivity or evaluate the performance levels of the channel members, a corporate system will be more beneficial.

Companies like Sears source more than 40 percent of their products from companies that they own partially or fully. Decision-making is more or less centralized, since there is no requirement to consult the other channel members as in the case with the conventional, administered or contractual systems. Despite the loss of flexibility and the heavy investments involved, many companies have developed corporate vertical marketing systems to differentiate their offerings from those of competitors.

Administered VMS

Unlike in the case of the corporate system, in the administered type of vertical marketing system, no channel member has complete control over other channel members. Managers of companies following the traditional distribution systems often attempt to first develop an administered system to compete against companies in corporate vertical marketing systems. The extent to which one channel member exerts an influence or control over others varies. One of the channel members becomes dominant because of expertise, brand image, market share, channel power, etc., In an administered VMS, the level of control is greater than in the traditional distribution system but less than that of a corporate system.

This type of vertical marketing system is widely prevalent in the retail sector because of the increase in the bargaining power of retailers over the last decade. Retailers have become more market and more corporate-oriented, with a centralized administration and distribution, increased product range, and retail branding. This phenomenon has led to retailers seeking relationships with those suppliers who can contribute to their developing a competitive advantage. Retailers want suppliers to work closely with them in product development, new product concepts and designs, quality control, and delivery schedules. Overheads need to be minimized while out-of-stock situations are absolutely forbidden. Due to these changes in the procurement needs, the traditional market mechanism operating between the supplier and the retailer has given way to a preference for a more stable and mutually beneficial relationship. Such a shift has been aided by views that stable relationships have certain advantages or the view that managing relationships in a vertically integrated system can improve the retailer's competitive performance at the horizontal level. In highly stable administered systems, retailers also provide financial loans to suppliers in their investment programs and give training in new production technologies.

The administered distribution systems are more long-term oriented and stand the test of time due to the prevalence of a strong channel culture and possible competitive advantage for the dominant channel partner. In administered systems, price is not the sole criterion that decides the extent of inter-relationship between suppliers, manufacturers, or retailers. The total relationship orientation on a long-term basis is considered. This type of system is widely prevalent in the grocery, apparel, and furnishing sectors. Honda used this system for dealer management in each of the businesses that it chose to enter. It was able to develop, train, and support a network of dealerships in merchandising, floor planning, selling, and service management.

Some of the factors that bring about the need for an administered vertical marketing system are mentioned below.

Need for consistent product quality: When the products are difficult to manufacture and require stringent norms to be adhered to, it leads to this type of vertical marketing system.

Need to have a flexible delivery response: Shorter lead times and flexible delivery schedules also give an impetus to administered relationships.

Joint product development: The administered system is beneficial when there is a need for mutual cooperation between upstream and downstream channel members.

Specialized delivery systems: In the food processing and fast food sectors, distribution arrangements have to be consistent and stable due to the nature of the products. McDonald's has set up an administered distribution system in India, to source the different materials used in its products.

Strong manufacturer brands: Suppliers have to maintain stable relationships with companies that have strong brands in order to have a steady supply of products. The retailer has to initiate an administered system and absorb the resultant costs.

This type of system provides advantages to both the producers/suppliers and the retailers. Producers, unlike in the traditional system, have the benefit of reaping profits through steady sales and do not have to compete in changing relationships. They can also ensure the maximum product exposure through the retailers because of the nature of the relationship. Wholesalers and retailers are also benefited because they are assured of a steady supply of products of the required quality and of the delivery schedules.

Contractual VMS

This is another type of vertical marketing channel in which an organization enters into agreements or contracts with other channel members to perform the different channel functions. Contractual systems consist of independent organizations that integrate their distribution operations through contracts. These organizations try to reap the advantages of a vertically integrated system while operating independently. The success of such inter-organization contractual arrangements depends on the commitment to cooperation from the different channel members.

Contractual systems work through different forms of cooperation. The oldest form of cooperation is where organizations combine similar marketing resources to succeed in increasing market coverage or to present the products to consumers in a better way. Lloyd's Insurance Corporation is one such organization, which comprises partnerships between more than 300 individual and independent syndicate partners. This form of contractual system can be used when the individual firms feel that it is too risky to offer products or services to customers independently.

Another approach towards cooperation through contracts is to trade resources between firms for mutual benefits. Mitsui and Mitsubishi Corporation have been using this form of arrangement since the seventeenth century. Channel members can trade information about customers and competitors (increases customer understanding) or trade product supplies (decreases inventory costs). Contractual VMS is appropriate when a channel member wants the maximum flexibility to alter its products and strategies or when it wants to reduce risk through minimal investment in other channel activities. The channel member can easily exit from this sort of vertically integrated system if the system fails to provide positive results.

In a contractual VMS, the channel members must have a sound knowledge of the legal requirements since all the contractual agreements drafted are legally enforceable. Generally, companies that have high bargaining power or those operating in highly volatile industries like information technology prefer to adopt a contractual system. All the members in the system must commit themselves, at least partially, to working as a team in order to fulfill certain common goals. This is because organizations enter into such a system with different objectives in mind. Expanding the market demand for their products may be one such objective. This objective holds true for products that have entered the maturity stage of the product life cycle. Industry level promotion where companies not only promote their products but those of other channel members is one form of this approach. It is widely seen in the milk, egg, and beef products industry.

Exhibit 19.2

Franchising

Franchising is an efficient form of distribution that makes use of contracts to coordinate and control the distribution activities of the channel members. It is one of the best ways to enter foreign markets and build up a market presence. Franchising helps to reduce the costs of operations and avoid the substantial investments that are part of the corporate VMS. Franchising also helps to rapidly build up economies of scale and operational efficiency. Franchising has become the common form of distribution and nearly one-third of retail sales in the US are through the franchising concept. This concept was first used by German brewers in the eighteenth century, and was known as the tied-house system. The franchising concept used at present, known as the business format or 'package' franchising, owes its origin to A&W restaurants.

Franchisee relationships work on the premise that working in groups can lead to more value-addition than when operating independently. The degree of autonomy that the franchiser delegates to the franchisee in the contract plays a crucial role in the success of the relationship. The degree of autonomy can be ascertained by the franchisor specifications and the extent of supervision prescribed in the contract. Franchisor specifications include the extent of autonomy on site selection, supplier selection, daily operations, accounting systems, and pricing. The degree and frequency of monitoring also influences the extent of autonomy of the franchisee.

The guiding force involved in a franchisor-franchisee relationship is the contract. The contract must be fair to both the parties and be mutually beneficial. All aspects on performance standards, rights, and responsibilities must be clearly stated without any ambiguity or unfair benefits to one of the parties. In the US, the anti-trust law, the Sherman Act, and the Clayton Act are some laws that have been formulated to ensure equal rights to both parties. The success of the relationship will depend on the ability of the franchisor and the franchisee to forge strong bonds and build up a sense of trust, to exchange information, and assist each other at all times.

The different industry segments that make use of the franchising type of contractual system include automotive products and services, educational products and services, employment and health services, and food and non-food retailing. Franchising has been most successful in food retailing and the electronic appliances sector. McDonald's is the best example of franchising. Benetton, the Italian apparel giant, also makes use of franchising to retail its apparel. It has over 4,000 franchisees all over the world. But this form of franchising is restricted to the retail level. Coca Cola Co has adopted a franchising system that involves channel members at a higher level in the vertical channel system. The company has franchisee arrangements with different bottlers for bottling and transporting the filled bottles to distributors, who distribute them to stockists and retailers down the channel.

Adapted from Ronald P. Stephenson and Robert G. House, "A Perspective on Franchising," Business Horizons, August 1981, Volume 14, Issue 4, 35-42 and Richard C. Hoffman and John F. Preble, "Franchising Into the Twenty-first Century," Business Horizons, November/December 1993, Volume 36, Issue 6, 35-43.

Another objective of entering into contractual systems is for firms to cross-subsidize operations. The firm with the better bargaining power may cross-subsidize or undertake operations on a mutual basis. AT&T, Western Union, and 58 other firms followed cross-subsidization which led to the early development of the satellite communications market in the US. The members mutually benefited by this approach. The objective of all firms entering into such an arrangement is to achieve value-addition. Otherwise, the whole purpose is lost.

Retailer-sponsored cooperative organizations (RCOs) and wholesaler-sponsored volunteer organizations (WVOs) are two of the best-known forms of contractual vertical marketing systems. RCOs are formed when groups of independent retailers combine together and support a single wholesaler. The wholesaler caters to the different needs of the retailer groups and the retailers get benefits in the form of rebates or price discounts from the wholesaler. The channel power is in the hands of the retailers. In a WVO, the wholesaler takes on the onus of establishing a voluntary group of retailers. The wholesaler meets the needs of the retailers far more economically and effectively than the dealers could manage if they were on their own. Except for the difference in sponsorship and channel power, RCOs and WVOs operate in a similar manner.

One of the most widely used and successful forms of a contractual system is franchising. Exhibit 19.2 describes the success of the franchising system all over the world.

Despite the widespread development and success of vertically integrated systems (corporate, administered or contractual), a new form of channel cooperation and relationship has emerged – Value Adding Partnerships. It involves companies cooperating with each other to manage the movement of products and services along the value-chain. Exhibit 19.3 describes this concept, which is very different from the concept of vertical integration.

Exhibit-19.3

Value-Adding Partnerships

The concept of cooperation among channel members has turned a full circle over the years. Vertical marketing systems involves one of the channel members exercising considerable influence over other channel partners to carry out the different channel functions. This approach favors large companies that hold considerable bargaining power and have the ability to achieve economies of scale. Value-adding partnerships (VAP), on the other hand, involves partnerships between smaller organizations, where each organization independently performs a function that adds value to the total value-chain. The cornerstone in the success of a VAP is the understanding that each member of the value chain has a part to play in the other's success. This concept has its origin in economics, which describes the value-added chain as a series of steps that a product or service goes through from the raw material stage to consumption.

VAP is more advantageous than vertical integration because of its flexibility in adapting to changing requirements. In a vertically integrated company, the emphasis is on a single competitive dimension, say, innovation or cost cutting. Since all the processes and functions are aligned to fulfill this aspect, it becomes very difficult for the vertically integrated company to perform functions that are different from the present operations. But in VAP, each small organization performs only one part of the value chain. This allows it to tailor its processes and operations to suit any changes in.

This type of arrangement has its advantages. Emphasis on a particular function in the value-chain allows the companies to have low overheads and avoid excess staff. Differences in operations give rise to diversity in the value chain that may lead to innovation across the chain. Thus, VAP has a dual advantage -- it has the benefits of large integrated corporations (coordination and economies of scale) as well as those of small firms (flexibility and low overheads). Sharing of information also makes managers aware of the activities taking place throughout the chain. Flow of information is crucial in maintaining healthy relationships between different firms. Modern technological developments like inexpensive software packages, bar codes, networking solutions, computer-aided design, and computer-aided manufacturing have helped in the free flow of information. The Japanese trading corporations are the best examples of successful value-adding partnerships where buying and selling of goods is arranged at each stage of the value-chain. Matsushita and Marubeni are two such Japanese companies that started off as trading corporations. Nowadays, many auto companies also make use of VAP. For example, Toyota and Chrysler produce only around 20% and 30% respectively of the total value of cars that they sell.

Adapted from Russell Johnston and Paul R. Lawrence, "Beyond Vertical Integration--The Rise of the Value Adding Partnership," *Harvard Business Review,* *July/August 1988, Volume 66, Issue 4, 94-101.*

BENEFITS AND COSTS OF VERTICAL MARKETING SYSTEMS

Channel members must be aware of the costs and benefits of adopting the vertical marketing system through integration. The costs or benefits accrued depend on the channel power, channel level, and the objective of the participating channel member.

Benefits

Whenever a company plans to diversify, vertical integration is one of the most sought after strategies. The company must consider the benefits of vertical integration from two different angles -- first, in terms of internal benefits, and second, in terms of the effect on the competitive benefits. Internal benefits include improved profitability, better control on the product quality, and increased efficiency in inventory management. Competitive benefits may include the increased ability to respond to changing market needs, better economic control, improved marketing know-how, decreased costs leading to better competitive advantage, stability in operations, and reduction in risks arising from competitor actions. Another principal benefit that prompts many companies to vertically integrate is differentiation. The vertically integrated system enables the channel members to differentiate their offerings in terms of better product availability, lower costs, or improved service.

Costs

It is necessary to keep in mind that vertical integration is always associated with the additional costs associated with administrating the processes. Administrative overheads take up a significant portion of these costs. They involve costs associated with setting up and maintaining the system. A company must estimate the costs that it might incur due to opportunism of the channel members, volatility of the markets, and industry instability along with the administrative overheads, before planning to integrate vertically. There is a possibility of inflexibility in operations for the company -- the heavy investment along the entire channel makes it difficult to change processes, policies, and strategies quickly to counter external conditions. Since the company has to manage the different functions in the channel, it might not have the opportunity to specialize or gain expertise in a particular functional area of the distribution channel.

HORIZONTAL MARKETING SYSTEMS

A horizontal marketing system is an arrangement within a distribution channel in which two or more firms at the same channel level work towards a common goal. In this system, the two firms are unrelated to each other and come together with the objective of cashing in on a market opportunity. Most companies operate through a strategic alliance or a joint-venture. This type of an arrangement is arrived at because the organizations on their own do not have the resources, experience, or the know-how to exploit the marketing opportunity. Horizontal systems have become popular due to the fact that cooperating firms bring to the arrangement skills and resources the others do not have. Organizations have started making use of horizontal integration to gain advantages that are not possible in the vertical system.

The success of a horizontally integrated system lies in the integration of four different functional areas -- operational integration, intellectual integration, social integration, and emotional integration among channel members. Operational integration is mainly concerned with the standardization of the production and distribution processes between the cooperating firms. Oracle Corporation has succeeded in integrating the diverse divisions with the help of information technology. Intellectual integration involves sharing of information about the requirements among the cooperating firms, leading to the development of tailor-made processes. Ogilvy One, a subsidiary of

Ogilvy and Mather, was able to develop market research tools and integrate operations for some of its large clients like IBM and American Express to combine and launch a new product. Social integration involves the ability of personnel at the same levels in the cooperating firms to discuss, analyze, and implement programs that are approved by both. Companies like Goldman Sachs have been successful because of the emotional integration through shared purpose, identity, knowledge, and culture across the different levels of the organization.

Horizontal arrangements have been successful in the hospital supply distribution, pharmaceutical, and retailing segments. This type of arrangement is generally formed at the R&D level for new product development or at the wholesaler or retailer level for products like electrical appliances and hardware. Such arrangements are mostly seen in the US market.

HYBRID CHANNEL SYSTEMS

With the ever-increasing competition, difficulties in sustaining profitability, and changing consumer tastes, companies have been looking for alternatives to the traditional systems of selling. Earlier, companies depended solely on a direct sales force or the distributors. But alternative modes of selling have now emerged and these include retail selling, direct mail, Internet selling, and telemarketing. When companies simultaneously use a number of such channels, it leads to the development of hybrid marketing systems. One of the earliest organizations to take the help of multiple channel systems was IBM. It added nearly 18 channels that included telemarketing, value-added resellers, and catalog selling for its range of computers.

Hybrid channels have developed due to the need of companies to increase their market coverage or reduce sales and distribution costs. Sales and distribution costs constitute a major portion of a company’s total expenses. For example, in 1989, the selling and administrative costs accounted for 24% of the revenues generated for companies in the US. Further, the cost of one-to-one selling to a customer was $300 an hour for a sales representative while the cost of using telemarketing amounted to only $17 per hour and direct mail a meager $1.

Designing and Managing Hybrid Channel Systems

Channel members adopting a hybrid channel system must be aware of the intricacies involved in successfully designing and managing these systems. Let us discuss these two aspects in the following sections.

Designing hybrid channel systems

The fundamental problem that arises in designing a hybrid system is the question of which channels will best accomplish the functions of managing and selling the organization’s products to the consumers. This requires managers to identify the different selling tasks that are necessary to achieve the desired objectives. Next, the manager must decide on the tasks that must be assigned to each channel so that they will be successfully accomplished. For example, a company can use telemarketing to identify and qualify prospects for large orders and to identify and close sales for mid-size customers. A direct sales force can be assigned the task of closing sales for large customers who were qualified through telemarketing. Managers involved in designing a hybrid system must have an in-depth understanding of the costs incurred in managing each channel. Knowledge of customer buying behavior is also crucial. Otherwise, there is the possibility of adopting a channel that customers do not prefer, to perform the selling tasks. Designing a hybrid system involves giving equal weightage to aspects that are best for the organization and also best for the end-users (company costs vs consumer needs).

Exhibit 19.4

Developing Strategies for Designing Hybrid Marketing Channels

A framework can be developed that will enable companies to develop successful channel strategies from the various options available. The first step involves identifying the factors that influence the channel mix properties. The next step involves identifying the channel mix properties in terms of the number of channels needed, the degree of channel integration, and the extent to which customer contact must be established. The third step involves selecting the channel mix. The final stage involves analyzing the effectiveness of the hybrid system in terms of the difference the implemented strategy brings in sales, costs, flexibility, and control.

Determinants of channel mix characteristics: The design of hybrid channel strategies is influenced by transaction costs, the marketing orientation, and strategic considerations. Transaction costs are measured in terms of the asset specificity (the influence of fixed assets on the transaction costs between channel members), degree of difficulty in measuring the performance of

channel members, and the uncertainty in the external environment. Marketing orientation is measured on the basis of channel power and conflict, customer differences, brand position, and product sophistication. Strategic considerations include competitive strength, bargaining power, strategic objectives, and scope of economies of scale. Asset specificity influences the number of channels that an organization will select to sell its products (high asset specificity means fewer channels). High internal uncertainty leads to a need for more channels. Companies serving diverse customers require many channels.

Identifying channel mix properties: The type of channel strategies that a company adopts is based on the number of channels selected to optimally serve the needs of the customers, the degree of channel integration in terms of the extent to which the company controls or owns the channel (traditional, contractual, or corporate systems), and the level of customer contact needed in terms of using direct channels or indirect channels. Personal customer contact is a major issue due to changing customer expectations and buying behavior.

Selecting the channels: Based on the objectives to be fulfilled, the company may decide to select a single channel or a combination of channels. The channel may include a vertically integrated system, a direct selling team, telemarketing, direct mailers, account management system, and so on.

Outcomes of the hybrid system: The effectiveness of the channel design strategy can be measured by comparing the outcomes with the expected results. Some companies may implement a hybrid channel strategy to reduce costs or improve sales and productivity. Others may use it to fulfill certain specialized requirements, which may be short-term oriented. Using a mix of channel types can give a company better flexibility and also reduce risks. Environmental uncertainty may force organizations to adopt hybrid channel strategies that focus on improving the flexibility of operations. A high level of personal contact leads to improved sales results. Low-contact channels reduce the cost of operations.

Thus, different hybrid channel strategies can be formulated to ensure the desired outcomes.

Adapted from Filipe Coelho and Chris Easingwood, "Multiple Channel Structures in Financial Services: A Framework," Journal of Financial Services Marketing, August 2003, Volume 8, Issue 1, 22-34.

It is very difficult for managers to decide upon the number of channels required to successfully fulfill the company objectives of increasing market coverage or reducing costs. Exhibit 19.4 describes a framework that can be used to develop strategies needed to design successful hybrid marketing systems.

Managing hybrid channel systems

Managing hybrid channels is a difficult task since hybrid systems invariably lead to conflicts between channels. Conflicts arise due to the resistance of existing channels to the introduction of new channels. The resistance is due to the fear that the new channels may erode revenue as well as the customer base serviced by existing channel(s). To effectively manage the hybrid channel system, the manager must be able to identify the source of conflict, assess its magnitude, observe the reaction of customers and channel members, and analyze the time needed to solve such conflicts. The intensity of these variables will vary for different industries. Companies manage hybrid channels by servicing the large customers through a direct sales force and the small-size customers through other less expensive methods. Customer characteristics, geography, and products help to avoid overlapping of tasks, which leads to intra company competition. Customer characteristics include size of customers, size of orders, and complexity of decision-making. Decision-making is simple for commodity products and complex for technical/specialty products. Different channels can be used for different countries or continents. A direct sales force may be used for the US market and distributors for the Japanese market. Xerox Corporation makes use of the product characteristics to differentiate its channels. It makes use of the direct sales force for selling high-end machines, and retail channels (mass merchants, electronic and appliance stores) to sell its low-end office-automation products.

Though there are many ways to manage multi-channel systems, they can be clubbed into two approaches -- the monolithic system and the pluralistic system. In the monolithic system, the wholesaler or distributor sells the products to customers through a single distribution channel. A monolithic system consists of both direct channels and the indirect channels where each channel is assigned to perform different channel functions for different segments. For example, Becton Dickinson's VACUTAINER Systems division (BDVS), which sells blood collection tubes and needles to different segments for different applications, uses the monolithic system. In a pluralistic system, the supplier sells different products through different channels for different segments. Usually to avoid channel conflicts, channel functions are separated on the basis of type of products. For example, Ingersoll-Rand's Stationary Air Compressor Division (SACD) produces a range of compressors in different sizes using different technologies. SACD makes use of the direct sales channel, independent distributors, and manufacturer's representatives to sell compressors of different configurations and sizes to different customer segments.

The hybrid marketing system can be managed effectively by ensuring that the channel structure and policies support the overall objectives of the hybrid system. Second, it should not lead to any hurdles in the systematic flow of revenues through the different channels. For example, some companies have compensation policies that pay employees in older channels to permit employees in newly introduced channels to sell the products or services.

Modern technical systems are being used as tools to ensure the effective functioning of hybrid marketing systems. The Marketing and Sales Productivity (MSP) system is one such tool that helps to develop and customize channels according to the customer needs. Exhibit 19.5 describes the Marketing and Sales Productivity (MSP) system.

Advantages and disadvantages of hybrid channel systems

Some of the advantages of using hybrid channels are better product promotion, reduction in transaction costs, increase in market and customer coverage, and the benefit of developing a customized approach to selling and distribution of products. Generally, companies keep adding new channels without any proper distribution strategy in an effort to cut costs and increase market coverage. This finally leads to a host of problems. The channels may not be well integrated, and so it may not result in the expected synergic effect. Sometimes, the channel structures may not match the external environmental conditions. It is crucial to remember that whenever an organization ventures from a direct channel to an indirect channel or vice versa, it always inadvertently leads to the creation of a hybrid system. Some of the problems

Exhibit 19.5

Marketing and Sales Productivity System

The Marketing and Sales Productivity (MSP) system is used to effectively manage a successful hybrid marketing system. This system consists of a marketing database that is centralized and updated regularly. It contains information on customers, products, and marketing plans. The advantage of this system is that it gives access to specific information like characteristics of certain customers, quotations, needs of customers, techniques of selling, etc., Such information allows the organization to keep track of costs and productivity and avoid channel conflicts. The MPS system also helps to generate leads, manage customers, and coordinate the different channel functions efficiently. Another significant advantage of the system is that it enables a company to develop a tailor-made or customized channel offering.

Adapted from Rowland T. Moriarty and Ursula Moran, "Managing Hybrid Marketing Systems," Harvard Business Review, November/December 1990, Volume 68, Issue 6, 146-155.

that arise include overlapping of the functions of different channels, problems associated with monitoring and controlling the different channels, and conflicts between the different channels that compete for the same customer base.

Hybrid channels are being effectively used in the services industry, especially the financial services industry. Insurance and banking companies make use of hybrid marketing systems to customize and sell their portfolio of products. The banking industry makes use of a variety of channels such as telemarketing, Internet, digital TV, kiosks, direct mail, ATM etc., to sell its products.

SUMMARY

Companies the world over produce millions of dollars worth of goods for consumers. These goods reach the end-consumer through a maze of distribution systems. Over the last few decades, companies have realized that effective distribution systems can be a source of competitive advantage. Companies can develop their own distribution channels or delegate the functions to different channel members through channel integration. Channel integration involves streamlining the different channel activities and information flow in a manner that leads to mutual benefits to all the partners concerned. The advantages of channel integration are manifold. It reduces transaction costs, improves inventory management, reduces business opportunism, acts as a barrier to new entrants, bridges the time, space, and variety gaps between production and consumption and reduces the business opportunities lost due to stock-outs and delayed delivery.

To gain the advantages of integration, companies have adopted vertical marketing systems. VMSs have emerged as the dominant mode of distribution over the traditional systems. In a VMS, one of the channel members may own the others, influence the others due to better bargaining power, or develop a contractual arrangement with the different channel members. The three types of VMS's are administered, contractual, and corporate. An administered VMS is similar to a conventional distribution system except that there are greater inter-organizational relationships and sharing of an overall objective. Contractual VMS consists of independent firms operating at different channel levels and forming a system on a contractual basis. Contracts direct the channel members to cooperate with each other for mutual benefits. Franchising is one of the best known forms of this system. The other popular forms of contractual system are the retailer-sponsored cooperative organizations (RCOs) and the wholesaler sponsored voluntary organization (WVOs).

In a corporate VMS, one of the channel members exerts complete control over the rest of the channel partners and everyone follows the objectives and procedures as dictated by this dominant channel member.

The benefits of VMSs include improved profitability, better control on the product quality, increased efficiency in inventory management, increased ability to respond to changing market needs, better economic control, improved marketing know-how, decrease in costs leading to better competitive advantage, stability in operations, and reduction in risks arising from competitor actions. Another principal benefit that prompts many companies to vertically integrate is differentiation.

A new concept that has emerged is value-added partnerships. In this form of integration, small firms come together and form a system. Here, each participating channel member performs a single channel function at a particular channel level.

A horizontal marketing system is another approach that has gained widespread support. It is an arrangement within a distribution channel in which two or more firms at the same channel level work towards a common goal. In this system, the participating organizations usually operate in different segments and are unrelated. The advantage of this type of arrangement is that the firms pool together resources and skills the others do not have, with the objective of exploiting the available market opportunity. Most companies operate through a strategic alliance or a joint venture.

Hybrid channel systems develop when organizations begin to use a number of channels to sell their products. These channels include a direct sale force, direct mail, telemarketing, catalog selling, and retail selling. The advantages of using hybrid channels include better product promotion, reduction in transaction costs, increase in market and customer coverage, and the benefit of developing a customized approach to selling and distribution of products. Designing hybrid systems involves identifying the tasks required to fulfill the desired objectives and then segregating the selling tasks and assigning them to the respective channels. Designing hybrid systems involves determining the channel characteristics, identifying the channel mix properties and selecting the number of channels that will bring about the desired outcomes. To effectively manage the hybrid channel system, the manager must be able to identify the source of any conflict, assess its magnitude, observe the reaction of customers and channel members, and analyze the time needed to solve the conflict. Modern information systems have enabled organizations to effectively manage the hybrid channels and avoid overlap of activities and draining of resources.

Chapter 20

Channel Management

In this chapter we will discuss:

- Recruiting channel members
- Criteria for selecting channel partners
- Motivating channel members
- Evaluating channel members
- Modifying channel arrangements
- Managing channel relationships

In the present day competitive market environment, customers seek convenience and service, while purchasing goods. At the same time, distributors are becoming more organized with regard to operations and providing specialized services. In this scenario of growing customer expectations, it is extremely important for companies to manage their channels effectively. Efficient channel management helps companies decrease costs, reach potential customers and make profits. Factors such as convenience and service are not under the direct control of manufacturers as intermediaries play a key role in providing these to customers. Additionally, as distributors are becoming increasingly specialized, it is all important to have effective organization and management.

There are some key aspects managers should consider for managing channels better. First and foremost, the company has to select and recruit the right channel members. Once this is done, it has to focus on motivating channel members and increasing the firm's profitability. Later, the company has to constantly evaluate the performance of channel members to ensure that they remain competitive in the market. Based on market changes, managers should accordingly modify their channel arrangements. Exhibit 20.1 and 20.2 discuss some critical aspects of managing channels effectively.

In this chapter, we will discuss the selection and recruitment process of channel members, the criteria for selecting channel members and how to motivate and evaluate them. The chapter concludes with a discussion on managing channel relationships.

RECRUITING CHANNEL MEMBERS

To be successful in the market, companies have to focus on strengthening core competencies and outsource other activities. Distribution channel function is a key area that can be outsourced, but channel members have to be selected carefully. This is very important for any company as they represent the company in the market. Replacing existing channel members is a complex phenomenon, especially in international markets. Therefore, firms have to tread cautiously while recruiting so that an ideal channel member can be selected. An ideal channel member will be one who will serve the right customer at the right time with the right attitude. For selecting channel members, who suit the company's requirements, a careful recruiting and screening procedure is essential.

Exhibit 20.1

Effective Channel Management

If a company fails to manage its channels effectively, it is putting itself at greater risk in the present competitive environment. Channel structure and design are changing quite frequently to adapt to the evolving business environment. However, manufacturers need not always redesign their channels to achieve better performance. Efficient channel management also ensures profitability in the marketplace.

Incentives are a critical factor in channel management. However, they should be provided only to deserving channel members. It is always better to customize incentives to different channel members based on their performance rather than offering incentives uniformly. Training is another critical dimension of effective channel management. Training distributors on crucial issues such as customer purchasing patterns will help distributors greatly in increasing sales volume.

Adapted from John M. Abele, William K Caesar *and Roland H. John, "Rechanneling Sales,"* *McKinsey Quarterly, 2003, Issue 3, 64-75.*

Exhibit 20.2

Tips for Effective Management of Channel Partners

For managing distribution channels effectively, the company should devise suitable strategies. Some key distribution management strategies for manufacturers are:

Understand purchase behaviour of end users: It is essential for manufacturers to assess customers to find their most preferred channel. If needed, manufacturers should conduct a survey to analyse the purchase habits of customers.

Develop a clear vision: Manufacturers should have a clear vision about what they are expecting from distributors and what they will offer them in return.

Understand the needs of end customers: Manufacturers have to understand the expectations of end users so that they can select the right kind of distributors.

Gain expertise on the distributor's business: Manufacturers must understand what makes distributors successful in their business and what should be done to motivate them to perform better.

Gain better insight on target market: Manufacturers have to gain better understanding of the markets they are serving. Leaving everything about managing markets to the distributor will be disadvantageous to the company. A manufacturer should have thorough knowledge about the market, sales patterns, weightage enjoyed by the company's products in the distributor's product line, the distributor's marketing strategies and so on. Knowledge of these factors significantly helps manufacturers select and manage the right channel partners.

Involve distributors in planning: Manufacturers should seek active participation of distributors in planning. Developing plans on which markets and customers to target and the key functions of each channel member are some issues that are an integral part of planning.

Develop common programs: Manufacturers should coordinate with channel members to develop common strategies to cut costs and enhance profits. Media strategies, communication strategies and inventory strategies can be commonly developed by both manufacturer and distributor.

Develop distributor assistance programs: Manufacturers have to develop proper distribution assistance programs, where suitable communication strategies are designed in order to attract customers to purchase the company's products from the distributors.

Adapted from Todd Englander. "Managing Middlemen – Issues Strategies and Resources." <http://www.cardex.com/articles/7030.html >

Once companies recognize the significance of recruitment and selection of proper channel members, they should start recruitment by considering some guidelines that should be followed for effective recruitment. The first is to assess the exact role to be played by channel members, in other words, the nature of the job they have to perform. Then, the qualifications of the channel member have to be analysed in terms of the firm's requirements. Subsequently, the authority to be delegated to channel members needs to be specified. Finally, changes that may occur in the future with regard to the role played by channel members has to be specified.

Recruiting as a Continuous Process

Recruiting channel members should be a continuous process for two main reasons. The first, obvious one is that channel members may leave the organization. The other is that the organization might feel the need to change existing channel members. Therefore, recruitment of channel members has to be a continuous process. Factors influencing these reasons can be numerous. For instance, a change in the company's product policy may need new types of channel members. Alterations in customers' tastes and preferences will also influence the company to change existing channel members if they are unable to cater to the changed conditions.

Recruiting Manufacturers

It is not that manufacturers only recruit channel members, it can be the other way round too. In recent times, there is a growing number of retailers who choose the right kind of manufacturer for maximizing their sales.

Screening

Screening is done for the process of elimination. In the channel member recruitment process, screening involves elimination of applicants who do not match set criteria. There are certain guidelines for screening channel members. The foremost is to screen based on the market segments the channel members have to serve. The second is to assess the channel member's capability to serve the market and compatibility of service with the product's stage in the product life cycle. As distribution requirements change during the different stages of the product life cycle, it is essential to select channel members who best suit these requirements. For instance, if a new type of air purifying equipment is launched, it needs highly specialized distributors during the initial stage of the product life cycle. They should be able to explain technical intricacies to customers clearly. Once the product reaches the maturity stage, specialized distributors are not needed for demonstrating technical details to customers, as they are well aware of the product and its usage. Usually, manufacturers tend to select distributors who are successful in the market. But, successful distributors carry a large number of products and may not have space for more products. However, this does not mean manufacturers should settle for sub-standard or ineffective channel members. Instead, they should select appropriate channel members who can allocate sufficient time for effective distribution and improve sales. This is especially important in the present environment where customers are keen on convenience and service while making purchase decisions. Finally, the last criterion for screening channel members is support. If channel members need financial and strategic support during the initial stages of the relationship, the company can extend such support, if it feels that the accrued benefits will offset the costs involved. Otherwise, the company should screen out such applicants.

CRITERIA FOR SELECTING CHANNEL PARTNERS

Once screening is over, the firm will be left with a small list of potential channel members for selection. From this list, the company has to spot the most suitable channel members who will best fit its requirements. Some criteria for selecting channel partners are sales, product, experience, administrative and risk factors. Let us elaborate these.

Sales Factors

The primary factor to be considered while selecting channel members is the member's ability to sell the company's products in the market. Apart from sales factors, the channel member's knowledge and expertise of the market are also important preconditions for selection.

Product Factors

Product factors involve the channel member's expertise and knowledge of the products to be handled. The channel partner's ability to handle products effectively and deliver the required after- sales services to customers are primary factors that determine selection of a channel member.

Experience Factors

It is important to have a look at the distributor's experience. Assessing the type of customers handled in the past and their satisfaction levels will provide a good insight and help selection of channel members.

Administrative Factors

Administrative factors such as the amount of work the channel member is handling and the distributor's pricing patterns are some factors that have to be considered at this stage for evaluating channel members.

Risk Factors

Risk factors include evaluation of the potential channel member's past performance, the channel member's commitment to the organization's progress, costs incurred in selecting a member and subsequent dealings with all stakeholders of the company.

MOTIVATING CHANNEL MEMBERS

As channel members act as intermediaries between manufacturers and end consumers, companies have to ensure that channel members are motivated enough to put in their best. To develop motivational measures, it is important for firms to first understand the different needs of channel members and the problems they face from time to time. For instance, Intel decided to let channel members choose the advertising media for effectively reaching out to its customers. Distributor advisory councils help firms determine the needs and problems of channel members.

Distributor Advisory Councils

As said, distributor advisory councils are necessary to determine the needs and problems of channel members. They help in information exchange between channel members and manufacturers so that both parties can understand the duties and responsibilities of one another. The role of the distributor advisory council is to encourage channel members to contribute significantly to the planning process and improve channel performance. Thus, these councils give channel members a sense of belonging, which motivates them to put in their best performance. Personal contact with channel members also provides sufficient information to manufacturers about their needs and problems.

Some other strategies that can be used for motivating channel members are relationship marketing, where the manufacturer will try to forge stronger relationships with distributors, to enhance their performance. The company should offer appropriate benefits and incentives to distributors to help them improve the supply chain, reduce the capital employed, lower the operating costs, lower the risks involved, enhance customer finance schemes and engage in sales promotions.

EVALUATING CHANNEL MEMBERS

Once channel members are selected, they have to be constantly evaluated and based on their performance, the company can retain them or forge alliances with new channel members. Channel members can be evaluated using parameters like sales quota attainment, average inventory levels, proper management of inventory, channel members cooperation in promotional and training programmes, etc. It is essential for

Exhibit 20.3

Evaluating Distributors

Distributors can be evaluated on the following parameters:

- The distributor's experience in providing quality customer service.
- The distributor's capability to cover adequate markets and to search for new customers.
- The distributor's ability to manage sales, finances and inventory properly.
- The distributor's ability to meet sales targets fixed by the company's management.
- The distributor's share of the market in the assigned area.
- The distributor's willingness to carry all products of the company and serve all customers' needs.
- The distributor's annual inventory turnover.
- The distributor's warehousing facility and efficiency.
- The financial condition of the distributor relating to criteria such as fixed assets, payment records and so on.
- The distributor's ability to grow in the allocated market.

Adapted from James D.Hlavacek and Tommy J. McCuistion, "Industrial Distributors – When, Who and How?" Harvard Business Review, March/April 1983, Volume 61, Issue 2, 96-102.

the company to counsel channel members whose performance is deteriorating, provide them additional training and motivate them before deciding to discard them. Terminating the relationship should be a last resort if all these measures fail. Simultaneously, the firm should also identify channel members who are putting in profitable performance and reward them suitably. Exhibit 20.3 provides some parameters for checking channel member's performance. Usually, manufacturers evaluate performance to assess capabilities in carrying products from time to time. For instance, IBM evaluated the performance of several of its distributors and retained only a few to carry its new PS/2 range of personal computers.

MODIFYING CHANNEL ARRANGEMENTS

Companies tend to relax once channels members are in place. But this is not sufficient and channel members have to be constantly evaluated. Further, the organization should keep an open mind on modifying existing channel arrangements periodically. This is necessary because of constant changes in customer preferences, emerging competition, expanding markets and other environmental factors influencing market performance. Channel modifications can be made through product life cycle changes, customer-driven refinement of existing channels and growth of multi-channel marketing systems.

PLC Changes

It is important for companies to understand that distribution requirements for a product keep changing according to its stages in the product life cycle (PLC). No single distribution model will work for any product during its entire life cycle. If the product is in the initial stage, and is a technical product, it needs a highly specialized distribution channel, as customers have to be told about the technical aspects of the product. During the maturity stage of the PLC, the distribution channel need not be so specialized as the product becomes standard and customers get used to it. A product needs different kind of distribution channels at different stages of the PLC. For instance, if we consider toothpaste in the introductory stage, personal selling might be appropriate. When the product is reasonably successful and is in the growth stage of the PLC, it can be sold through conventional retail outlets. Once the product reaches maturity and is moving towards decline, the company may think of adding new distribution channels to attract new customers.

Customer-Driven Refinement of Existing Channels

Channel modification is an essential element for a firm's success. If channels are not modified from time to time, they stagnate and will not meet customer expectations. As a result, customers will lookout for better channels, which deliver the required value. Eventually, companies, which cannot modify existing stagnant channels, will fail in the market. It is therefore vital that companies identify changing customer requirements and meet their demands. Usually it is difficult to modify existing channels because of stiff resistance from existing channel members.

Growth of Multi-Channel Marketing Systems

Multi-channel marketing system is the process by which firms use more than one distribution channel to reach one or more customer segments. Traditionally, companies used to rely only on one distribution channel for selling goods in the market. Of late, due to increased segmentation, companies are relying on more than one channel for distributing goods effectively. The practice of adopting more than one marketing channel is also called dual distribution. Firms add channels to leverage the benefits of increased market coverage. If existing channels cannot reach potential new segments, the firm has to employ a new distribution channel that can reach the new segment. Multi-channels are developed to reach different customer segments using different strategies. For instance, Eureka Forbes, which is into water and air purification systems, may use personal selling for industries and institutions to sell its products, as they buy products in large numbers. It may resort to telemarketing for selling products to individual customers.

MANAGING CHANNEL RELATIONSHIPS

Once channels are established, they have to function smoothly without hiccups. Managing channel relationships, therefore, becomes an organization's primary function. Good channel relationships can be maintained with the help of mutual understanding between producers and intermediaries. We will now discuss some factors influencing a firm's channel relationship.

Cooperation and Coordination

Maintaining proper relationships with channel members by actively seeking their cooperation and coordination will be advantageous to the company and help it utilize its resources optimally. Here, cooperation can be defined as a channel member's willingness to work with another channel member by developing similar policies, strategies and procedures. For cooperation to exist, it is first important for channel members to coordinate with each other. Coordination can be called the combined efforts of channel members to achieve the channel objectives.

Conflict

If channel members are working in a way that will jeopardize the goal attainment of other channel members, conflict is bound to arise. There are two stages of channel conflict -- the affective/perceptual stage and the manifest stage. In the first, it is perceived that conflict exists. In the second, action is taken based on this perception. A channel member's behaviour, which hampers goal attainment by other channel members, will lead to manifest conflict.

Power

A channel member's capability to change the behavior of another channel member can be termed channel power. There will be no question of power existing if channel members completely agree on all issues. A channel member becomes powerful if it possesses resources that are valuable to other channel member. There are five common types of power relationships:

Coercive power: Coercive power exists when one channel member (A) has the capacity to punish the other (B), if (B) is not willing to accept what (A) says. A channel member can extend coercive power on another by decreasing profit margins or by withdrawing exclusive rights given earlier. For instance, manufacturers may reduce profit margins for certain retail outlets if they are not maintaining the specified standard of service.

Expert power: A channel member can acquire power if it possesses knowledge relevant to other channel members. Expert power is held by a channel member when it has special knowledge required for proper functioning of the channel. For instance, manufacturers and wholesalers provide retailers with training on sales and promotional activities. Expert power, however, cannot be retained for long periods, as the required expertise is passed on to other channel members gradually. Channel members, therefore, try to retain expert power by methods like limiting the share of expertise and continuously updating themselves on the latest information so that they can pass this on to other channel members.

Legitimate power: This power exists when one channel member exerts power on the other, based on legal authority. A contract between two channel members can be a source of legitimate power. If channel member 'A' asks channel member 'B' to perform according to the contract, then it is legitimate power wielded by 'A'. Manufacturers and wholesalers possess legitimate power over retailers.

Referent power: This is power based on a channel member's association or identification with other channel member. Referent power can be found in marketing channels where manufacturers feel proud, if their products are carried by well- known outlets. For instance, a small manufacturer of apparels may take pride if his or clothes line is displayed in leading retail outlets like Shopper's Stop or Lifestyle. Thus, the manufacturer can exercise referent power over other channels.

Reward power: Reward power is exercised by a channel member over others when it has the ability to reward them. Manufacturers wield this power by rewarding channel members who are performing better. These rewards can be in terms of higher margins, different promotional allowances, discounts, etc.

These are the various power bases exercised by channel members to achieve their objectives. In practice, they are used in combination for better results.

SUMMARY

Managing channels is one of the most important dimensions of businesses across the world for improving their value in the market. Customers are constantly on the look out for convenience and service, when purchasing goods. Effective channel management helps companies decrease costs and reach potential customers profitably. Effective channel management involves proper recruitment of channel members. Recruiting channel members should be a continuous process. In the recruitment process, screening involves elimination of applicants who do not match the criteria set for the position. After effective screening, the company has to make the final selection based on some criteria. These criteria can be divided into sales factors, product factors, experience factors, administrative factors and risk factors.

After selecting channel members, they have to be constantly evaluated and based on their performance, the company will either retain existing channel members or try to forge relationships with new channel members. Channel members can be evaluated by using parameters like sales quota attainment, average inventory levels, proper management of inventory, channel members' cooperation in promotional and training programmes, etc. The distribution requirements of a company will keep changing according to changes in the product life cycle. Modifying channels accordingly is essential for the success of the organization. However, care should be taken in dealing with channel members for proper channel management. Conflict management among channel members is another important activity for the management of the organization.

Part V
Channel Control

Chapter 21

Evaluating Channel Performance

In this chapter we will discuss:

- Performance measures in marketing channels
- Models to diagnose channel profitability
- Appraisal of channel members’ contribution
- Result of channel performance

A distribution channel consists of several relationships that assist channel members in carrying out various channel functions. Suppliers tie up with various intermediaries in the distribution channel as the latter help suppliers or manufacturers achieve the objectives of making products available to end customer cost effectively. While designing or structuring a distribution channel, an analysis of the performance of channel partners by suppliers becomes necessary to evaluate the channel's effectiveness. Evaluation of the functioning of intermediaries or resellers should identify the ways in which they help manufacturers achieve business objectives. A distribution channel can be assessed in terms of performance dimensions such as channel effectiveness, channel efficiency, channel productivity, channel equity and channel profitability.

In this chapter, we will examine how to evaluate the performance of a marketing channel. Beginning with measures that analyse the performance of a marketing channel from the macro and the micro perspective, we will proceed to discuss strategic profit model – a diagnostic tool for estimation of channel profitability. This will be followed by a discussion on the contributions made by channel members and their appraisal using activity based costing and direct product profit. The chapter will end with a discussion on the result of channel performance that emphasizes and evaluates the quality of services offered to customers.

PERFORMANCE MEASURES IN MARKETING CHANNELS

The performance of a marketing channel can be evaluated from various perspectives. The evaluation assesses the channel's financial performance and looks into societal contributions made by individual members of the channel. From the societal perspective, the performance of marketing channels can be evaluated by measurement of overall channel performance in terms of the channel's efficiency, equity and effectiveness. To evaluate at a micro- level, an individual channel member's financial performance is determined by studying the channel tasks undertaken by the member. The following section deals with evaluation of channel performance at macro and micro levels.

Channel Performance at a Macro Level

A marketing channel's performance is measured in terms of the intermediaries' ability to meet the manufacturer's objectives. Performance at macro- level is evaluated in terms of contributions made by the intermediaries to the society. Major elements that will determine the success of an intermediary are channel efficiency, productivity, effectiveness, equity and profitability.

Channel efficiency is a channel performance dimension that judges the ability of intermediaries to undertake necessary channel functions by incurring minimal costs. Productivity deals with the extent to which the total channel investment in the form of inputs have been optimized to yield maximum outputs. Productivity and efficiency deal with maximizing outputs for a given level of inputs while keeping costs down irrespective of problems encountered during the distribution process. The channel's performance is also measured by the intermediary's assistance to suppliers in meeting their objectives. . The intermediary's contribution towards the supplier's efficiency and productivity is determined by the extent of contribution to the suppliers's profit and sales.

However, the CEO's of about 75 % of financial service companies perceive channel productivity as an area of concern. Exhibit 21.1 describes the symptoms that can alert distributors to poor channel productivity.

Exhibit 21.1

Symptoms of Poor Channel Productivity

The increased investment in marketing channels has not been accompanied by a commensurate rise in channel productivity. Most distribution channels suffer from low productivity, the symptoms of which are discussed below.

- The costs incurred on the distribution channels increase considerably without a corresponding hike in returns from the channel.
- The inability of existing channels to perform leads to the emergence of new channels, which add to costs instead of increasing returns.
- The availability of numerous ineffective channels leads to customer dissatisfaction.
- The number of personnel managing channels goes up considerably as there is no cross-channel responsibility.
- Customer satisfaction is ignored as competition within channel managers leads to each manager focusing on the performance of his or her own channel.
- Channels do not share valuable information that will improve channel performance.
- Lack of coordination between front-office and back-office transactions results in inconsistent and inefficient channel performance.
- As customer satisfaction cannot be measured using channel performance, it cannot be improved by bettering channel performance.

Adapted from "Evaluating Distribution Channel Issues," <http:// www.cincom.com/ financial/ channel/ issues/evaluating/evaluating.htm>

Channel effectiveness is another dimension that measures channel performance and considers its ability to satisfy customer needs. It focuses on issues like lot size, delivery time, location convenience and assortment breadth. It has been observed that channel effectiveness in industrially and technologically developed countries is usually higher than that in developing countries. Developed countries meet customer demands better and cost effectively as well.

Channel equity refers to the distribution of opportunities available to all customers in accessing the market channels of a region. It has been observed that even in advanced countries there is no equitable distribution of accessibility of marketing channels. Even in countries like the U.S, the under- privileged see no equity in distribution and pay more for products of inferior quality.

Channel profitability is concerned with a channel member's financial performance and is discussed in the section "Models to diagnose channel profitability."

Channel Performance at a Micro Level

Channel performance at micro- level involves a closer look at the performance of individual intermediaries associated with a marketing channel. Each intermediary should aid the manufacturer attain the objectives of goal attainment, pattern maintenance, integration and adaptation.

Goal attainment refers to achieving the firm's goals by interacting with the task environment and maximizing outputs given the constraints of costs and company-specific obstacles.

Pattern maintenance involves coordination of processes and functions among organizational units to help the system function smoothly.

Table 21.1: Framework for Assessing Reseller Performance

Supplier's Objective	Reseller's Objective	Reseller's Contribution
Goal- attainment	Efficiency	Contribution to profits
	Productivity	Contribution to sales
Pattern maintenance	Human resource development	Reseller competence
Integration	Stability	Reseller loyalty
	Control	Reseller compliance
Adaptation	Growth	Contribution to growth
	Adaptation	Reseller Adaptability
	External legitimacy	Customer satisfaction

Adapted from Nirmalya Kumar, Louis W. Stern, "Assessing Reseller Performance from the Perspective of the Supplier," Journal of Marketing Research, Volume 29, Issue 2 (May 92):238-254.

Integration refers to the coordination among the components of a channel or an organization to meet common objectives and maintain the entity as one single unit. Adaptation is the modification of resources required to meet system objectives.

An organization must be able to fulfil all four objectives to facilitate smooth functioning of the system. Table 21.1 presents a framework to assess the reseller's performance from a seller's viewpoint.

An intermediary's or reseller's performance and their contribution towards the manufacturer's objectives can be measured on three different types of scales -- the facet scale, global scale and composite scale.

Facet scales are used for a detailed study of any facet of reseller performance like sales performance, financial performance, reseller competence, reseller loyalty, reseller compliance, reseller adaptation, reseller growth or customer satisfaction. These facets can be used as measures of reseller performance. Global scales are used for summarizing the performance or contribution based on a few performance parameters. Composite scales require individual facets to be added as it is assumed that an entity is made up of its components.

MODELS TO DIAGNOSE CHANNEL PROFITABILITY

Apart from measuring a reseller's contribution to meeting the manufacturer's objectives, evaluation of channel performance also involves measuring the financial performance of a reseller or a channel intermediary. In other words, channel profitability has to be analysed.

Channel profitability is a dimension that considers the financial performance of channel members in terms of Return on Investment (ROI), liquidity of the channel member, financial leverage, growth pattern and potential for sales and profits.

Of all the financial dimensions, profitability or ROI is accepted as a good performance indicator in both the wholesale and retail trades. Profitability forms an important element in ascertaining the financial well being of a business. The Strategic Profit Model (SPM) functions as an efficient tool to evaluate the profitability of channel members.

The term 'profit' is somewhat ambiguous in terms of its reference. It is sometimes used for profit before tax, sometimes for profit after tax and sometimes for dollar (or any currency) profit. However, return on net worth (RONW) is the most commonly used measure of profitability and the SPM uses RONW to measure the profitability of a business.

Strategic Profit Model

The SPM is a tool for planning and evaluating the financial performance of a business. It considers RONW as the most informative and significant measure of profitability of a business. It uses data from the income statement as well as from the balance sheet to measure profitability and performance of a business. The formula used in strategic profit model is given below.

$$\boxed{\text{Profit Margin}} \times \boxed{\text{Asset Turnover}} = \boxed{\text{Return on Assets}}$$

$$\boxed{\text{Return on Assets}} \times \boxed{\text{Financial Leverage}} = \boxed{\text{Return on Net worth}}$$

The formula can be broken down as:

$$\text{Profit Margin} = \frac{\text{Net Profit}}{\text{Net Sales}}$$

$$\text{Aseet Turnover} = \frac{\text{Net Sales}}{\text{Total Assets}}$$

$$\text{Return on Assets} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

$$\text{Financial Leverage} = \frac{\text{Total Assets}}{\text{Net Worth}}$$

$$\text{Return on Net Worth} = \frac{\text{Net Profit}}{\text{Net Worth}}$$

Hence, the formula for the strategic profit model can be simplified into:

$$\frac{\text{Net Profit}}{\text{Net Sales}} \times \frac{\text{Net Sales}}{\text{Total Assets}} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

$$\frac{\text{Net Profit}}{\text{Total Assets}} \times \frac{\text{Total Assets}}{\text{Net Worth}} = \frac{\text{Net Profit}}{\text{Net Worth}}$$

The SPM identifies three areas, which have to be focused on to improve a firm's return on net worth. A firm can maximize its profitability in terms of RONW through profit margin management (net profit/net sales), asset management and debt management. Management of profit margins, assets and debt are discussed in detail in the following section.

Profit margin management

A significant and perhaps vital factor for an owner is the profit margin (net profit/net sales). The net profit margin considers profit as a percentage of sales. The ratio is useful for planning and analysis as it describes the way in which a firm manages its costs in relation to its revenues. Margin management involves planning and controlling sales and expenses and plays an important role in improving business profitability.

Asset management

Another factor expressed in the SPM that can help a firm improve financial performance and profitability is its assets. The utilization of an asset is commonly determined by its turnover ratio that measures the amount of sales generated for each dollar of investment in assets.

Asset turnover ratio is calculated as:

$$\text{Assets Turnover} = \frac{\text{Net Sales}}{\text{Total Assets}}$$

A higher turnover ratio indicates that assets are being converted into sales more number of times and is an indicator of better productivity. However, for comparison of a firm's financial performance with other industries, the asset productivity has to be measured in terms of profits. The return on assets ratio measures the ratio of net profit to total assets. It relates the profit margin percentage and the asset turnover ratio to obtain the ratio of net profit to total assets, that measures the asset productivity in terms of profit.

$$\frac{\text{Net Profit}}{\text{Net Sales}} \times \frac{\text{Net Sales}}{\text{Total Assets}} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

i.e. Profit Margin × Asset Turnover = Return on Assets

The management can work towards better asset turnover by increasing sales for a given level of assets or decreasing assets for a given level of sales through better management of current assets like cash, accounts receivable etc.

Financial leverage

Return on assets measures the effective utilization of the firm's assets but does not assess the return on net worth. A company can maximize its profitability using debt management as a tool. Debt management for a firm involves considering the cost of debt, the impact on shareholders and the company's financial soundness. A company uses bonds, debentures etc. as instruments of borrowing to raise debt capital. Financial leverage is one of the elements in debt management and refers to the contribution of owners and creditors in financing a firm. The leverage ratio is a measure of debt capital that a firm has used. It establishes a relationship between total assets and net worth and measures the leverage taken by the owners of the company using their capital or the net worth.

Leverage ratio is calculated as

$$\text{Leverage Ratio} = \frac{\text{Total Assets}}{\text{Net Worth}}$$

To decide the composition of owners' and creditors' funds in the capital structure, the management has to consider costs associated with debt and equity. The cost of debt covers the interest rate to be paid on borrowed funds, while cost associated with equity refers to the rate of return to be paid to shareholders. The company has a greater obligation in terms of interests to be paid to bond, debenture or other debt holders. Interest to debt holders has to be paid before shareholders are paid their returns as the former do not have ownership rights in the company and are legally entitled to receive payments before shareholders. Since the risks assumed by a debt holder are less (as payment is more or less guaranteed) than those of shareholders, the rate of interest earned by debt holders is less than returns earned by shareholders. The difference in rates of return earned by debt holders and shareholders leads to financial leverage. Financial leverage deals with increasing the debt component in the capital structure so that returns to shareholders are maximized due to the lower costs associated with the debt component. In other words, financial leverage involves using an optimum debt component in the capital structure to maximize shareholders' returns. Financial leverage rises with an increase in debt.

Impact on net worth

When the rate of interest to be paid to debt holders is higher than returns to shareholders, bringing in additional debt will lead to a reduction in a firm's net worth. A higher debt component is not advisable in times of high interest rates.

Higher leverage in capital structure should be carefully considered as it has an inherent risk of bankruptcy if the company is not able to make regular payments to creditors.

Thus, the strategic profit model identifies the best way to achieve a company's financial targets through systematic control and evaluation of margin management, asset management and debt management.

Economic Value Analysis

Managers use EVA as a tool to determine the true cost of capital, to decide on financial resource allocations. EVA considers the cost of both debt and equity capital. EVA ensures that capital is allocated most efficiently. It is extensively used in cases that require decisions on cost justification. It is determined as the difference between the net operating profit after tax and the total cost of capital.

EVA is computed as

EVA = after-tax operating profit – total annual cost of capital

EVA also examines the capital used by an intermediary in the distribution channel.

APPRAISAL OF CHANNEL MEMBERS' CONTRIBUTION

A firm's financial performance is analysed through the SPM and economic value analysis. These also serve as tools to improve productivity and profitability of intermediaries in a marketing channel. However, to study channel performance in detail, activity based costing and direct product profitability have to be used.

Activity Based Costing

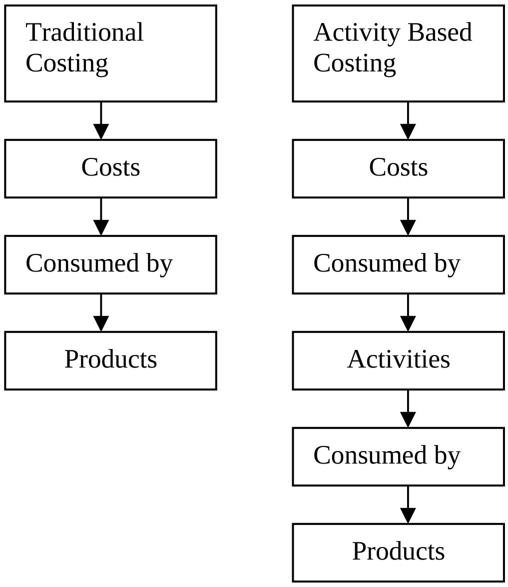
Activity based costing (ABC) is a method that calculates the cost of a product or service depending on the activities that constitute the making of the product/service. It measures the cost of performing activities within an organization and provides accurate cost information to decision makers. ABC provides better reports of overhead costs involved in the production process by considering all indirect and support expenses incurred and linking them with activities and processes. These costs are then associated with the products or services concerned.

The basic assumption of ABC is that the manufacture of a product leads to a series of activities that govern associated costs, unlike classical or traditional costing, where it is assumed that costs are directly governed by the products or service.

Figure 21.1 represents these approaches diagrammatically.

ABC performs a micro- analysis and identifies all activities associated with production of a particular product or a group of similar products, irrespective of the size of the group or the number of products in each category.

Figure 21.1: Traditional Vs Activity Based Costing



Adapted from "ABC-The Road to Cost Management, "TCM Bulletin on Activity Based Costing (ABC), CII TCM Publication

The identification of activities is followed by a description of revenues generated and resources utilized by each activity. This allows a manager to prioritize activities based on revenues and costs associated and focus on top priority activities. The managers can separate the expenses and associate them with a level of activity and resources utilized. They must find means to carry out activities with lower resource utilization. Reduction in utilization of resources for a given level of output or an increase in output for a given level of resources, contributes directly to increased profits.

Usage of ABC has helped companies like Procter & Gamble to increase profits as it enables cost-revenue analysis at a micro- level. Controlling costs by looking only at financial statements will not help managers, as control over expenses cannot be exercised from a macro- level.

Managers can use ABC to identify activities related to a segment of business, ascertain revenues, resources and costs associated with activities and take necessary steps to earn more profits. Refer to Exhibit 21. 2 for Hewlett-Packards's activity based analysis.

Activity based costing involves:

- Activity accounting: This involves determining product costs accurately. Special emphasis is laid on attributing overhead costs related to production, unlike in traditional accounting.
- Cost drivers: Cost drivers are activities that incur costs.
- Direct traceability: Costs are allotted to products or processes on which they are incurred, allowing managers to track them at any point of time.
- Identification of costs that do not add value: Costs that do not add any value to the product or service, or the process concerned are identified so that they can be minimized or eliminated.

Exhibit 21.2

Hewlett-Packards's Activity Based Analysis

Hewlett Packard, a world leader in manufacturing PCs, computer systems, printers, scanners, and workstations, has four product distribution centres across the world. Hewlett-Packard's North American Distribution Organization (HP-NADO) alone distributes 21 product lines through its six customer resale channels. In 1994, HP-NADO distributed products worth nearly $7 billion through five depots to more than 300 principal resellers nationwide. The distribution centres were in need of better and accurate business information to help them and their business partners to take better decisions.

The primary manufacturing plants at Hewlett-Packard procured raw material from suppliers and produced standardized versions of the company's products. The products were then dispatched to various distribution centres, which customized them to specific markets. This was followed by packaging and shipping to Hewlett-Packard's main reseller channels.

Due to the numerous steps involved in customization and the bulky volume of products, tracking costs of products and services was tedious. Moreover, Hewlett-Packard was using a traditional costing process that spread overhead costs across the entire organization. The management at Hewlett-Packard needed more accurate business information about the costs incurred by distribution centres to know their impact on the company's profitability. This was essential to identify areas for cost reduction.

Activity based analysis helped Hewlett-Packard analyze both product profitability and customer profitability. It allowed the firm to assess the relative cost of its major customers and customer segments, products and product segments and distribution channels. The data generated through activity based analysis provided the management with significant information about the company's customer and product profitability. The data revealed that customer behavior showed wide degrees of variability in profitability, though customers purchased the same products or product lines. It was found that the company's least profitable customers generated multiple enquiries related to order status or product availability and submitted numerous unnecessary billing enquiries.

On the other hand, the most profitable customers generated very few additional order fulfilment or billing demands. This might have been due to higher levels of channel integration and information sharing measures taken by the company using electronic data interfaces. The valuable information provided by the activity based analysis helped Hewlett-Packard improve its profitability by pinpointing areas where it was incurring additional and avoidable costs.

Adapted from Tom Freeman, "Transforming Cost Management into a Strategic Weapon,"<http://www.cam-i.org/columns/transforming.pdf>

ABC is combined with Economic Value Added for better understanding and calculation of after-tax profitability.

The concept of ABC can be applied to distribution channels for cross comparison of productivity and costs incurred across channels. An activity based costing process in a distribution channel involves identifying the channel resources used and costs incurred in making the product reach end users, allocation of costs to specific channel activities, allocating flow costs by channel and preparation of profit and loss accounts for each channel.

ABC has been applied in diverse fields like education, health care, financial services etc. Modern firms use ABC to measure channel performance, to study channel strategies and the way changes in channel activities affect the channel and the supply chain. Though ABC was initially used to calculate product costs, it has evolved to become a tool that can help managers increase profits by reducing costs wherever possible. ABC has helped marketing channels by providing superior and accurate cost related information that has helped channel members in improving profitability.

The growing application of IT has also contributed towards enhancing the functionality of ABC. Using activity based decision support systems has helped many companies to manage costs to their advantage. The tools offered by the decision support software provide a wide range of functionality to managers. They offer a broad range of services starting with activity analysis at the basic level to a fully integrated ABC and management system. The software's cost accounting capabilities offer the functionality of cost analysis, internal cost controls and analysis of funding opportunities.

Hence, ABC makes it clear that a complete understanding of organizational activities and costs involved with each activity is mandatory for efficient cost management. It helps a channel intermediary improve his performance through evaluation of benefits accrued and costs incurred.

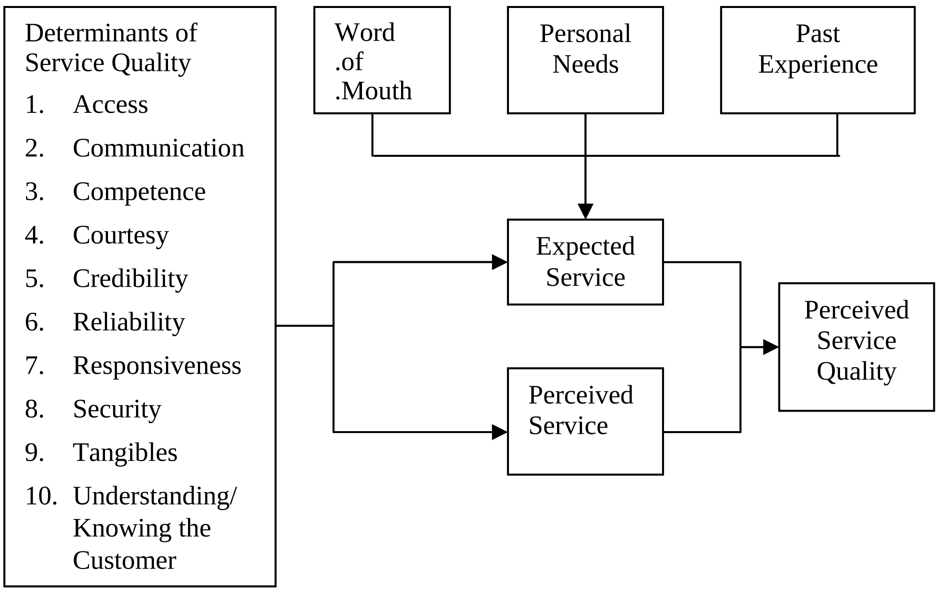
Direct Product Profit

Allotment of shelf space is an important parameter for sellers as products differ in their contribution to sales and profits. Channel members give more priority to allocation of shelf space to profitable items. Different approaches like mathematical programming, non- linear programming and direct product profit (DPP) are adopted by intermediaries while allocating shelf space. Of these, DPP is an important tool used by retail outlets for shelf management.

Direct product profit represents a product's contribution to the channel member's profits. DPP is a method used to derive contribution to profits on the basis of an item's gross margin.

DPP looks beyond gross margins as it is believed that gross margin alone might not reflect a product's true performance. It subtracts direct costs like warehousing costs, delivery costs and costs incurred in placing products on the shelf, from gross profit. Any cash discounts offered are added to gross profits.

Figure 21.2: Customer's Perceived Service Quality



Adapted from Parasuraman A., Zeithamal Valarie A., Berry, Leonard L., "A Conceptual Model of Service Quality and its Implications for Future Research", Journal of Marketing, 49 (Fall 1985):41-50.

Financial performance of individual items is taken into account to arrive at direct product profit. As individual profit and loss statements are created for each product carried by intermediaries, this method requires accounting data provided by implementation of costing techniques like ABC.

DPP helps channel members identify products that require high costs for storage and maintenance. The intermediaries then rework the packaging, sizing or distribution methods to reduce costs.

RESULT OF CHANNEL PERFORMANCE

Distribution channels comprise intermediaries who facilitate the flow of goods and services manufactured, from producers through the channel to end users. The efficiency of channel performance is measured by the quality of goods and services offered by channel members. Though there are methods available to test the quality of tangible goods offered, measures to evaluate the (intangible) quality of services offered by channel members are inadequate.

Evaluation of service quality offered is difficult both for consumers and producers. Consumers cannot evaluate service quality objectively as they perceive it by comparing their expectations with the actual service offered. Figure 21.2 gives a diagrammatic representation of the dimensions involved in a customer's perceived service quality.

Exhibit 21.3

Determinants of Service Quality

Consumers use the 10 dimensions of communication, competence, credibility, reliability, access, tangibles, security, responsiveness, understanding the customer and courtesy in framing their expectations and perceiving the quality of services offered.

- Communication: It is concerned with keeping the customer informed in simple and unsophisticated language and customizing it to customer category.
- Competence: It deals with the knowledge and skills of personnel to carry out transactions with customers. It involves competence at the operational, tactical and strategic levels.
- Credibility: It involves an honest and a trustworthy performance keeping the best interests of customers in mind.
- Reliability: It deals with consistency of services offered by suppliers in terms of billing accuracy, timely service, maintenance of records etc.
- Access: It refers to the convenience offered to customers for availing services and includes time and location convenience.
- Tangibles: It includes the physical aspect of proof of service offered, like the physical quality of the credit card, identity card and so on.
- Security: It involves protecting customers from all kinds of uncertainties. It might involve physical safety, financial security or maintaining the privacy of customers' transactions with the firm.
- Responsiveness: It deals with the willingness of employees to offer timely service to customers, such as responding to a query.
- Understanding customers: It involves getting to know customer requirements and extending individual attention to them.
- Courtesy: It is the consideration and respect shown to customers availing services.

Adapted from Parasuraman, A., Zeithaml,Valarie A., Berry, Leonard L., "A Conceptual Model of Service Quality and its Implications for Future Research,"Journal Of Marketing,49(Fall 1985):41-50

The characteristics of intangibility, heterogeneity and inseparability of services further complicates evaluation. The intangibility of services arises because they are experiences and are not physical entities with distinct identifiable features like style, color etc. Owing to the intangible nature of services, a set of standards or specifications cannot always be found for services. Hence, their quality cannot always be measured objectively.

The heterogeneity of services adds to evaluation problems. The quality and process followed for offering services are not consistent among all producers and at all times. Inseparability refers to simultaneous production and consumption of services. For most services, the production and consumption take place simultaneously. Examples are the services offered by medical practitioners, lawyers etc. Participation of clients in the delivery of services also has an impact on the quality of services offered. Such situations make evaluation complicated.

Parasuraman, Zeithaml and Berry (1985) identified 10 ten dimensions, based on which consumers perceive quality of service. Exhibit 21.3 describes the dimensions affecting consumers' perception of service quality.

Though these dimensions were formulated after research in the services industry, they are as relevant in distribution or any other business. Hence, all businesses can focus on these dimensions and work towards offering better services to customers to be successful and score high on channel performance.

SUMMARY

The performance of a channel can be measured across multiple dimensions. The parameters that are measured usually are effectiveness, efficiency, productivity, equity and profitability of the channel.

While channel efficiency emphasizes controlling costs incurred by intermediaries while performing channel functions, channel productivity is concerned with maximizing outputs for a given level of inputs. Channel effectiveness deals with the intermediary's proficiency in satisfying customer needs and channel equity measures the distribution of accessibility of the channel among customers.

While performance at a macro- level is evaluated through societal contributions of intermediaries, a micro- level evaluation involves assessing the performance of individual intermediaries in terms of achieving the manufacturer's objectives of goal attainment, integration, adaptation and pattern maintenance. The performance of intermediaries is measured on three scales, namely facet, global and composite scales.

In addition to an intermediary's performance in meeting supplier aims, his or her channel profitability that is concerned with his or her financial performance is also evaluated. While the channel profitability is assessed using the Strategic Profit Model from a broader perspective, Activity Based Costing and Direct Product Profit are used for detailed analysis of channel performance. Another pivotal factor for channel performance is the quality of services offered through the channel.

Thus, the success of a channel and its efficiency are determined by the efficiency of channel intermediaries in delivering goods and services to customers and the quality of services offered in the process. An effective distribution channel can provide channel services demanded by customers and extend its capacity within the constraints of the market environment.

Chapter 22

Managing Channel Conflicts

In this chapter we will discuss:

- Sources of conflict
- Types of conflicts
- Conflict management techniques
- Channel leadership

"Because conflict occurs in patterns within the distribution channel, it can be identified, anticipated, and possibly controlled."

Larry J. Rosenberg

With more and more innovations in the distribution process, there is increased discontent among channel members, resulting in channel arrangements being unable to function smoothly. A primary reason for this phenomenon is rising channel conflicts. Conflict has become an inherent part of distribution channels. Manufacturers complain that distributors enjoy the benefits of training and get support from them, but fail to market products properly. Suppliers, on the other hand, find fault that manufacturers do not provide support and the right margins to sell products. Thus, instead of cooperation, there is conflict among channel members, leading to loss of market share, decrease in profitability and competitive advantage. In this chapter, we will discuss the sources of conflict, types of conflicts, the concept of conflict management and different conflict management mechanisms. Finally, we will discuss channel leadership with reference to the role of channel leaders in resolving channel conflicts.

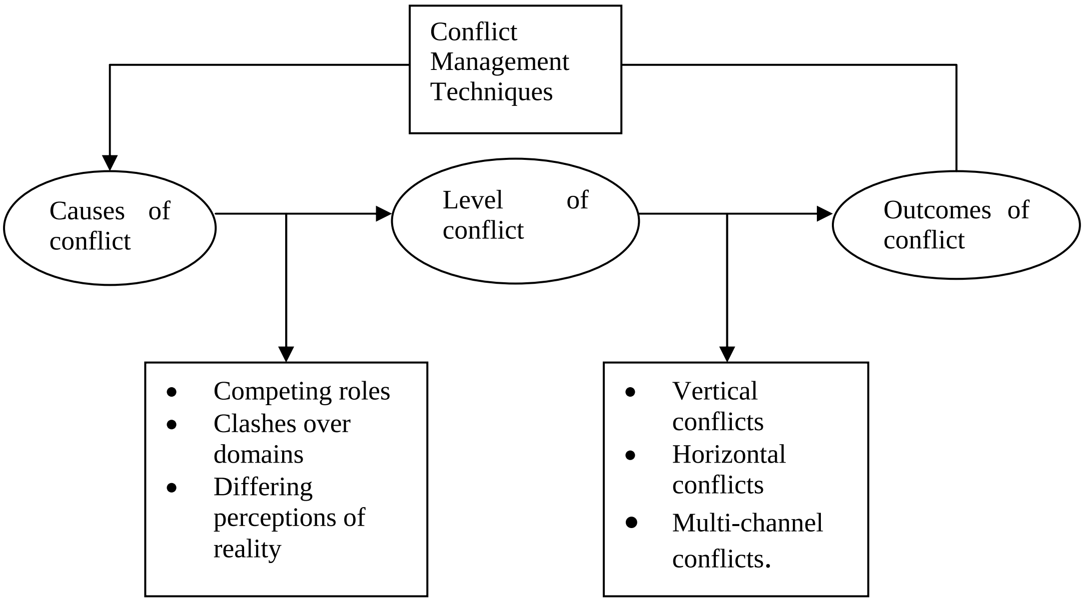
Several studies have tried to explain the source and causes of conflicts in distribution channels. The concept can be better understood if it is viewed as a dynamic process. In this approach, conflict in the distribution channel is seen as beginning with incompatibility, transforming into affective conflict, manifest conflict and finally reaching the outcome stage. The outcome of any conflict is frustration among channel members and disturbance in the effective functioning of the distribution channel. The intensity and frequency of conflict varies depending on the relative perception of the conflict situation among channel members. To avoid the pitfalls associated with channel conflicts, channel members must clearly understand the causes and impact of conflict and take necessary measures to monitor channel activities. They should develop conflict management techniques. This will enable channel members to manage conflicts effectively and be able to fulfil individual goals through collective effort. The conflict process can be viewed in the form of a simple model for better understanding. See Figure 22.1 for the channel conflict model.

The model is based on three important premises – the causes of conflict, level of conflict and the outcome of conflict. Causes must not be confused with issues in conflict. The causes of conflicts may not be realized by channel members. Issues in conflicts includes aspects of a situation that channel members have observed or stated clearly to other channel members. The causes progress from the covert stage (conflict causes) to the overt stage (conflict issues). Here, channel members can measure the levels of conflict from the intensity and frequency of conflicts and the relative differences in perceiving situations. The intensity of conflict influences channel members' performance. In turn, the actual performance of channel members will exert an influence on the first aspect of the conflict model, i.e., causes of conflict. The different aspects of the conflict model are discussed in detail in subsequent sections.

SOURCES OF CONFLICT

There are many reasons why conflicts arise in distribution channels. Learning about them is the first step in conflict analysis. Conflicts primarily arise because of faulty channel design. The different sources of conflicts can be broadly divided into -- those arising from attitudinal differences and those arising from structural differences among channel members. Structural causes arise mainly due to goal divergence or incompatibility among channel members, tendency towards autonomy and greater control by channel members and competition for scarce channel resources (financial, technological support), especially from manufacturers in multi-channel systems. Attitudinal sources arise from differences in perception, channel roles and channel communications. Unexpected changes in the competitive environment, consumers and markets, differences in economic and ideological objectives among channel members, etc., also lead to conflicts. In addition to external changes, market channel strategies adopted by channel members are also an important source of channel conflicts. Exhibit 22.1 describes some common marketing channel strategies that become a source of conflict between the manufacturer and intermediaries.

Figure 22.1: Channel Conflict Model



Source: Larry.J, Rosenberg and Louis.W, Stern, "Toward the Analysis of Distribution Channels: A Descriptive Model", Journal of Marketing, October 1970, Volume 34, Issue 4, 40-46.

Now, we will discuss some prevalent sources of conflicts in distribution channels. They are -- role incompatibility, differing perceptions of reality and clashes over domain.

Goal Incompatibility

Conflicts may arise due to differences or incompatibility of goals among channel members. Differences in policies and procedures of a channel member may be problematic and impede the progress of other channel members. Channel conflict arises when a channel member has a set of goals and objectives that are incompatible with those of other channel members. This divergence of goals may lead to one channel member acting in a way that is detrimental to goal achievement for another channel member. This may occur without the former being aware of its impact on the latter.

Goals may differ within an organization. The goals decided by top management may vary from 'operational' goals, that are set as a result of day-to-day operational policies. Hence, it is necessary to ensure that operational goals are aligned with other goals of the organization.

Difficulty in measuring goals is another reason for goal incompatibility, leading to channel conflicts. It becomes impossible for channel members to compare the compatibility of their mutual goals and measure the extent of performance of other channel members. For example, customer service levels. Such lack of awareness leads to a sense of doubt and conflict.

Exhibit 22.1

Market Channel Strategies as a Source of Channel Conflicts

Other than external and internal sources of conflict, developing and implementing certain marketing channel strategies can also lead to conflicts among channel members. Some strategies are:

- **Bypassing strategy:** Manufacturers may sometimes bypass existing intermediaries appointed by them to sell directly to customers through the company sales force or a factory outlet. This helps manufacturer save costs and cater to a larger customer base. But, it leads to great dissatisfaction among channel intermediaries.
- **Large number of resellers:** Companies may sometimes permit a large number of intermediaries at various levels of the channel to sell the company's products. This can lead to over-saturation, where no dealer gets sufficient profit by selling the company's products. This leads to conflicts.
- **Channel structure:** If a manufacturer has a very long channel structure involving many levels, the chances of conflicts are higher. This is because the greater the number of intermediaries, the greater will be the goal incompatibility among them.
- **Equal importance to all channels:** Manufacturers may give equal importance to all channels of distribution in terms of resources and time. But, this may lead to conflicts when one channel member may view another as inferior and not worthy of sharing the same amount of resources and support from the manufacturer. This will act as a source of conflict.

Adapted from Allan J. Magrath and Kenneth G. Hardy, "Avoiding the Pitfalls in Managing Distribution Channels", Business Horizons, September/October 1987, Volume 30, Issue 5, 29-33.

The difference in goals also comes up due to inherent conditions in the channel. Each channel member will have certain constraints (resources, expenses, etc,) at their level in the distribution channel. As the constraints are limited to particular levels in the channel, members at each level will develop individual goals shaped by these constraints. These goals will be different from the goals of other channel members. Goal conflict is widely prevalent in principal-agent relationships. It is known as agency relationship, where the principal is dependent on and directs the agent to perform channel functions on its behalf. Conflict arises in this relationship when the agent acts against the principal's interests. Again, the reason is difference in goals and objectives of the agent from that of the principal. Goal conflicts in an agency relationship can be reduced by designing contracts that are mutually beneficial for both the principal and agent. The contract must consider the functions and structure of ownership arrangements within the channel and the compensation on achieving required performance levels for channel members part of the agency relationship. Thus, the solution to reducing conflicts in an agency relationship is to ensure that the agent's goals align with the principal's goals.

Differing Perceptions of Reality

This is another prominent source of conflicts in distribution channels. It is perception of reality that guides channel members to anticipate future events and their consequences. This, in turn, induces channel members to develop alternative courses of action and estimate the probable results. The perception of reality also has an influence on the goals and values of channel members. However, perceptions of reality can vary. Some different perceptions of channel members may be:

- When one channel member wrongly perceives the role of another channel member regarding marketing channel functions and flows, conflicts arise.
- Lack of proper communication flow among channel members affects the way reality is perceived by them.
- Information influences the decision-making process, which affects the behaviour of channel members.

Thus, when channel members have divergent approaches to interpreting information, decisions made and goals set, conflicts arise among channel members.

Clashes Over Domains

Conflicts in marketing channels stem from the domain definition and the extent to which other channel members accept it. The domain of channel members consists of three elements. They are, product range, population and territories served, and functions or duties to be performed. Differences in domain will automatically lead to conflicts among channel members.

Product range

Handling a large number of products leads to reduction in loyalty among channel members. Distributors cannot show the same level of loyalty towards the products of all manufacturers. This variation in loyalty will lead to conflict of interest between manufacturers and distributors.

Population and territory coverage

When there are many channel members catering to a particular consumer segment, conflict over customer accounts and territory coverage is bound to arise. Channel members may service certain accounts and other channel members may compete for the same accounts. Unless clearly defined in the terms of the contract, channel members do not prefer to share accounts with other channel members who have recently joined the channel. Hence, it is necessary for manufacturers or suppliers to specify territories for channel members.

The same is true in franchising. Market territory expansion is a major source of conflicts in franchising. The franchiser's decision to increase market penetration with the help of new franchisees may reduce the sales of existing franchisees. This may occur despite the franchiser protecting the territories of existing franchisees. This is because a franchisee attracts customers from beyond the assigned territories too. When a new franchisee enters the region, customers beyond the actual territory may shift to the new franchisee due to proximity of location. Hence, even though the franchiser does not infringe the contract, franchisees become dissatisfied.

Franchise conflicts regarding customer and territory coverage are greater in business-format franchising than in product-format franchising. This is because in the former, the franchisee does not have the flexibility to modify the business model or mode of operations to adapt to changing local conditions. Hence, the loss of potential customers, though not in the franchisee’s assigned territory, becomes a potential source of conflict. For example, Taco Bell, the American food retailer, had to take over many of its Pup N' Taco drive-up units that were franchised, and convert them into company-owned Taco Bell outlets when several franchisees expressed discontent about competition from company-owned outlets. Conflicts are lower in product-format franchising because the franchisee has the flexibility to modify operations. The franchisor only gives the rights to market products and is not concerned with the mode of business operations.

Performance of channel functions

In a channel, members are expected to perform certain functions based on interdependence and common expectations. Sometimes, channel members may feel that they are being asked to reciprocate by performing functions incompatible with their organizational goals. This happens when channel members prefer to undertake only channel functions that help them attain individual goals. As these goals are not common to all channel members, functional conflicts arise. For instance, manufacturers have a strategic outlook towards marketing their products, while

Exhibit 22.2

Channel Structure as a Source of Conflict

The design of the channel structure can be a source of conflict. A properly designed channel structure helps improve coordination and control among channel members. By developing cooperative channel systems through inter-organizational relationships, channel conflicts can be reduced considerably. Over the years, different channel structures have evolved to increase channel performance, improve stability and provide better control over channel activities. Increasing channel conflicts have led to channel members seeking better ways to cooperate and yet maintain their independent status, which was associated with the traditional loosely- integrated channel arrangements. Vertical channel systems have proved the best arrangement in terms of cooperation and coordination and in maintaining the independent status of channel members. It includes corporate-owned, administered and contractual vertical channel systems.

Conflicts may arise from different sources within the channel structure. It may be related to wholesalers, manufacturers or retailers. Conflicts could arise from different channel functions like delivery schedules, huge inventories due to numerous products, hard-selling by sales personnel of channel members, frequent price increase, order errors, out-of-stock situations, absence of standard credit policies, etc. Studies have concluded that the probability of developing conflicts due to these sources varies across different channel structures. Vertical channel structures may have conflicts mostly from out-of-stock situations, whereas multi-channel structures may have frequent conflicts from untimely price changes.

Adapted from Robbins John E., Speh Thomas W. and Mayer Morris L. "Retailer's Perceptions of Channel Conflict Issues", Journal of Retailing, Winter 1982, Volume 58, Issue 4, 46-67.

retailers concentrate on operational aspects. For example, let us consider the product refund policy. To avoid inconvenience of operations, retailers may not train their personnel to identify whether a product returned is genuinely faulty, and then refund customers. Owing to this lacuna, manufacturers will face losses when many products are returned and retailers have to be compensated. Thus, a difference in roles among channel members causes conflict.

Other than the above-mentioned sources of conflicts, the channel structure by itself can lead to conflicts among channel members. See Exhibit 22.2 for a description.

TYPES OF CONFLICTS

Channel conflicts can be divided into different types depending on timing and levels of the channel. They are pre-contractual and post-contractual conflicts, vertical, horizontal and multi-channel conflicts. We will briefly discuss each aspect in the following section.

Pre-contractual and Post-contractual Conflicts

Channel conflicts may arise at two different points of time in the channel relationship. It could be before a relationship develops or after it commences between channel members. These conflicts arise whenever channel members enter into new relationships. It is frequently seen in agency relationships.

Pre-contractual problems crop up when the principal decides to offer a contract to an agent. The major issues here are whether a particular agent has the characteristics the principal wants and what strategy the principal should employ to find this out. For example, these problems occur during recruitment of new salespeople or marketing personnel, selection of dealers for their distribution channels and choosing advertising agencies.

Post-contractual conflicts happen once the relationship between channel members begins. The causes are generally unforeseen events or contingencies, which must be identified and dealt with immediately. One major issue that appears in post-contractual conflicts is the method by which agents should be evaluated, so that their actions confirm to the principal's goals. For instance, differences may arise between the principal and agent while designing compensation programmes for sales personnel or other facilitating agencies. For instance, Porsche, the UK based car manufacturer, had to abandon its plans of converting its franchisees into commission agents in the US, when nearly 80 per cent of the franchisees sued the company for damages over this move.

Thus, at both stages of the channel relationship, it is necessary to identify and manage conflicts to ensure proper channel coordination. Channel members must take all necessary precautions to identify possible sources of conflicts and design mechanisms to prevent them.

Channel Level Conflicts

Conflicts can take place at different levels of the channel system. For instance between manufacturer and retailer, wholesaler and retailers, between two wholesalers or retailers at the same level and so on. Channel level conflicts can be divided into vertical, horizontal and multi-level channel conflicts. Vertical and horizontal types of conflict are commonly called intra-channel conflicts.

Vertical channel conflicts

Vertical channel conflicts occur between channel members operating at different levels within the same channel structure. For example, conflict between manufacturer and distributors, when the manufacturer tries to enforce pricing and service policies on the distributor or expands distribution, is a type of vertical channel conflict. When Levis Strauss decided to allow Sears and J.C Penney to sell its branded jeans, it led to conflict with the 12,000 small retailers who were earlier exclusive sellers of the brand.

Horizontal channel conflicts

Horizontal type of channel conflicts arises between channel members operating at the same level within the channel structure. For example, a conflict between two franchisees over clash of domains comes under this type of conflict.

Multi-channel conflicts

Multi-channel conflict come to pass when the manufacturer has established two or more channels catering to the same market. For example, conflicts arise between the manufacturer and wholesalers, when the manufacturer tries to bypass wholesalers by resorting to newer channels like the Internet or direct mail. IBM avoided potential conflicts in its multi-channel distribution system by deciding to restrict the number of dealers selling its microcomputers to 2,500. It wanted to avoid excess number of distributors. IBM also decided to sell all but three of its company-owned stores. This was beneficial to dealers, as they did not have to face competition from company outlets.

Though conflicts are generally perceived as dysfunctional, a complete elimination of conflict among channel members is not recommended. This is because channel members may become complacent in developing symbiotic relationships with other channel members and will not compete effectively. Innovation may also be lost. Hence, a certain level of conflict acts as a constructive mechanism in channel relationships. Exhibit 22.3 describes the aspects of functional and dysfunctional conflicts in distribution channels.

Exhibit 22.3

Functional Vs Dysfunctional Conflicts

Though conflicts are generally considered as having a negative impact on channel functions and relationships, they also exert some constructive influence. Let us look at both view points.

Dysfunctional conflicts: Also called destructive conflicts or pathological conflicts because these situations prompt channel members to behave in ways that go against the actions of other channel members. This approach leads to opportunistic behaviour directed at thwarting or destroying the growth of other channel members. Other negative impacts of dysfunctional conflicts are loss of distribution efficiency and confidence stemming from emotional disturbance among channel members.

Functional conflicts: These are also called constructive conflicts. Moderate levels of conflict motivate channel members to adapt, grow and seize new opportunities. Conflicts inspire channel members to be on the vigil constantly and search for ways to improve existing channel functions and relationships. Conflicts also make channel members more innovative, which improves the competitive advantage of the distribution system.

Adapted from Rosenberg Larry J., " A New Approach to Distribution Conflict Management", Business Horizons, October 1974, Volume 17, Issue 5, 67-74.

CONFLICT MANAGEMENT TECHNIQUES

The types of intra-channel conflicts prevailing in a distribution channel and the characteristics of their sources have important implications for channel members. Intra-channel conflicts that arise due to structural differences require different conflict management techniques. Conflicts between two channel members (dyadic framework), can be solved either by one channel members modifying/changing its organizational goals or by conceding some amount of autonomy/resources to the other channel member. Conflict resolution processes can be done through mutual agreement or the use of channel power.

Conflict resolution mechanisms can be divided into two categories. In the first (systematic mechanism), the conflict resolution mechanism is based on the policies that channel leaders implement to resolve channel conflicts in a streamlined manner. These conflict resolution mechanisms are aimed at increasing interaction and communication among various channel members. Some systematic mechanisms include joint memberships in trade organizations, exchange of personnel between two or more channels, distributor councils, arbitration and mediation boards and various programmes such as co-optation. The second category of conflict resolution mechanisms is based on behavioural and attitudinal responses channel leaders have to solving conflicts in a distribution channel. These responses of channel members can be divided into problem-solving, persuasion, bargaining and political strategies.

Some strategies implemented under both categories are discussed in the following sections.

Negotiation (Bargaining)

Negotiation or bargaining is used by channel members as a method of resolving conflicts. Negotiations usually take place over price, cash credit, discounts, delivery, inventory levels and other elements in the marketing mix. In negotiations, goal differences are considered as fixed and conflict resolution mechanisms do not mean that common goals have to be developed. The outcome of negotiations vary depending on the number of channel members and the extent of balance of power among them.

During negotiations, channel members indulge in low risk behaviour, where information exchange is kept to the minimal to lessen the financial, social and physical costs incurred. Channel members, during the bargaining process, sometimes behave rigidly and stick to their stand. Threats, promises and conditional commitments are commonly seen during negotiations. Negotiations generally occur under asymmetrical power conditions. For example, negotiations between a retailer and manufacturers of private store labels take place in conditions where the retailer has a strong bargaining power. Asymmetric negotiations also occur between franchisers and franchisees.

The negotiation process is very important for channel members, especially in marketing channels, because its efficiency has a direct impact on the selling and purchasing costs among channel members.

Some differences commonly seen during negotiations under asymmetric power conditions are:

Initial bids

During bargaining, channel members with greater power than their partners make more demanding initial bids. Similarly, weak bargainers send less demanding bids or conditions.

Extent of flexibility

Channel members with greater power do not yield much from their initial bargaining conditions compared to channel members who have less power.

Time of negotiation

When negotiations take place in asymmetric power conditions, more powerful channel members are able to obtain an acceptable agreement faster than less powerful channel members.

Communication content

Channel members with greater power frequently make use of commanding language and actions during negotiations with other channel members.

Negotiation outcome

In asymmetric power conditions, channel members with more power achieve agreements that give them a larger share of total profits of the channel group. In this process, the overall profitability of the channel decreases.

Persuasive Mechanism

Persuasive conflict resolution mechanism is another method used by channel leaders to resolve conflicts. The objective is to move both parties (channel members) towards a common set of goals. In this method, each channel member tries to influence and change the view of other channel member with regard to the conflicting issues. The basic approach used in persuasive conflict resolution mechanism is to highlight the importance of mutually beneficial common goals over individual goals and also reduce differences present in individual goals of each channel member. However, in this method, channel members involve in high risk behaviour by sharing important information to arrive at a common goal. This is in contrast to the low-risk behaviour observed during negotiations. This type of conflict resolution mechanism is often seen between franchisers and franchisees. For instance, franchisers may have to persuade franchisees to maintain product quality levels consistently across franchises to project a uniform image.

Problem-Solving Strategies

This method is also used as a conflict resolution mechanism to settle conflicts in distribution channels. Here, both parties share common objectives but differ on the criteria used for decision-making. Open transfer of information about goals and objectives happens and both parties try to sort out differences by seeking alternative solutions. Cooperation and coordination is also present between channel members, unlike in negotiations. Channel members are ready to concede or modify certain conditions to reach a mutually acceptable solution.

Political Strategies

This is another form of conflict resolution, similar to bargaining. As channel members have disagreed over each other's objectives, they agree to a third party becoming involved. This party acts as an ally to the channel members. This method is resorted to only when all other interpersonal methods of solving conflicts have failed. Political-based conflict resolution strategies involve the use of diplomacy, mediators and arbitrators to solve conflicts.

Diplomacy: It is an approach where each side sends a person or group to meet its counterparts to resolve the conflict.

Mediation: It is a process where a third party tries to settle conflicts between channel members, either by urging them to continue negotiations till a solution is reached, or takes into consideration recommendations made by the mediator.

Arbitration: In arbitration, the two parties agree to present their agreements to one or more arbitrators, referees or a private judge and accept the verdict delivered. Usually, channel members have a clause in their contracts stipulating the use of arbitration in case of conflicts between them. There are many arbitration centres all over the world, where organizations can take their disputes. The American Arbitration Association is one of the oldest such centres in the world.

Co-optation

Co-optation is an information-intensive mechanism, which involves free exchange of information between aggrieved parties. Co-optation is a mechanism where a new member from outside the organization is selected and is involved in the decisions and policies of top management. A channel member makes an effort to win the support of other channel members by including them in its advisory council or board of directors.

Co-optation permits the concept of sharing responsibility so that channel members from different levels can become prominent in the entire channel system and are committed to the programmes and policies of one another. In this method, one channel member may have to make concessions on its policies and plans to win the support of the newly elected member from other channel organizations. Co-optation can be used to reduce conflicts as long as the channel member treats the new individual member(s) seriously and listens to them. This mechanism is risky due to the physical, economic and financial costs involved. Coordination and cooperation are pre-conditions.

Exchange of personnel between two or more channels is also used as a conflict resolution mechanism. This enables participants to visit each other's facilities and understand each other's points of view. Another frequently used method is the encouragement of joint membership in and between trade organizations. For example, if manufacturers and retailers are associated with each other's trade associations, they become aware of each other's limitations and problems, apart from approach to business .

In addition to these strategies, channel members can reduce the frequency and intensity of conflict by adopting some practices during routine channel functions. Some routine practices by channel members to avoid or minimize channel conflicts are:

Personal relationships: Channel members must strive to develop personal relationships to reduce the intensity of flare-ups and discuss various conflict issues rationally.

- **Error clarification:** Whenever a channel member errs, it must be brought to the notice of the other channel partner, so that new problems due to lack of awareness of the reciprocating firm do not occur.
- **Distribution indicators:** Channel members must develop distribution indicators that will alert those affected. The indicators can be inventory levels, value of sales or order volumes.
- **Meetings:** The sales personnel of manufacturers must be in frequent touch with sales personnel of other channel intermediaries so that they can share views and prevent eruption of conflicts.
- **Appreciate each channel member's requirements:** By visiting the manufacturer's plant and observing activities like ordering procedures and quality management activities, the intermediary can gain a clear picture of potential difficulties in getting a product delivered on time. Likewise, by making joint visits to trade fairs and sharing information, both parties can achieve a harmonious working relationship.
- **Communication:** The communication process within the channel structure and between channel members should be streamlined. This can be achieved by continuous sharing of information through networks. It is generally observed that attitudinal differences arise due to lack of proper communication and information processing among channel members. Hence, by designing communication programmes that increases exchange of information about goals, role expectations and future plans among channel members, the quantum of intra-channel conflict will be considerably reduced.

CHANNEL LEADERSHIP

Effective channel management can be achieved if channel members appoint effective leaders who take a broad inter-organizational perspective of distribution opportunities and problems. These leaders must emphasize the need for developing cordial channel relationships. Frequent conflicts due to differences in role perceptions, goals and objectives forces channel members to take the help of channel leaders. Channel leadership can be effective only when the leader judiciously plans the channel control mix. Channel leaders can use positive reinforcement as well as negative reinforcement to ensure that channel members comply with formulated policies.

Role of Leadership Power in Resolving Conflicts

Channel leaders can use their leadership power to manage and resolve conflicts effectively, leading to improvement in coordination and functioning of channels. The effectiveness of channel leaders depends on the extent of power they hold and the acceptance and attitude of the rest of the channel members. Channel leaders must seek to reduce functional conflict and levels of dysfunctional conflict in the channel. Channel leaders can use different methods to resolve channel conflicts. They include coercion, economic rewards and the use of legitimate, expert and referent power. Let us briefly look at each aspect.

Reward power

Channel leaders can use reward power to resolve channel conflicts. This is based on the belief of channel members that the channel leader is capable of granting benefits if they comply with the dictated policies. For example, the channel leader may have the power to grant better promotional allowances or higher margins to channel members.

Coercive power

Channel leaders can use coercive power to control the actions of channel members. The channel leader can use negative reinforcement methods like sanctions, cancellation of exclusive distribution rights or decrease in margins to ensure that all channel members toe the line.

Expert power

The channel leader can make use of expert power to align the activities of channel members for better cooperation and coordination. Expert power can be in the form of knowledge about certain channel functions that other members are unaware of, but would stand to benefit from. For example, the manufacturer may have expert knowledge about competitors products, which will be beneficial for dealers.

Referent power

Channel leaders have the right to permit other channel members to be associated with certain trade associations. They can develop policies that permit memberships of channel members in certain associations, only on condition of compliance with rules and regulations.

Legitimate power

Channel leaders can reduce conflicts by using their legitimate power, which gives them the right to make certain decisions and ensure that other channel members follow them.

The role of the channel leader in resolving conflicts will be restricted if power sources cannot be used extensively. The extent to which channel leaders can effectively inhibit conflict depends on the extent to which the channel leader can direct the use of leadership power over each channel member. The level to which leadership power has an influence on the performance of channel members is also crucial. The channel leader’s role in resolving conflicts will be restricted if power sources cannot be used extensively.

SUMMARY

All channels are based on the premise that anyone joining the channel and performing channel functions stands to benefit. Channel conflicts arise in channel systems when one or more channel members start perceiving the behaviour and actions of another channel member as an impediment to goal attainment.

There are many sources of channel conflicts. They can originate from competing roles, clash of domains and differing perceptions of reality. Marketing channel strategies and channel structures are also important sources of conflict.

Channel conflicts can be of different types. They can be primarily divided into pre-contractual and post-contractual conflicts and conflicts based on channel levels. Based on the timing of conflicts, they are divided into conflicts that arise before channel members enter into agreements and those that arise after channel members enter into agreements. Channel level conflicts may be vertical, horizontal or multi-level.

To ensure effective coordination and channel functioning, different conflict management techniques can be used. They are primarily segregated into structural and behavioural conflict resolution strategies. Some commonly used strategies include negotiation, persuasion, problem solving, co-optation, arbitration and mediation. Channel members can also resolve conflicts by exchange of personnel between channels and by association with different trade organizations.

Channel power is also frequently used as a conflict management tool. Power sources are usually effective when wielded by channel leaders. Channel leaders can use referent, expert, legitimate, coercive and reward power to minimize channel conflicts. Creative and effective channel leadership result in channel members moving towards shared goals. If this ideal situation is achieved, distribution channels will be in a better position to satisfy the demands of target customers and maximize profits of individual channel members.

Chapter 23

Channel Information Systems

In this chapter we will discuss:

- Elements of channel information systems
- Impact of information systems on channel flow
- Impact of information systems on channel relationships

A sea change is taking place in all aspects of business activity in the wake of the knowledge revolution. Information has become an important component of business strategy for organizations across the world to gain a competitive advantage over rivals. Computers and telecommunication technology have revolutionized the way information is stored, processed and transferred. The utility of information to an organization depends on the extent to which it facilitates the efficient functioning of different processes in the organization. Information systems are being used by sales organizations too to improve the effectiveness of marketing channel transactions. The advent of new information technologies has revolutionized the organization and conduct of distribution of goods and services. Channel information systems (CIS) include components like Electronic Data Interchange (EDI), electronic scanning, bar coding, database management and multimedia offerings.

CIS are primarily used to collect, store and interpret information in a manner that adds value to an organization's distribution functions. The importance of information systems to an organization can be studied in terms of 'information value' and 'information intensity'. Information intensity refers to the proportion of profits that can be attributed to a company's information assets. A company is more information intensive if its information assets contribute to a greater proportion of profits. The degree of information intensity can influence the relative balance of power between manufacturers and buyers. For example, McKesson (a US based drug distributor) and Wal-Mart (the US based retail giant) have more power over manufacturers in their respective industries due to their greater degree of information intensity. Thus, there has been a fundamental shift in the role of channel members along the value-added chain. Information systems have also removed the necessity for lengthy distribution channels prevalent in traditional distribution structures. The changing nature of channel relationships has not only altered the degree of competition but the extent of rivalry, competitive positions and industry structure as a whole.

Information systems have brought about radical changes in channel management. This can be illustrated well in retail distribution. Exhibit 23.1 describes how the implementation of information systems at McKesson radically transformed the carrying out of distribution functions.

This chapter examines the different aspects of CIS. It begins with a discussion of CIS elements and proceeds to detail the impact of CIS on channel flow and channel member relationships. It is important to remember that large investments in IT will not by itself lead to development of efficient information systems. Good understanding of the need for implementing IT in organizations, its advantages, costs and time involved will help obtain the desired results.

ELEMENTS OF CHANNEL INFORMATION SYSTEMS

As stated earlier, a CIS is a mechanism to preserve, collect, interpret and transmit useful and timely information to respective channel members. The basic elements of a channel information system are a) hardware and networks and database for CIS.

Hardware and Networks in an Information System

Hardware and networks consist of software, computer components, programs and other related technologies that help efficient transmission of information among channel members. The hardware and networks used in information flow among channel members can be differentiated, based on applications, into

- Business-to-business applications
- Retailing applications
- Business-to-consumer applications
- Interactive applications for consumers

Let us elaborate these:

Exhibit 23.1

Information Systems in Pharmaceutical Distribution

McKesson, a San Francisco-based drug distributor, was one of the first organizations in the mid-seventies to electronically link the distributor and the retailer. It pioneered the use of bar codes and scanners to enable pharmacists to automatically place orders as and when a product moved off the shelves or was sold.

McKesson also used IT to change the mode of operations in its warehouses. IT enabled the company to manage inventory, delivery schedules and reduce the number of employees required in the warehouse to take orders. It successfully developed an instrument -- a computer plus laser scanner plus two-way radio -- all in one, strapped to the employee's arm. Once the employee received an order, the product code is typed and the instrument shows the stock position and product location in the warehouse. Once the required quantity is entered, the instrument instantly sends the billing information to the warehouse manager. It also calculates the extent of stock replenishment in terms of minimum inventory levels to be maintained.

Adapted from Myron Magnet and Ricardo Sookdeo, "Who's Winning the Information Revolution," Fortune, November 1992, Volume 126, Issue 12, 110-115.

Business-to-business applications

Information systems facilitate the transmission of relevant information among channel members within a distribution channel. Owing to increasing competition and changing consumer tastes, channel members have begun to cooperate and coordinate with each other so that they can develop a competitive advantage through a distribution system. CIS facilitate the sharing of information among manufacturers, suppliers, wholesalers and retailers, improve inventory management, develop efficient production schedules, reduce transaction costs, help assortment planning, new product development and order processing and replenishment.

One of the earliest and most well known strategic information systems is Analytic Systems Automatic Purchasing (ASAP) developed by the American Hospital Supply Corporation, an American company dealing with hospital products, (now Baxter Healthcare after its purchase by Baxter). It is a computerized system for ordering, tracking and managing hospital supplies. Other companies that introduced similar automated and proprietary order-entry systems include Johnson & Johnson's Cooperative Action Plus (COACT) and Abbott's Quik Link. Over the years, information systems have evolved from automated order-entry systems to sophisticated information-based logistics services. In 1990, Baxter implemented another information system, the ValueLink program, to enhance customer-supplier relationships. This program is based on an integrated information management process that coordinates product flow and services between Baxter and its customers. The program aids dispatch of assorted medical products to different hospital departments, based on their requirements, in a ready-to-use form and in the manner specified.

Some commonly used systems that facilitate performance of distribution functions include Shipping Container Marking (SCM), Computer- Aided Design (CAD), Electronic Data Interchange (EDI), Transaction-Based Information, Efficient Consumer Response (ECR) and a host of others. Shipping Container Marking is used not in business-to-business applications but also in retailing applications. It will be discussed along with retailing applications.

Let us now discuss some information systems that improve b to b - relationships among channel members. Most technologies described below facilitate effective communication among channel members within a given distribution channel. These systems enable faster flow of information, leading to better customer service, lower transaction costs and risks.

Quick response (QR) system

It is widely used in the apparel industry to ensure that fabric makers, apparel designers and retailers can share information about product design, orders, billing production, delivery schedules and so on. It enables channel members along the entire chain to be aware of the requirements of one another well-in-advance. QR ensures that manufacturers and retailers coordinate activities along the whole chain so that the right product is available to the consumer in the right place and at the right time. The technologies used in the QR system include bar-coded carton labelling and universal product code (UPC) labelling.

Efficient consumer response (ECR)

It is a variation of the continuous replenishment program used in the apparel industry. ECR uses category management to organize product replenishment based on product groups. Product groups are formed based on the urgency of requirements and the profitability of certain types of products to the distributor. The supplier categorizes products of similar profitability into a single product group. ECR uses activity-based costing to evaluate profitability. This system was developed by independent grocers to offset the entry of retail giants like Wal-Mart and KMart into the grocery industry. ECR is a computerized system that uses software to collect retail-sales data. Based on this information, the manufacturing, distribution and sales activities of products are developed. ECR serves to provide a wide assortment of products to the consumer, provide the best possible distribution system from the manufacturer to the retailer and save costs by promoting products with consumer demand. This is possible from retail sales data collected using ECR.

Transaction-based information system (TBIS)

A TBIS helps integrate the process and communication of information about every transaction, right from product purchase at consumer level back to the manufacturer's level. Each channel member's goal is to leverage information about every transaction in the chain and convert it into an asset. The efficiency in gathering information on all transactions throughout the chain comes over time through experience. TBIS also acts as an information barrier to prevent the entry of new players into a particular distribution channel. The system helps create an information network that aids the smooth collection and transmission of information while preventing outside channel members from gaining access to this precious information.

Extranets

These networking systems enable manufacturers to share information and conduct transactions with other channel partners like suppliers and distributors by linking their internal information network to an external network. The organization has to develop means to offer selective access to internal information to other channel partners. Initially, router networks were used for this purpose. Later, as network security architecture matured, a new external protection software tool – 'application layer gateway' firewall was introduced. Recently, virtual private networks that provide a gateway for external parties to selectively access company information have been developed.

Companies develop information systems to fulfil a host of requirements. Companies develop different systems to service individual requirements, but in general, they provide some common benefits. Exhibit 23.2 describes the competitive advantages gained by companies using information systems.

Exhibit 23.2

Advantages of Information Systems

Information systems can help a company acquire competitive advantage over competitors and other channel members in terms of comparative efficiency or bargaining power. The first enables the company to manufacture products and services cheaper than competitors, while the second gives the firm the ability to negotiate with other channel members to its advantage.

Competitive advantage in terms of comparative efficiency:

Inventory costs are lowered: Information systems enable a company to transmit relevant data about product requirements and delivery schedules to suppliers. Thanks to 'just-in-time' delivery, the company saves costs, which would have been incurred for storage and transport. It also enables shipping orders economically with minimum time spent on trans-shipment of goods. The ordering pattern of suppliers can also be identified to facilitate proper delivery schedules.

Data utility: Information systems enable information to travel at high speeds between channel members. The data can be transmitted in a standardized format, which means the firm can modify and analyse data quickly and easily, leading to better responses in shorter time-periods.

Reduces the need for personnel: Information systems assist customers and suppliers to access and check information electronically. This reduces the requirement for personnel to interact with customers and to enter and edit data.

Benefits of integration: Implementing information systems helps firms enjoy the benefits of vertical integration like better control over channel activities, cost reduction and improved coordination of different channel functions.

Increase sales: Information systems increase the sales of a firm's products by allowing cross selling of high-margin products. Ordering procedures are also simplified, leading to higher orders and improved sales.

Evaluate promotional activities: It enables the company to precisely evaluate customer response to discounts, rebates and other promotional activities. The company can also develop individualized sales messages based on information pertaining to customer purchase patterns, recorded in the information systems.

Competitive advantage in terms of bargaining power:

Switching costs are high: By linking channel members with a unique information system, the firm reduces the chances of these members switching to a different system. The need to retrain employees to ensure compatibility with a new system, the prohibitive cost of purchasing hardware and software, and costs of organizing an information system, prevents channel members from moving to a different system.

Differentiated offering: Implementation of information systems can provide a unique advantage over other distribution channels in terms of better product image, increased customer service, more information on product availability and better product handling and ordering.

Source of information: It allows customers to access information on product specifications, alternative suppliers, price discounts, methods of ordering and delivery and so on.

Adapted from Johnston H. Russell and Michael A. Vitale, "Creating Competitive Advantage with Interorganizational Information Systems," MIS Quarterly, June 1988, Volume 12, Issue 2, 152-165.

Retailing applications

Retailers use information systems to enhance communications between headquarters and retail outlets. Some retailers use computer-based networks running on proprietary software while some use satellite information networks to transmit information between different units. IT plays a critical role in enhancing in-store service for customers by providing value-added delivery services. It also helps retailers to configure their stores, prevent stock-outs and develop product assortments that give superior value to customers. A retail information system (RIS) involves software management and training, server and database technologies and wide and local area networking. IT-based systems extensively used in retailing applications are Shipping Container Marking technology (SCM) and Electronic Shelf Labels (ESL)

Shipping Container Marking technology (SCM)

SCM technology has vastly improved the distribution process at both wholesaler and distribution centre levels for the retailer. This technology improves the efficiency of ordering and distribution tasks. Retailers prefer to place purchase orders with flexibility in the time of product delivery, to overcome the problem of fluctuating sales volumes. The use of scanned shipping container labels in SCM technology helps this by keeping track of information about the automatic shipping notice, the original purchase order and the specific cartons to be dispatched. When these cartons reach a distribution centre, scanning the carton label reveals information on the carton's contents, the order schedule and the store where it is to be delivered.

Electronic Shelf Labels (ESL)

Electronic shelf labelling has been adopted in retail supermarkets and hypermarkets. Many retailers stock as many as 20,000 assorted products. Putting a price tag on each item in the store shelf is tedious and labour-intensive. Moreover, some large retailers like Tesco, J.Sainsbury and Safeway make frequent price changes. For example, Safeway Plc which is an 'every day low price' (EDLP) retailer, makes as many as 1,500 price changes per week. ESL enables retailers change prices whenever the need arises, without changing labels on the shelf or for all products. This saves costs. The need to inform advertisers and make changes in point-of-sale devices and warehouse billing systems can also be avoided. ESL also helps maintain price integrity by ensuring that the price at the point of sale is the same as the price on the shelf.

Nike Inc. has used point-of-sale information systems to gather and analyse data to schedule channel operations for its outlets all over the world. Exhibit 23.3 describes the use of the ConnectRemote software application by Nike Inc. to streamline retail operations.

Business-to-consumer online applications

Companies use electronic sales channels to provide information to customers about products and services. These channels include online Internet services and interactive multimedia. For example, Digital Equipment Corporation (an American-based computer company acquired by HP) has its own on-line catalogue and ordering service, Digital's Electronic Store. This contains information on the entire range of computer products the company manufactures. The customers can place online orders for products they want without hassles. Electronic markets are one step ahead of electronic stores and include products of competitors too in the company's database. The Apollo Information System of United Airlines and Sabre Information System of American Airlines provide details of availability of seats and reservation for all airlines.

Interactive multimedia applications

Shopping through interactive multimedia has become an important marketing channel. Companies and retailers are increasingly using online information systems for mutual benefit. Unlike other information systems, online systems enable customers to respond to information in the form of queries or purchase orders. J.C.Penny, an American retail giant, uses Telaction, an interactive online shopping system that provides customers a virtual shopping experience from the comfort of their home. Customers access this system through a cable television channel and obtain product

Exhibit 23.3

Information Systems at Nike Retail

Nike Retail, a subsidiary of Nike Inc., accounts for $ 700 million of Nike's annual sales of around $ 9.6 billion. To maintain contact with its worldwide outlets, Nike Retail shifted from OS/2 to Windows NT operating system and from the IBM 4690-series-point-of sale cash registers to PC-based systems. Nike Retail includes Nike Town shops, Nike outlet stores and employee stores in the US, Australia, Canada, Japan and Europe. Nike has installed more than 800 point-of-sale systems in the US alone, and the corporate office has remote access to each outlet.

Earlier, the company was using around 10 different methods to collect from and transfer information to various stores. This included sending compact disks and paper documents everyday through the mail.

Connect:Remote is another software Nike Retail uses as for standard data gathering. It is a Windows NT version remote access tool. Connect:Remote software enables Nike Retail to schedule operations in a centralized manner. It provides headquarters with the payroll, inventory and sales data from all store locations and sends information on price, shipping and product data. The system also keeps track of the hardware and software inventories at remote locations and performs software distribution and file backup for remote machines in stores all over the world. The information system has enabled the company to provide better store information to employees and to manage business effectively.

Adapted from Kristina B. Sullivan, "Nike `Just Does' Remote Access", PC Week, 17 May 1999, Volume 16, Issue 20, 91-92.

information using a push-button telephone. Similarly, Sears- Roebuck and IBM have created Prodigy, a home shopping and entertainment system that users can access through personal computers.

Private information service providers are also available. Customers can access such systems and collect information for a range of products and services. Information services like DowJones News Retrieval Service and Compuserve Information Service are well known in America. The diffusion of computer technology has become the major determinant for the success of online information services. Customers enter the product features and the system gives a list of products matching the criteria. If the customer decides to purchase a product, the information system directly sends the order to the manufacturer's shipping centre.

Databases for Channel Information Systems

A company can achieve greater accuracy in results by using information stored in a database. However, data stored in databases has to be converted into useful information for distribution channels to become more efficient. In this section, we will discuss the importance of databases and their application by channel members in distribution channels.

Data warehousing

Data warehousing involves copying and storing data from different operational databases into a centralized database, known as a data warehouse. Data warehousing allows employees from different departments to access information stored in the centralized database. This is an advancement on traditional operational databases where access to stored data was complicated and collection of relevant information by users was not easy. Information in a data warehouse is arranged so that it is comprehensible to the user, who can obtain information needed to solve a particular problem without wasting time scanning the mounds of information in the database.

Data warehousing is a useful decision-support tool and helps channel members take correct decisions from information garnered. Victoria's Secret, a US-based retail chain selling apparel for women, has used data warehousing to good effect.

Retail database systems (RDM)

Retail database management technology enables retailers to gather useful data about individual customers from the information base in an easy, cost-effective and simple manner. By giving a query, an employee of the retail chain, such as the chief financial officer, can access relevant information from the in-house database. In a very short time, the retail database system delivers the information in the form of customer analysis reports. Since RDM systems are updated every 24 hours, they provide up-to-date information about customers quickly. RDM also helps retailers divide customers into different segments, manage promotion campaigns and analyse results. Customer buying habits can also be evaluated at individual customer level. An in-house RDM system can provide retailers with information on the purchase patterns of customers in a given region so that promotional material can be developed to aid cross-shopping. For example, based on information obtained from an in-house database, the retailer can work out a special Father's day promotion campaign for all customers coming under the same postal code, and who have purchased gifts on Mother's day. An RDM system can provide retailers with information that allows them to categorize customers into various types like window shoppers and those who actually purchase a product.

Let us now discuss some information management systems in use at present.

PrecisionCode

It is a Windows NT geocoding system used by retailers in the US. It categorizes customers based on geographic region. Using a Qualitative Marketing Software geocoding engine, it calculates the address or intersection latitude and longitude coordinates of customers. It then adds these coordinates and market segmentation codes from leading segmentation packages to customer address files. Thus, the information system standardizes customer address records (modifies street, city, and state names within the customer's file) to adhere to United States Postal Service (USPS) standards.

Data designs for healthcare

This is a Windows 95-based database management system designed specifically for the health-care industry. It enables health-care professionals to gather and compile data from different information systems into a single database. DataDesigns combines patient, physician and contract information into a single file. It also assesses medical plans, contracts and claim proposals. The system evaluates physicians for consistency across contracts, categorizes and monitors patients into groups for specific diagnosis and makes outcome comparisons.

Archer Retail Database Marketing System 4.2 (ARDMS)

Retail Target Marketing Systems, an American software solutions provider, developed Archer Retail Database Marketing System 4.2 (ARDMS), an information system designed for large retail companies. ARDMS is a decision support system enabling retailers to develop individualized marketing programs for customers based on current customer information and buying patterns. Retailers can also segregate customers into segments, transfer data, organize promotion campaigns and so on.

Another example of a company making use of information systems to improve customer service down the channel is Toyota Motor Sales Corporation. In the USA, Toyota uses a centralized database system and surveys to collect information from dealers about customers' service experiences. All dealers are required to link their

Exhibit 23.4

Product Information Management at IBM

IBM's product information management system provides information about the 150,000 or so software and hardware products developed by the company. This huge database primarily runs on the Cardonet Product Master software. The product information management system ensures that IBM collects, maintains and transmits relevant product information to over 1000 global sales channels of the company. The software automatically collects information on new products from IBM's internal databases. It then segregates the information based on user specifications and channel type. The segregated information contains data on currency, language and product selection depending on channel partner's requirement and the country of operation.

Cardonet software has the capacity to support more than 1,000 selling partners and distribution channels across the world. The distribution network covers business-to-business websites, resellers, sales offices and other distribution points along the channel. This software has enabled IBM reduce the time needed to launch new products or send information about product changes throughout the business-to-business channel by a couple of weeks, thus saving millions of dollars. Thus, IBM's database serves as a model for speedy and accurate transfer of relevant information in a customized format to channel members across the world.

Adapted from "IBM Expands Investment in Cardonet Product Master", Worldwide Databases, August 2004, Volume 16, Issue 8.

databases to the centralized database. Dealers are provided with survey results so that they can improve their operations. Exhibit 23.4 describes the importance of databases in ensuring smooth channel operations.

Data gathered at various channel levels can be used to improve the management of functions at other channel levels. Data collection requires the development of a well-designed and efficient database. A company can use its database to formulate customer-retention and product-promotion strategies, improve customer service, study consumer behaviour patterns and keep track of sales at different outlets across the world on a periodic basis.

IMPACT OF INFORMATION SYSTEMS ON CHANNEL FLOW

With the advent of information systems, companies have adopted numerous methods through which products can be delivered to the consumer or end-user. Gone are the days when manufacturers circulated their products through traditional relationships with distributors or a group of exclusive dealers. Companies can use CIS to improve channel functions and flow. Implementing a channel information system can affect channel flow, right from inventory holding to ordering and payment. Efficient performance of channel functions improves channel flow, which leads to lower costs of operating the channel, reduction in channel conflicts and gaining competitive advantage.

Let us look at some ways in which information systems impact channel flow.

Transaction Flow

Inter-organizational systems using IT have influenced channel distribution significantly. Electronic Data Interchange (EDI) systems, a category of inter-organizational systems, facilitate the flow of products and services between channel members. EDI involves electronic exchange of purchase orders, invoices, shipping manifests and other business documents between retailer and supplier computer systems. It has proven more efficient than mailing or faxing documents and entering them manually later. EDI greatly reduces errors that occur when information is manually entered. Many organizations have therefore turned to EDI systems. Even in 1988, 75% of the Fortune 100 and 39% of the Fortune 500 companies used some form of electronic data transmission to perform different channel functions like ordering, invoicing and providing shipping or backorder notification.

EDI systems improve the speed and accuracy of transactions between channel members and provide complete data on channel transactions. Faster transactions reduce order processing times. This improves channel flow through better flow of goods between channel members. Quick response is a source of competitive advantage to downstream channel members. For example, General Electric (GE) uses electronic data transmission systems to help its independent appliance dealers compete with category specialists like Circuit City. GE delivers products directly to customers from its warehouses within 24 hours of order entry into GE's computerized system. This has helped independent appliance dealers to maintain minimal inventory levels, reducing operational costs.

Inventory Flow

Information systems have a marked influence on inventory management of channel members. Efficient processing and flow of information is crucial for wholesalers, suppliers and retailers, as it can give competitive advantage. Better information flow leads to better inventory management. This helps channel partners shore-up bottom lines, especially in the retail industry where most channel members make significant investments in stocking goods.

Continuous Replenishment Program (CRP) is an inventory management method using information systems. CRP advocates increased information sharing so that products are delivered on time at the right place with maximum accuracy. When such sizeable information is transmitted across channel members with speed and accuracy, the transit time become minimal. This leads to lower product refusal and returns. CRP also reduces the costs of transportation planning and invoicing, contributing to smoother flow of various channel functions. CRP, however, has to be compatible with the processes of different channel partners and aligned with their business objectives. The software and hardware must be customized.

Toshiba America Information Systems Inc, a California-based information systems developer, has designed a web-based configuration and ordering system for its channel partners. Distributors and value-added resellers (VARs) can ask the company to ship products directly to customers without having to stock products. Toshiba plans to use the configuration system to reduce inventory levels down to two weeks and deliver standard stock keeping units (SKUs) in a week's time. The system will make the ordering process easier for resellers and enable Toshiba to ship products directly to customers.

Distribution Flow

Information systems have improved product flow from the manufacturer to retail stores. A typical case is Pepsi Pennsauken, one of PepsiCo's biggest bottlers in the US. At Pepsi Pennsauken, wireless technology has helped the company save thousands of dollars and its reputation too. The bottler had a problem of not being able to receive sales orders in time from its sales personnel. With New Age teas, juices and waters competing for market share, the situation was grim for PepsiCo.

Generally, bottlers sell soft drinks to retailers either on a route-sales basis (where drivers travel on specified routes, take orders from retailers and deliver cases on the spot) or pre-sell (where sales personnel take orders in advance and deliver them the following day). Every weekend, the bottling company had a backlog of 30,000 to

Exhibit 23.5

Distribution at Kao Corporation

Kao Corporation is the largest soaps and cosmetics company in Japan and the world's sixth largest. Kao Corp. has developed an excellent information system that makes its distribution system among the most flexible in the world. This system allows the company and its wholly owned wholesalers to deliver products within 24 hours to any of its 280,000 stores. The average order of each of these is only seven items, but together, they amount to a large quantity.

There is flexibility by linking the information system to various stores and transmitting data at an average speed of 10 GB per second at any given time. Information from the point-of-sale systems is passed on to the production floor. The system also links production, R&D, marketing, purchasing and cash registers and enables channel members to know, within a day, whether any competitor has launched a promotion programme. Sales managers can obtain information about daily stock levels, sales and production figures simultaneously. Thanks to its command over market information, Kao Corporation is less dependent than competitors on external sales forecasts and buffer inventories.

Adapted from Thomas A. Stewart and Emily Thornton, "Brace for Japan's Hot New Strategy", Fortune, September 1992, Volume 126, Issue 6, 62-67.

40,000 cases because the sales reps and route drivers could not communicate order details back to the company over the telephone because of busy signals. To overcome this, Pepsi Pennsauken gave its sales reps and route drivers hand-held computers that instantly transmitted information to distribution centres over a wireless network. The distribution centre had access to data, moments after it was sent from the retail outlet. Thus, by the time the drivers returned, their delivery schedule was ready. This enabled Pepsi Pennsauken to reduce its fleet from 39 trucks to 19. There was also a 25% increase in labour efficiency and the company was able to deliver orders within 24 hours.

To better understand how information systems can improve the flexibility of channel functions and flow, see Exhibit 23.5.

Many organizations have developed software and application programs that facilitate channel flow. One such is VitalSuite 3.0 developed by International Network Services, a California- based network and business solutions provider. VitalSuite 3.0 contains a Business Transaction Management System that helps identify and keep track of transactions using sales-order automation, supply-chain management, order fulfilment and other applications. The software also helps identify causes of slowdown in transactions and related performance issues.

Promotional Flow

Information systems are also useful to improve a channel's promotional efforts. Direct marketers have used databases for a long time to send catalogues and other promotional material to prospective buyers. Many companies use electronic-based promotional systems nowadays. E-based systems help channel members identify and customize promotional activities aimed at customers. For example, Procter & Gamble, with the help of Philips Consumer Electronics, placed point-of-sale kiosks in Boots and Tesco supermarkets throughout the UK. P&G developed these kiosks exclusively to promote their new 'Oil of Ulay' colour cosmetics line. Each kiosk is tailor-made to suit the consumer profile of each store and is staffed by a colour consultant from P&G or the concerned retailer. Consumers enter their personal details at these kiosks and get suggestions about products suitable to their skin types and complexion.

Negotiation Flow

Negotiations between channel members have also changed due to the adoption of different information systems. New technologies like EDI, Quick Response System, Continuous Replenishment Program, Efficient Consumer Response etc., have led to channel members discarding old-fashioned negotiation methods. Upstream channel members are aware of information on consumer tastes, product specifications and delivery schedules. Similarly, downstream channel members get to know of the costs and difficulties of production and distribution. This has led to retailers consciously demanding the best prices and quality products. Mass merchandisers and manufacturers also want to reap the advantages that retailers and vendors have, by negotiating for changes in prices and delivery schedules. Channel members are able to spend more time negotiating better terms and conditions instead of haggling over prices and profits.

IMPACT OF INFORMATION SYSTEMS ON CHANNEL RELATIONSHIPS

Companies are building powerful information systems to serve customer needs better, and in the process, developing the marketing channel as a source of differentiation and competitive advantage. The necessity for detailed information about customer needs has tilted the scales in favour of downstream channel members, especially retailers, as they are in direct contact with customers. In this section, we will discuss the impact of channel information systems on channel power, conflict, cooperation and coordination.

Power

IT has become the single-most important factor to change the dynamics of power among channel members in a given value-chain. This shift in power is somewhat difficult to comprehend because of the various ways in which power can be defined and measured. Power over channel members may be in the form of economic power or bargaining power. The sources of power (referent, coercive, reward, legitimate and expertise) and the relationships between channel members (supplier-retailer, wholesaler-retailer, supplier-wholesaler) also add to the difficulty in understanding power shifts in a channel. We will focus our discussion on Customer Information Systems and the impact on the shifting of power among channel members.

The traditional channel roles of manufacturers, wholesalers and retailers have changed after customer information systems were put in place. Point-of-sale systems were primarily responsible for the shift in power from manufacturer to retailer. These systems enabled retailers to collect first-hand information about customers' tastes and shopping behaviour. Wal-Mart, the retail giant, is a wonderful example of this shift in power to retailers. Wal-Mart's centralized buying approach compels manufacturers to provide products at low prices and high service levels. Point-of-sale systems are widely prevalent in the United States and UK. It will be some time before they are implemented in India.

Many retailers are using point-of-sale systems and frequent-shopper programs to collect valuable information on customers, to develop customer information systems. A&P Stores, a grocery chain in the US, is a retailer that has developed a comprehensive customer information system to leverage itself on channel power. Exhibit 23.6 describes the steps taken by A&P to develop a customer information database.

Exhibit 23.6

Customer Information Systems and Channel Power

A&P Stores, a grocery chain in the US, developed an exhaustive customer database using data obtained from its frequent-shopper programme. A&P also used its 'Bonus Saver Cards' programme, which enabled customers to avail discounts on hundreds of products stocked by the store. In this programme, customers availed discounts during checkout, where the cashier ran the card through a card-reading device linked to the cash register. Information about the customer's purchase details and identity are recorded in a central computer. As part of promotions, A&P issued discount coupons at check-out counters to customers for products not regularly purchased by them. The discount coupons were issued based on the customer's purchase history. For example, regular Pepsi drinkers were offered discount coupons for Coke to induce them to shift brand loyalty. As the store had access to in-depth information on customer purchase patterns and preferences, it was also able to streamline its inventory management and direct manufacturers to conform to its terms and conditions. A&P was thus able to individualize its promotional campaign through its customer information system.

Adapted from Jim Bessen, "Riding the Marketing Information Wave", Harvard Business Review, September/October 1993, Volume 71, Issue 5, 150-160.

Not only retailers, but manufacturers too have taken steps to build detailed customer information systems. Cigarette makers like R.J Reynolds and Philip Morris have developed extensive customer information databases through special promotional programmes. They used discount coupons and prizes to collect customers' responses through questionnaires. For example, in 1987, Philip Morris conducted a blind taste test where respondents were offered free packs of an unnamed brand. Around two million smokers then filled up a questionnaire and everyone received two packs of Philip Morris's Merit brand and follow-up mailings. At the end of the programme, not only did Philip Morris collect a wealth of information on smokers, but half a million existing smokers shifted loyalty to the Merit brand. Customer information has helped the cited companies to withstand pressure from retailers to offer heavy discounts to improve sales. Thus, the use of information systems helps manufacturers increase their bargaining power over downstream channel members.

On the whole, however, it has to be accepted that the balance of power has shifted in favour of retailers since they have the natural advantage of getting first-hand information on customers and can directly measure customer response to products and promotion.

Conflict

Channel conflict takes place when there is a difference in the roles that channel members are expected to perform. Channel conflicts may be vertical, horizontal or multi-channel in nature. Conflict among channel members may arise due to several reasons. It may arise because of goal incompatibility, differences in perception or dominance of a channel member over others. To reduce the probability of conflicts, it is necessary that the roles and rights of all channel members are clearly specified. Information systems play a major role in transmitting information about the activities of different channel members in a timely manner. This reduces the possibility of incompatibility of roles. In the absence of an information system, the manufacturer may ship a wrong consignment or the shipment may not arrive on time. In both cases, the retailer has to face a stock-out situation, which will be detrimental to the store's reputation. Sometimes the retailer places orders at the last minute or keeps changing the order quantity or assortment. It then becomes difficult for the supplier to deliver the required order on time. These problems can be avoided by using information systems to facilitate regular information exchange between channel members.

Conflicts may also arise between supplier and retailer due to differences in channel functions. Some common functional issues that give rise to conflicts are minimum order size, retail assortment, speed of delivery, retail inventory levels, retail promotion and performance management. In addition is the issue of retailers carrying competitors' products. The use of systems like Transaction-Based Information System (TBIS), Continuous Replenishment Program (CRP), Efficient Consumer Response system (ECR), Point-of-Sale systems (POS), Quick Response System (QR), Electronic Data Interchange (EDI) and a host of others reduces the chances of conflict. For example, CRP helps retailers maintain inventory levels; POS keeps track of retail promotion and performance; EDI and QR help streamline order size and assortment problems.

Information systems also provide channel members with complete information on each other's activities. So, the chances of a channel member exercising information or referent power over others are minimized. Differences in views regarding the advantages of channel information systems can be a source of conflict. If a retailer feels that the costs associated with participating in an information system offset the profits, the retailer may refuse to participate despite the advantages. Wal-Mart faced such a situation when it implemented EDI technology. In the beginning, Wal-Mart encouraged its suppliers to adapt EDI systems by providing training and installation facilities. Later, when very few shifted to the new system, it used coercion power by refusing to deal with suppliers who did not use EDI technology.

Studies have been undertaken to identify the source of conflicts and differences in the intensity and types of conflict across different channel levels and channel systems. Some studies have revealed that greater integration between channel members can give rise to more conflicts. The details of these studies are beyond the scope of this chapter. Irrespective of the divergent opinions of experts, it is generally accepted that the use of information systems is an ideal solution to reduce potential channel conflicts.

Cooperation and Coordination

CIS have changed the way channel members operate by influencing the traditional relationships between channel members. It facilitates channel coordination and permits channel members to adopt mutually acceptable goals that supersede individual goals.

Earlier, channel members made every effort to get the best bargain from each individual transaction with other channel members. Information systems have changed this. One can gain the full benefits of information systems only when channel members cooperate and coordinate with each other. This has led to channel members looking at the interests of the channel as a whole and not just themselves. Collective goals have superseded individual goals. Information systems have led to sharing of data, which has facilitated the growth of 'information partnerships'.

Cooperation

Channels differ based on the extent of cooperation between channel members. Some channel members cooperate informally without formal commitments while negotiating channel transactions. These channels are more or less similar to conventional channels in their mode of operation. A higher degree of cooperation among channel members gives rise to consensus. Vertical and horizontal channel systems represent the highest level of formal cooperation and coordination among channel members.

Channels can also be differentiated based on the type of channel members. In horizontal cooperation, channel members of the same type cooperate with each other. For example, a retailer cooperates with another retailer. In inter-type channel cooperation, different types of channel members operating at the same level cooperate with each other. For example, a discount store cooperates with a department store. Vertical cooperation involves cooperation between channel members at different levels in the channel. For instance, cooperation between a manufacturer and a wholesaler. Another variant is channel system cooperation. Here, cooperation takes place between types of channel systems. It is widely seen in multi-channel systems. For example, the traditional distribution system for one product cooperates with the direct selling system for another product.

Coordination

Companies begin their quest for channel coordination by trying to acquire other channel members across the channel. However, the total failure of Allegis Corporation, an integrated travel company started by United Airlines, signified a change in this approach to one where channel partners could gain mutual benefit without having to merge. Enormous changes in the price and performance of systems that process, store and transmit data have led to improved coordination among channel members for mutual benefit. In general, information system-based coordination or partnerships are divided into four major categories - joint marketing partnerships, intra-industry partnerships, customer-supplier partnerships and IT vendor-driven partnerships. We will focus our discussion on coordination between channel members within a channel.

Information systems have been used in different ways to enhance coordination among members at all levels across the value-chain, be it manufacturers-wholesalers, manufacturers-suppliers, companies-dealers/agents, etc. McKesson, Singer, General Electric and Eastman Kodak have achieved excellent coordination between manufacturers and suppliers through information systems. Information coordination between companies and suppliers were best seen in the inter-organizational systems developed by American Hospital Supply (now Baxter Healthcare) and General Motors. Some other companies in this category are Ford, United Airlines, CIGNA and Chevrolet.

Many retailers have established partnerships with suppliers to efficiently coordinate channel activities. Wal-Mart uses a ‘Retail Link System’ to share information with vendors. Wholesalers have taken advantage of information systems to coordinate channel functions. McKesson, a pharmaceutical supplier developed the ‘ECONOMOST System’ to share information with retailers and customers. Grocery retailers and manufacturers are also slowly moving from merely controlling and analysing information in large databases to cooperation through information sharing. This enhances their productivity. For example, a leading grocery retail chain in the US entered into a arrangement with a manufacturer of diapers, according to which the retailer would automatically transmit information to the manufacturer whenever a shipment of diapers left for the stores from the warehouse. Under the agreement, the manufacturer had to ensure that stocks are replenished immediately without a specific purchase order being needed or a delivery schedule being given by the retailer.

Information flow in a distribution channel cannot be separated from product flow. Unless an effective communication system unites channel members, coordination is difficult. Efficiency of physical distribution will also be impossible to achieve. Hence, it is necessary to share and transmit information efficiently and on a timely basis to plan and coordinate physical product flow adequately.

SUMMARY

Information technology has made a big difference to channel operations and management. Information systems have revolutionized the way information is collected, stored and transmitted between channel members. They add value to the distribution function and enable channel members to integrate different channel functions, which was not possible in conventional distribution systems. Channel information systems have also influenced the structure of distribution channels. Lengthy channels have given way to shorter and highly efficient distribution systems.

Channel information systems comprise an information database and the hardware and networks that help in the collection, processing and transmission of information. The hardware, software and networks vary depending on the application requirements of channel members. They vary for business-to-business applications, retailing applications, business to consumer applications and interactive applications for consumers. Transaction-Based Information System (TBIS), Continuous Replenishment Program (CRP), Efficient Consumer Response System (ECR), Point-of-Sale Systems (POS), Quick Response System (QR), Electronic Data Interchange (EDI) etc., are some commonly used information systems. Many companies have developed information systems to suit their needs. McKesson's ECONOMOST system, United Airlines and American Airlines' Apollo and Sabre systems, Analytic Systems Automatic Purchasing (ASAP) by Baxter Healthcare, Johnson & Johnson's Cooperative Action Plus (COACT) and Abbott's Quik Link information systems are some successful information systems. PrecisionCode, DataDesigns, Archer's Retail Database Management System (ARDMS) and Product Information Management System by IBM are examples of database systems developed by companies.

Channel Information Systems (CIS) have influenced the way in which different channel functions are performed. It has streamlined operations leading to improved channel flow. CIS has also changed the order in which different functions are performed. CIS has influenced the physical distribution of products or distribution flow. Transaction flow, promotion flow, inventory flow and negotiation flow have improved with the advent of information technology in channel management.

Information systems have a profound impact on channel member relationships. They influence the balance of power, intensity of conflict and the extent of cooperation and coordination among channel members. CIS has changed the dynamics of power among channel members. EDI systems have reduced asset specificity, complexity of product specifications and coordination costs. This has led to a shift in the balance of power among channel members. Many retailers like Wal-Mart have developed efficient information systems that offer them substantial leverage over their suppliers. Even manufacturers like Philip Morris have conducted extensive programmes to build an exhaustive database about consumer preferences, which allowed them to influence downstream channel members. CIS reduce conflicts that may arise between supplier and retailer due to differences in different channel functions. Some common issues that give rise to conflicts are minimum order size, retail assortment, speed of delivery, retail inventory levels, retail promotion and performance management and the issue of retailers carrying competitors' products. However, the use of channel information systems minimizes the chances of conflicts.

Coordination and cooperation among channel members have greatly improved due to CIS. Channel members have opted for collective goals over individual goals and have started looking for benefits to the channel as a whole. Information is easily available to all channel members, resulting in an increase in trust and commitment. Channels differ based on the type of channel members involved in cooperation and the extent to which members cooperate. Different channel systems include consensus systems, vertical systems, horizontal systems and inter-type systems. Channel cooperation and coordination have led to successful and profitable relationships at different levels in the channel – between manufacturers and suppliers, suppliers and retailers and between manufacturers and retailers.

Part VI

Channel Institutions & Future Trends

Chapter 24

Wholesaling

In this chapter we will discuss:

- Wholesaling and its importance
- Types of wholesalers
- Strategic issues in wholesaling
- Trends shaping wholesale distribution
- Impact of information technology on wholesaling
- Challenges in wholesaling
- Wholesaling in India
- Future of wholesaling

Distribution channels typically consist of individuals and marketing organizations that assist in the flow of goods and services from the producer to the consumer. As goods and services flow from the producer to the consumer, they pass through several intermediaries in the form of wholesalers, retail outlets, etc. Wholesalers purchase the goods from the manufacturer. Retail outlets like departmental stores and supermarkets then purchase the goods from these wholesalers. And consumers buy the goods from the retail outlets.

Thus, wholesalers are individuals or organizations that specialize in procuring goods from the producers and making them available to the lower level intermediaries in the distribution channel. Wholesalers act as facilitators for distributing goods and products. Figure 24.1 depicts the various levels of intermediaries in a distribution channel.

Of the various intermediaries in the distribution channel, it is the wholesalers who form the vital link between the manufacturers and the resellers. By taking up the distribution of goods produced by the manufacturer, a wholesaler allows the manufacturer to concentrate on production and other vital aspects that contribute to improving his profitability.

In this chapter, we examine the wholesaling system and its contribution in the distribution channel. Beginning with a discussion on the importance of wholesaling in an economy, we proceed to discuss the types of wholesalers. This is followed by a description of the strategic issues concerning wholesaling in which decisions that wholesalers need to take with reference to their target market and the marketing mix will be discussed. Thereafter, we examine the trends that have shaped wholesaling over the years. The chapter also focuses on the inevitable role of IT in wholesaling, the various challenges that are faced in the wholesale trade, and the wholesale scenario in India. It ends with a discussion on the future of wholesaling.

WHOLESALING AND ITS IMPORTANCE

As mentioned earlier, a distribution channel connects the producers or manufacturers with various customer segments through a number of intermediaries such as wholesalers, retailers, etc.

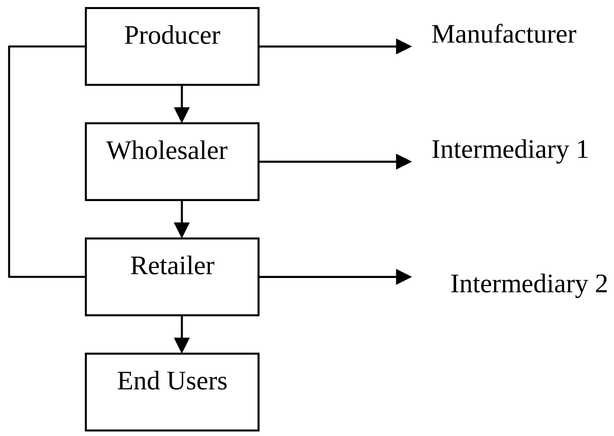
Each intermediary plays an important role in making the products available to the end users. A wholesaler gets the goods from the producer and delivers them to other intermediaries down the channel. The intermediaries, in turn, make the goods available to the consumers. For example, software wholesalers of the 1-2-3 spreadsheet applications purchase the product from its manufacturer, Lotus Development Corporation, and sell them to computer retail dealers. These dealers in turn, sell them to individuals or organizational customers.

A wholesaler is distinguished from other intermediaries by means of the particular class of customers to whom he supplies the merchandise. Wholesalers resell the merchandise to retailers, to industrial, commercial, farm or professional business users, and also to other wholesalers. They may also purchase or sell merchandise on a commission basis. In such transactions, the wholesaler plays the role of an agent or a broker.

Wholesale trade is most common in food products, beverages, drugs, tobacco products, household goods, etc. In India, for example, the Agricultural Produce Market Committees (APMCs) located in various cities deal in the wholesale trade of fruits and vegetables and make them available to customers through the markets.

Wholesalers simplify the product and information flows between the manufacturer and the end users in a distribution channel. They perform those functions in the distribution channel that would not be profitable for the manufacturer or the retailer to perform himself.

Figure 24.1: Levels in a Distribution Channel



Source: Kasturi V. Rangan, and Ramchandran Jaikumar, "Integrating Distribution Strategy and Tactics – A Model and an Application," *Management Science, Volume 37, Number 11(November 1991): 1377-1390.*

The type of support the wholesalers provide is difficult and expensive for the manufacturers or the retailers to take up themselves. Wholesalers make bulk purchases of goods from manufacturers and store them until the ultimate consumers need them. Maintaining large inventories of the goods or products is both uneconomical and impractical for manufacturers as well as retailers. Wholesalers also take up a few sales and marketing functions of the manufacturers, as for instance, order processing, customer service, and maintaining sales contacts. This frees up the time and resources the manufacturer spent on activities involving these functions. Wholesalers also make goods available to resellers in large quantities at a discounted price.

Wholesaling adds value to the goods offered by the manufacturer by making these available to the end consumers at the right place, right time and right price. The functions of a wholesaler can be broadly categorized into transactional, logistical, and facilitating functions. The transactional function involves buying, selling, and risk taking. The buying function involves purchasing goods or products from the producers and storing them in warehouses to make them available to consumers when the need arises. The selling function involves distributing the manufacturer's goods to retailers, thus enabling the manufacturer to reach individual customers through retailers. The risk-taking function involves obtaining the title to the goods and products produced by the manufacturer and storing them in inventory despite the risk of theft, spoilage, and possible product obsolescence.

The logistical function involves the assorting, sorting, storing, and transporting functions. The assorting function deals with building up assortments comprising products obtained from various manufacturers. This function of the wholesaler saves the customer time in having to search and locate these products himself. The sorting function deals with putting in one category products of the same kind that have been produced by different manufacturers. The storing function involves storing the manufacturers' goods in warehouses specially built for the purpose wherein goods and products are stored and dispatched to customers when there is a demand. This function of the wholesaler eliminates inventory cost, manufacturer's risk, as well as the need for customers having to maintain an inventory. The transporting function deals with facilitating the physical flow of goods and products from the manufacturer to the end consumer.

Exhibit 24.1

Need for a Wholesaling System as Evidenced in Russia

The first *piatiletka* (five-year plan) of Russia saw little need for wholesaling as the country had excessive production and distribution was not the focus area. Moreover, under the communist philosophy, the intermediaries symbolized the hated capitalistic system and were, therefore, viewed as parasitic elements whose only motive was to earn profits.

This scenario however, did not last long. The lack of coordination between the producers and the distributors, spoilage and damage of goods during transport, and lack of distribution depots in adequate numbers resulted in the All-Union Council of National Economy pointing out the need to reorganize the wholesale distribution in the country. It established a series of wholesale institutions that specialized on the basis of geography and product line, and shaped the wholesale industry in Russia.

Adapted from Theodore N. Beckman, "A Critical Appraisal of Current Wholesaling," The Journal of Marketing, Volume 14, Issue 2, September 1949, 307-316.

The facilitating function includes the financing, grading, and disseminating functions. The financing function involves extending credit to customers and providing finance to manufacturers by placing bulk orders and making immediate payments for them. The grading function entails grouping the products according to quality. The disseminating function involves keeping manufacturers and customers informed about competitors, new products, and price developments.

An efficient and dynamic wholesaling system benefits the ultimate customers by making the goods available to them at any time in adequate amounts at a low cost and at various locations. Exhibit 24.1 describes how the need for a wholesaling system arose in Russia.

TYPES OF WHOLESALERS

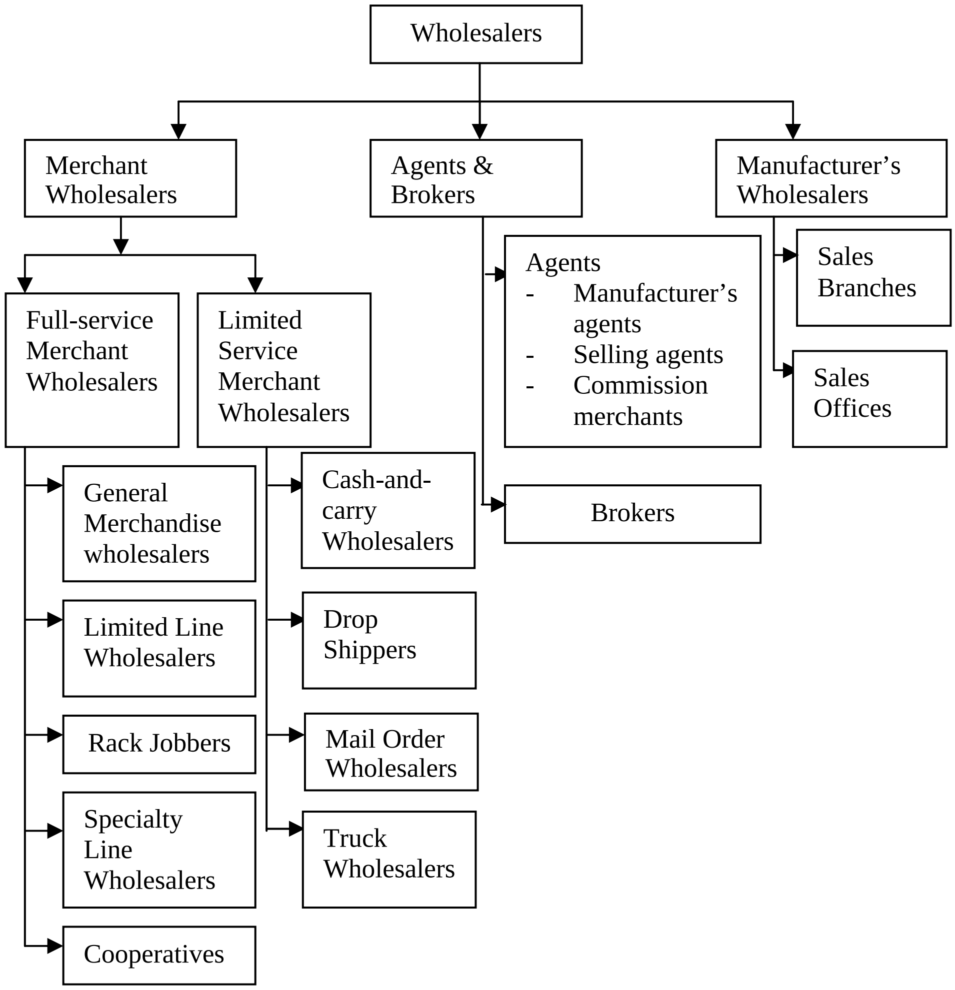
The evolution of distribution channels was accompanied by the introduction of several intermediaries in the distribution channel to make the products easily available to the end users. The period also saw an increase in the types of intermediaries to meet the growing needs of the customers as well as the producers. In this section, we will discuss the different types of wholesaler intermediaries that have evolved over time to meet the needs of producers and the retailers. Figure 24.2 presents the classification of wholesalers into various types.

Wholesalers can be divided into three broad categories – merchant wholesalers, agents & brokers, and manufacturer's wholesalers.

Merchant Wholesalers

Merchant wholesalers take over the title of ownership to the goods from the producer and are responsible for the stock owned. They buy and assemble goods in large lots and resell them in small quantities to retail outlets, industrial, commercial or professional users through salesmen. They sell and buy in the domestic market on their own account and make payments to the manufacturer for the goods purchased. Merchant wholesalers perform various functions of wholesaling such as extending credit to customers, delivery and merchandise servicing, and rendering trade related advice.

Figure 24.2: Types of Wholesalers



Based on the range of services or functions they perform, merchant wholesalers can be further classified into full-service merchant wholesalers and limited-service merchant wholesalers.

Full-service merchant wholesalers

Full-service wholesalers provide most of the services of a wholesaler like storing, delivery, providing credit facility, warehousing, taking title to the goods, etc. Depending on the products carried and the services offered, full-service merchant wholesalers are further classified into general merchandise wholesalers, limited line wholesalers, specialty line wholesalers, rack jobbers, and cooperatives.

General merchandise wholesalers carry a wide range of products that are resold to the retailers. They mostly cater to the needs of small retailers and carry almost all the products that customers need.

Limited line wholesalers offer a narrow range of products to retailers. They create an extensive assortment of products that are purchased from different producers and make them available to the retailers and other organizational customers.

Specialty line wholesalers carry a very specialized range of products, which is usually a single product or a few products from a product line. Examples of specialty line wholesalers are tobacco wholesalers, hardware wholesalers, etc.

Exhibit 24.2

Demerits of Rack Jobbers

With the growth of the distribution system, the role played by a rack jobber has lost its significance. Besides, retailers prefer to have greater control over the assortment of products. Retail stores in the US have been able to redefine their services through better inventory control and have, therefore, reduced the rack jobbing component. There is a general feeling that while other distributors can spot trends in sales, rack jobbers tend to manage the product mix based solely on sales. The service that a rack jobber offers like detailing, stocking, inventory and mix management, and stock balancing are also unbundled. Many retailers in the US have, therefore, stopped seeking the service of rack jobbers.

Adapted from Kristen Kenedy, "Risky Rackjobbing Services Losing Luster, Computer Retail Week, 10 April 1995, Volume 5, Issue 95, 43-44.

Rack jobbers purchase goods from the manufacturers, and display and stock them at the retailer's place. The rack jobber receives payment from the retailer only when the items are sold (consignment selling). However, the complexities involved in this form of distribution make rack jobbing an option that not many retailers prefer (Refer to Exhibit 24.2).

Cooperatives are owned by the members who run them and the profits are distributed equally among the members. Cooperatives are common in the dairy and agriculture industry. In the agriculture industry, farmers come together to form a group and manage the operations of the group to derive the benefit of bulk purchases of fertilizers, seeds, etc., and sale of agricultural produce. Examples of agricultural cooperatives in India are the sugar cooperatives in Maharashtra.

Yet another example of cooperatives is seen in the dairy industry. Some of the well-known dairy cooperatives in India are Gujarat Cooperative Milk Marketing Federation (GCMMF), known for the household brand, Amul; Andhra Pradesh Dairy Development Cooperative Federation Ltd (APDDCF), known for the brand, Vijaya; and Punjab State Cooperative Milk Producers' Federation Ltd (MILKFED), known for the brand, Verka.

Limited-service merchant wholesalers

Limited-service merchant wholesalers do not undertake all the functions of a wholesaler. They specialize and so offer only limited services to retailers. Limited-service merchant wholesalers include cash-and-carry wholesalers, drop shippers, mail-order wholesalers, truck jobbers, rack jobbers, and manufacturers' sales branches.

Cash-and-carry wholesalers

Cash-and-carry wholesalers do not perform the activities of delivery, credit facilitation, and promotional activities but they undertake warehousing and own the title of the goods purchased from the manufacturers. Cash-and-carry wholesalers do not arrange for transportation. The retailers have to arrange for transportation after paying the wholesaler for the goods purchased. Wholesale furniture outlets are an example of cash-and-carry wholesalers.

Cash-and-carry wholesalers adopt different strategies to move their products from the display shelf. For example, cash-and-carry wholesalers in Okachimachi district of Tokyo, in keeping with their 'no inventory' policy, slash prices of electronic gadgets that remain on the shelves for more than a day. In their efforts to display the latest gadgets on their shelves these wholesalers do not mind selling slow moving products at very low prices which might even sometimes affect their margins.

Drop shippers

A drop shipper does not physically handle the merchandise. Once he obtains the order from the customer, he locates a manufacturer who can fulfill the order and arranges for him to deliver the goods to the customer directly. Thus, drop shippers do not perform the storage function of wholesalers. The risk of the drop shipper begins at the time of his taking the order and lasts till the time the goods are delivered to the customer. It is during this duration that the drop shipper takes over the title of the goods. According to Jupiter Research[1], most online retailers lose money in shipments and in handling deliveries and plan to use drop shippers to reduce costs.

Mail-order wholesalers

Mail-order wholesalers make extensive use of catalogs instead of using the services of a sales force for marketing. Thus, mail-order wholesalers do not perform the personal selling function in wholesaling. Mail orders are usually used to buy jewelry, cosmetics, etc. The customers of a mail-order wholesaler include the retailers, and institutional and industrial buyers.

Truck wholesalers

Truck wholesalers are limited service merchant wholesalers who transport the stock in a truck to the customer's place, facilitating an on-the-spot inspection and selection of the goods by the customer. Truck wholesalers are also called truck jobbers. They perform the functions of selling and delivery for cash and usually carry a limited line of products like fruits, vegetables, milk, snacks, etc. Customers inspect the goods and select them when they are satisfied with the price, quality of stock, etc. The customers of truck wholesalers normally include hotels, hospitals, institutions, and small grocery outlets.

Agents and Brokers

Agents and brokers facilitate purchases and negotiate sales between buyers and sellers. They work on a commission basis without taking over the title of the goods. So what distinguishes agents and brokers from merchant wholesalers are that they do not take over the title of the goods and do not offer all the services of a wholesaler. Agents and brokers are also termed as functional middlemen. Agents represent buyers or sellers on a permanent basis (for example, insurance agents), while brokers represent buyers or sellers only temporarily (for example, real estate brokers, securities and financial services brokers). Both agents and brokers specialize in a particular product or type of customers.

Brokers

Brokers bring the buyers and sellers together and negotiate between them. They receive a commission for their services from the parties involved in the negotiations. They do not undertake the wholesaling functions such as carrying inventory, facilitating credit, or risk-taking. They only bring the buyer and seller together. A broker does not receive payment until the product is sold and has to ensure the best deal for the customer. The broker also has to ensure the timely delivery of the customer's order. He has to keep himself informed about the trends in the industry and share them with the clients. A broker can offer discounts and freebies to the retailers on the products he promotes. He also takes back the goods if they are not sold. Depending on their field of specialization, brokers can be classified into real estate brokers, securities and financial services brokers, tea brokers, etc.

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[1] Jupiter Research, a division of Jupiter Media, headquartered in Darien, Connecticut, is a leading international research advisory organization specializing in business and technology market research.

Exhibit 24.3

Advantages of Hiring Manufacturer's Agents

Marley Cooling Tower, a US-based company that manufactures industrial water-cooling towers, caters to its nine locations across North America with a sales force comprising 40 personnel. In addition, Marley also employs 70-odd manufacturer's agents who work on a commission basis. These agents have helped Marley to not only increase sales but also to overcome the difficulties of rapid business expansion. Manufacturer's agents possess a great deal of knowledge and experience regarding their particular territory and, therefore, hiring them is all the more advantageous to companies in terms of time saved in studying the market.

Since manufacturer's agents are paid their commission only after the sale takes place, employing them has resulted in significant cost savings for the company. The company has also been able to save on costs by not having to pay a regular salary to a direct sales force irrespective of the sales made. It has also been able to cut down on the recruiting and training costs involved in hiring sales personnel.

Marley has been selling for more than 60 years through these agents who were hired to tap new markets after the company started outgrowing its initial territories. The established relationships and contacts of these agents helped Marley to capture the new markets with ease. The most important benefit that these agents brought to Marley was the long-term relationships they had built up with their customers.

Adapted from Andy Cohen and Tricia Campbell, "Who Needs a Sales Force, Anyway?" Sales & Marketing Management, February 1999, Volume 151, Issue 2, 13.

Real estate brokers facilitate the buying and selling of property and real estate by bringing together prospective buyers and sellers. Securities and financial services brokers help in the buying and selling of securities and provide securities brokerage and related financial services to clients. US-based Charles Schwab is an example of a securities and financial services broker.

Agents

As mentioned earlier, agents represent buyers or sellers on a permanent basis. An example of an agent is an insurance agent who acts as an intermediary between the insurer and the insured for the duration of the policy. Agents can be further categorized into manufacturer's agents, selling agents, and commission merchants.

Manufacturer's agents are independent intermediaries and represent two or more sellers. They offer complementary products of the various sellers they represent and, therefore, customers have access to complete product lines. Depending on the industry and their performance, manufacturer's agents receive commissions ranging between 5 and 25% of the sales made. Manufacturers who sell through agents have significant cost benefits since they have to pay the commission only after the sale takes place. The manufacturers also save on cost incurred in recruiting and training a sales force. Apparel, furniture, and electrical goods are usually sold through manufacturer's agents. Exhibit 24.3 describes the advantages to a company from hiring manufacturer's agents.

Selling agents are independent middlemen who sell the manufacturer's entire output. They undertake the selling function in cases where the manufacturer is not able to directly sell the merchandise due to financial constraints or lack of marketing skills. The selling agents have complete control over pricing, promotional and distributional activities, and over the terms and conditions of sale. Selling agents usually deal with companies involved in seasonal production.

Commission merchants are agents who procure goods on consignment and transport them to bigger markets to sell them for the best price in the market. They deduct the commission and the transportation costs and pay the rest of the money earned to the producer. This is a common practice in selling seafoods, agricultural produce, etc.

Manufacturer's Wholesalers

Manufacturer's wholesalers perform the same set of functions as merchant wholesalers. These intermediaries are owned and operated by the manufacturers themselves. Manufacturers often undertake wholesaling operations through sales branches and sales offices in order to have control over inventory, selling, and promotion.

Manufacturer's sales branches are captive wholesaling operations owned and controlled by the manufacturer. They sell the manufacturer's products and provide support services to the manufacturer's sales force, especially in regions where there is a high demand for his products. A sales branch undertakes the functions of granting credit, inventory, delivery, and sale of goods. Manufacturer's sales branches are common in electrical supplies and in plumbing. Westinghouse Electric Supply Company and General Electric Supply Company are examples of manufacturer's sales branches in electrical equipment.

A sales office is a lot like an agent but is owned and operated by the manufacturer. It does not carry any inventory. A sales office can also sell products from other manufacturers that are complementary to the products of the parent manufacturer.

STRATEGIC ISSUES IN WHOLESALING

The highly competitive market place, changing customer preferences, disintermediation, i.e., direct selling without intermediaries, and e-commerce have made it necessary for wholesalers to design innovative strategies to survive in the business. Figure 24.3 gives a diagrammatic representation of the intermediaries found in electronic marketing channels.

Some key strategic decision areas in wholesaling include those pertaining to the target market, product assortment, and the 4 Ps of marketing.

Target Market Decisions

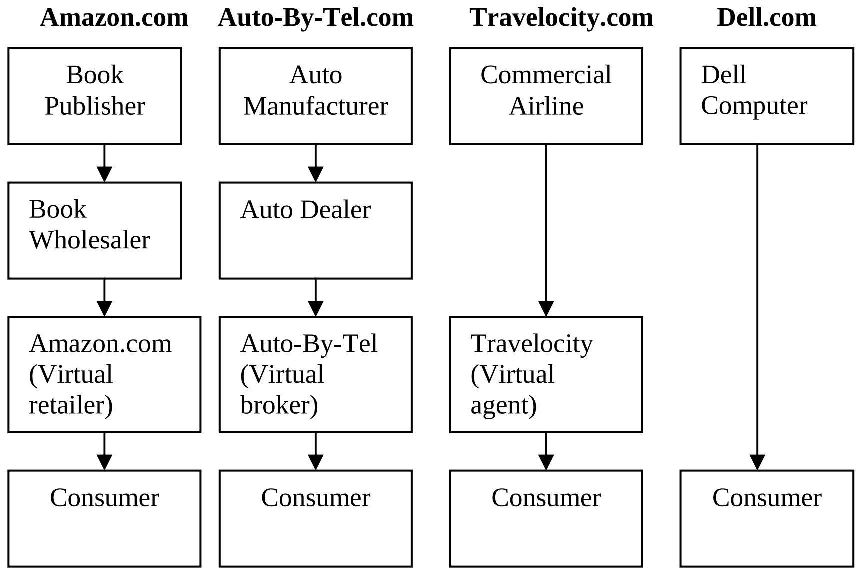
Like in any other business, there is a need for wholesalers also to identify their target market. The target market comprises an identified group of customers upon whom the wholesaler can focus for the bulk of his business transactions.

The target market for a wholesaler can be identified on the basis of size (large, medium, or small retailer), type of customers (urban or rural), distance from the wholesaler's location (within city limits, within a radius of 100 miles, 300 miles, etc), income range of the customers (high income, medium income, or low income) or requirements to fulfill in terms of products and services offered. After he has identified the target market, the wholesaler can design appropriate measures to reach it.

Marketing Mix Decisions

Yet another key area that requires strategic decision-making by the wholesaler is that of the marketing mix. Wholesalers must decide on the products to offer, their pricing and positioning, the promotional activities required, and the means to reach the target market.

Figure 24.3: Intermediaries in Electronic Marketing Channels



Source: "Managing Marketing Channels and Wholesaling," www-rohan.sdsu.edu/~renglish/370/notes/chapt15

Products to offer: A wholesaler must decide on the assortment of products to offer to his customers. Inventory management is a crucial aspect in wholesaling. Rather than carry a bulk inventory of products, wholesalers should carefully analyze the profitability associated with each product and carry only those that are profitable. Wholesalers should thus maintain a profitable assortment of products.

Product pricing: The pricing activity involves calculating a break-even price. This requires computing the variable and fixed costs the wholesaler incurs on purchasing merchandise from the manufacturer and storing it. The selling price can be calculated by dividing the sum of the variable and fixed costs by the number of units to be sold . Wholesalers add a standard markup to the cost of goods to cover the expenses incurred on transporting, packaging, assorting, etc. Adding a markup to the cost of goods helps the wholesaler earn a profit of 2-3%, depending on the market conditions. Sometimes, wholesalers have to be ready to compromise on their profit margins in order to target new markets and customers.

Product positioning: Wholesalers have to find ways to clearly differentiate their product from others available in the market. To do this, they have to make the customers aware of the product's important and unique features along with its benefits. They must also be able to devise means to make the products available to customers in ways that are superior to that of the competitors, if not at a lower cost.

Promotion: Promotional activities aim at increasing the brand awareness of the customers and persuading them to buy the products. Promotional activities also help a customer become brand loyal in the case of high quality products. Until recently, wholesalers did not focus much on promotional activities and targeted the market through a direct sales force. However, this trend has been slowly changing, with wholesalers seeking promotional support from manufacturers.

Place: The products have to be made available at places that are convenient to customers. Wholesalers have to take into consideration the transportation costs involved as well as the customer reach as criteria for taking the place decision. The use of information technology and the latest technologies have made the operations of wholesalers easier and more cost-effective.

TRENDS SHAPING WHOLESALE DISTRIBUTION

The wholesale business has been moving upward for the past 20 years. The growth of wholesaling has been driven by changes in business investment, especially in the case of producer durable goods & equipment, and changes in household consumption, which influence the orders generated in the distribution channels.

Manufacturers' attitude towards wholesaling has also contributed to the growth of the wholesale business. Earlier, manufacturers preferred to invest in research and production rather than on distribution channels because that produced a higher rate of return. Though a few manufacturers tried to venture into distribution by eliminating the middlemen, the advantages offered by wholesalers in the form of closeness to the markets, better inventory management, focus on marketing activities, etc., outweighed the costs involved. Increasing costs associated with direct sales call (about $100 per call), also made manufacturers hire industrial distributors to target key market segments.

There has also been a significant change in the mode of operation of the wholesalers. They have evolved from serving as mere warehousing points to exploring the profitability of potential markets. There has also been a shift in their focus from traditional markets to new markets. For example, many electrical and electronic distributors in the U.S., are now targeting new industrial and commercial markets in order to supplement their sales efforts in the established electrical-contractor market.

The basic trends that are responsible for bringing about a significant change in the business of wholesaling are discussed below.

Functional Overlap

The manufacturing and distribution activities in an economy can be fundamentally categorized into four levels – manufacturing, wholesaling, retailing, and consumption. However, the dynamic nature of markets has caused an overlap of functions between the various levels as a result of which there is no longer a sharp demarcation between them in the present-day market scenario. Wholesale-retail franchising, joint ventures, and conglomeration have given rise to horizontal and vertical market integration, which has further reduced the distinction among the intermediaries in the marketing channel. For example, Midas International, which started as an automotive warehouse distributor, buys and manufactures items for its franchisee network, comprising over 500 Midas Muffler and brake shops.

Increased Services

Wholesalers have redesigned their services over time to suit customer requirements. A number of wholesale druggists in the U.S. now handle the customer records of retail druggists. This serves to bind the retailers to one wholesaler. In the grocery business, for instance, wholesalers have shifted their focus from providing basic services like extension of credit to offering more sophisticated services such as merchandising support, inventory management counseling, conducting profit analysis for the retailers, etc. The aggressiveness of wholesalers in offering increased services is aimed at gaining a competitive advantage.

Pricing and Credit

The pricing of a product or a service is a critical element as the price influences the customer's decision to buy. The wholesalers in keeping with this concept, constantly work to arrive at a price that maximizes the value offered by the products. They are constantly on the lookout for better pricing mechanisms, such as system contracting, that offers better service to customers at a lower cost. Many wholesalers use the element of improved service to attract a large number of direct buyers.

Another key factor in attracting customers is the credit terms that the wholesaler offers. Developments in the field of finance have helped wholesalers to use a wide variety of financial tools to meet the customers' financial requirements. For example, a wholesaler in Canada modified his credit policy to incorporate the concept of accounts receivable management and control by exception and importance rather than giving equal emphasis to all issues. Accounts receivable management involves the profitability assessments of trade-related risks. With the implementation of the new credit policy, the wholesaler decreased the term of credit from 60 days to 40 days. Doing so released a significant amount of capital, which he used to invest in inventory and to find new markets.

The quest of wholesalers for new pricing mechanisms and credit alternatives has brought about a significant change in wholesaling over the years.

Regional Coverage

Wholesalers use their subsidiaries to cater to the needs of the local market segments by storing limited fast moving inventory. These outlets have access to a centralized warehouse to meet their inventory demands. This is a common practice among the distributors of plumbing, heating, and cooling equipment.

Wholesalers are also making use of a leapfrogging strategy that involves implementing backfire tactics. Under this strategy of market penetration, the wholesalers set up branches that are about 1000 miles away from the main office so that sales spread backwards towards the home base.

Organizational Form and Size

In the past, the wholesale market was dominated by sole proprietorships, partnerships and family run businesses. The current trend among wholesaling establishments has been to grow in size and assume a corporate form. Wholesalers have moved toward assuming a corporate form through the options of public finance, takeovers, and mergers & acquisitions. According to the US census report in 1997, the number of wholesale trade establishments in the US has grown to 453,470.

Wholesalers have an increasing interest in enhancing value for their shareholders. Favorable tax laws have made them more open to diluting their stake through public financing and employee stock options. However, the dilution of ownership along with bringing in cash inflows makes it necessary for the management to be innovative in its business practices to keep its shareholders happy. The management can invest the additional capital raised through public issues to implement information technology to make the wholesaling system more efficient and productive.

The trends just discussed show wholesalers' responsiveness to market forces and how they have transformed themselves to meet the growing demands of both manufacturers and resellers for improved service at lower costs.

IMPACT OF INFORMATION TECHNOLOGY ON WHOLESALING

The wholesaling industry has been adversely affected by direct selling, the underperformance of the manufacturing sector, high expectations from the buoyant retail sector, customer's demand for added value, etc. Wholesalers have also been facing hurdles due to information delay, communication hassles in data exchange, lack of accurate information, identification of exceptional conditions, process optimization, etc.

Exhibit 24.4

Market Center Distribution

Wholesalers in the US have begun to adopt a Market Center Distribution (MCD) model to secure a dominant position in the market. The North American Heating, Refrigeration and Air-conditioning Wholesalers Association (NHRAW) developed the MCD model to make its products available to the end users. MCD involves the integration of information technology with regional distribution centers that persons familiar with the local markets and customers manage. Systematic information exchange among manufacturers, distributors, and customers has helped eliminate inefficient and redundant practices in the distribution channels in the concerned industries.

Adapted from John R Hall, "The Future is Market Center Distribution," Meeting Update, NHRAW, December 24, 2001.

In addition to overcoming these problems, wholesalers have also been trying to lower costs and provide better services to tackle the competition in the dynamic market place. To respond quickly to unforeseen conditions in the market, they need a variety of information. Advanced and effective implementation of IT has become necessary for wholesalers to meet the demands from the manufacturing and the retail sectors and to add value to their supply chain and warehouse management activities. Wholesalers are leveraging on the use of IT to solve their business problems. Realizing this, many software vendors have come up with solutions to meet wholesalers' demands. For example, IBM offers an Industry Solutions Program (ISP) to address the needs of the wholesale industry. Wholesalers are beginning to integrate IT with the distribution function for effective performance of the distributive channel (Refer Exhibit 24.4).

The use of IT and the latest technologies has made wholesalers' operations a lot easier and more cost effective. The rapid growth in information technology has led to new ways of managing distribution channels. IT initiatives and innovative channel partnerships have evolved to include electronic data interchange, efficient customer response, continuous product replenishment, etc. Bar coding, scanning, and other digital technologies have helped wholesalers improve the efficiency and effectiveness of business processes. For example, McKesson, a large drug wholesaler known for its extensive use of IT, implemented Economost, an electronic order entry system, to help its retailers in their distribution of drugs (Refer to Exhibit 24.5).

Information technology has changed the way wholesalers have been conducting their business. IT has also contributed significantly to the assortment planning, new product development, inventory replenishment, order processing, and store selling tasks of wholesalers.

CHALLENGES IN WHOLESALING

The common goal of wholesalers as well as manufacturers is to maximize the return on investment, to reduce the costs involved in distribution and to grow as an organization through innovation and best practices. Wholesalers have to meet several challenges in trying to achieve these goals. Some of the common challenges that wholesalers encounter in their operations pertain to the areas of inventory management, sales management, promotion management, and financial planning and management.

Exhibit 24.5

Implementation of Electronic Order Entry System at McKesson

Information technology is altering the way business is conducted. When McKesson, a wholesale drug distributor in the US, implemented Economost, an electronic order entry system, it aimed at helping its clients, the small retail pharmacies, counter the threat of competition from large pharmacy chains. However, Economost has ended up not only helping the company to expedite order-processing and control its inventory, but also the management of its retail drug stores in their decision-making. This it does by collecting information from them, processing it, and selling it back to them.

The information is collected by the order entry system when a retailer pharmacist places an order with the McKesson's data center either on the phone, by fax, or electronically. Every order received is updated on the computer and an acknowledgment sent to the retailer. The order details are stored on an IBM mainframe. McKesson's regional distribution centers then extract the orders from the mainframe and deliver the order to the pharmacists at the earliest. A minicomputer is provided at all the distribution centers to help identify and label the products. McKesson uses mother trucks to distribute its products to remote centers that are not connected to the central computer at McKesson. The mother trucks carry the deliverables till a switching point and then transfer them to smaller trucks to reach the local pharmacists. A Decision Support System is used to schedule the timing of the trucks.

McKesson's customers have benefited from the company's implementation of the electronic order entry system due to the reduced costs, accurate ordering, and quick delivery it has made possible. Economost helps McKesson in quick and efficient order processing, and has been instrumental in a 17% rise in the company's productivity and an increase in its sales volume.

Adapted from "Strategic Systems and Reorganization," <http://www3.interscience.wiley.com:8100/legacy/college/turban/0471073806/add_text/ch13.pdf> and Rashi Glazer, "Measuring the Value of Information: The Information-Intensive Organization," IBM Systems Journal, March 1993, 1-6.

Inventory Management

This is a major problem that wholesalers face as they deal primarily with inventory storage and maintenance. Inventory management and control is a key challenge to anybody maintaining it. Most wholesalers face a dilemma in terms of the range and quantity of inventory to maintain. This is because both an excess and a shortfall of inventory have costs associated with it. With numerous new products flooding the markets, thanks to the increased investment by producers in research and development (R&D), the woes of the wholesaler have only multiplied. And what has aggravated matters is the innumerable modifications necessary in the size and packaging of existing products. The wholesaler has to identify, label, handle, stack, control, pick, pack, ship, and invoice each item in his stock. One way to overcome inventory problems to some extent is to limit the length of the product line to about 80-95%.

Another factor that needs attention is the inventory carrying costs. It has been observed that 20-35% of the wholesalers' inventory carrying costs can be attributed to the annual cost of possession of the inventory. A few wholesalers use inventory control techniques like Activity Based Costing (ABC) to maintain an optimum level of inventory. Ensuring inventory turnover is yet another method to reduce the annual cost of possession of the inventory. There have also been instances where manufacturers have taken measures to reduce the inventory carrying cost of their distributors. For example, American Standard shortened its product line by reducing its brass fittings by 30% to improve its line profitability and reduce the inventory problems of its wholesaler. Some manufacturers also conduct programs on inventory management and control to educate their distributors. For example, the UCON refrigerants division of Union Carbide has conducted many seminars for its distributors and provided them with checklists, worksheets, and specially prepared material to help them manage their inventory.

Sales Management

Though the wholesale trade sector has grown, there has not been a significant change in the wholesalers' focus on sales management. The number of wholesalers who use a professional and systematic approach to sales and promotion is very few. Most wholesalers use personal selling to reach their customers though a few of them use innovative sales methods. For example, wholesale druggists in the U.S use the telephone as a medium to reach high potential customers from whom they get about 80% of the orders. A few wholesalers in the field of electronics, healthcare, etc. use automatic reordering systems for repeat orders and save on the additional order getting costs and sales personnel time. Salesmen can use the time saved through such techniques to serve customers better and to devise innovative techniques of selling. Also, wholesalers who use selling techniques such as the cash-and-carry concept and catalog selling have been able to cut down on their sales force requirement. Wholesalers have thus focused on their selling efforts and used local sales branches to increase product availability, thus separating the selling function from product handling.

Promotion Management

Many manufacturers offer promotional support to wholesalers in the form of trade shows, catalog preparation, direct-mail promotion, advertising, and dealer shows, but the wholesalers, by and large, do not accept such support. They only agree to promotional programs that are customized to suit their operations, that help increase their profitability, and that are designed taking into consideration their handling costs and budgets. The bottom line is, of course, that they have been designed by manufacturers with whom they share a good rapport.

Some wholesalers are not content to merely resell merchandise produced by the manufacturers. They also want to be identified as a source of high quality product lines and look to creating an identity for themselves by offering only high quality products and undertaking a variety of promotional schemes. Big corporate wholesalers have demonstrated how the use of a sophisticated promotional campaign has helped increase their profitability. Many small-scale wholesalers too, who did not have a professional and systematic approach towards promotional activities earlier, are now working towards a better promotional orientation to improve their profitability.

Financial Planning and Management

The traditional wholesaler laid the stress on sales and did not focus much on cost justification. Fortunately, this has changed and wholesalers now also consider the profitability of transactions. Complex tax-reporting requirements, increase in competition, and the use of information technology and control systems have made wholesalers turn their attention to financial management. Wholesalers now attend seminars and training programs on financial planning to increase their awareness on finance-related aspects. Manufacturers like General Electric and Union Carbide, realizing that it is advantageous for them if distributors become more aware of financial management, conduct training programs on finance-related areas for them.

WHOLESALING IN INDIA

With India having become a commercial hub, the standard of living has considerably risen in the recent past. This has led to increased consumer spending on modern gadgets and materials. The modern lifestyle of people has thus, greatly benefited the wholesale and retail trade markets because people are more willing to buy and experiment with new products.

The wholesale business in India has been on the rise from 1990 following the opening up of the Indian economy, which allowed many multinational companies to set up their subsidiaries in the country. Unlike in the U.S. or Canada, wholesalers in India do not require a legal permit to start a wholesale business.

Most wholesale traders are members of associations that protect, preserve, and promote the interests of the members and interact and mediate with Government authorities. Agricultural Produce Market Committees (APMCs) are such quasi-governmental agencies that regulate the marketing of products at the wholesale level. The APMCs are set up for producers to market their products and generally deal in fruits and vegetables. APMCs are present in most of the cities. In New Mumbai, for example, there is an APMC complex where several wholesale businesses are conducted.

Another major factor that has affected the wholesale industry in India and elsewhere is technological advancement. Advances in technology have made the world more compact and encouraged international trade. Traders now procure goods from other countries if the cost of manufacturing them locally exceeds the cost of importing them . For example, Indian traders source most electronics goods like integrated circuits, cords, microphones, and headphones from China.

The development of wholesale markets has contributed to the growth of the economy and also increased the employment rate in India.

Thus the opening up of the Indian economy has paved the way for a better lifestyle, which has in turn, led to a boom in the retail sector and contributed to the growth of the wholesale sector.

FUTURE OF WHOLESALING

As in any other sector of business, the wholesaling industry too is likely to undergo a lot of changes in the future. Dynamic forces of change in the business environment like the availability of self-service options to customers, direct selling by companies, and the improved bargaining power of customers have compelled distributors to adapt to these changes in order to survive.

The wholesaling industry is itself in a state of transition, as competitive forces have made change essential for survival. In order to ensure their survival and success in business, it is essential for wholesalers to redesign and restructure their businesses while at the same time cutting costs. The wholesalers who survive will be the ones who formulate and adopt differentiation strategies that will give them a competitive advantage in the market and those who ensure availability of products at all times and offer their services at the best prices.

Another factor that will shape the wholesaling industry is consolidation, which will significantly reduce the number of establishments operating in the industry. The big companies that emerge as a result of mergers, acquisitions, and geographic expansion will dominate the industry.

The use of modern technology and innovative practices will help wholesalers to carry out their operations more efficiently and profitably.

Restructuring of the wholesale industry has reduced the marked functional distinctions that existed in the earlier structure. The present day intermediaries in the distribution channel perform cross-functional activities. Many large retailers use warehouses and hyper marts to undertake wholesale functions. Many wholesalers too have started taking over retail functions. For example, SuperValu, a leading food wholesaler in the U.S., now operates its own retail outlets to reach the customers directly and serve them better.

Wholesalers will provide a wide variety of services to retailers in the form of retail pricing, cooperative advertising, marketing and management information reports, accounting services, etc.

The limited scope for growth in domestic markets and facilitating agencies such as the North American Free Trade Agreement (NAFTA) will help wholesalers to trade across geographical boundaries.

Other key forces that will drive the future of wholesaling include e-commerce, strategic alliances, supply chain integration, and globalization. The Internet has revolutionized wholesale distribution and e-commerce is bound to have a tremendous impact on shaping the global wholesale sector. E-commerce will make distributors focus more on delivery of information and services rather than on storage and transportation, as was traditionally done.

Strategic alliances will also have a profound impact on wholesale distribution. Distributors will be able to ward off threats from competitors by means of strategic alliances. The alliances will also lead to a lot of innovative practices and help distributors pull products across the marketing channels.

Supply chain integration allows suppliers and distributors to reduce the costs associated with distribution. The maximum spending of suppliers and distributors is on inventory holding costs. Though the costs associated with the traditional, manual form of distribution are likely to decline, the costs incurred in present day wholesaling are likely to increase because of infrastructural investments.

Globalization has reduced the time and place barrier among countries and allowed them to sell their merchandise in offshore markets and compete with players in the foreign market.

The importance of wholesaler-distributors in international trade is growing and will continue to grow substantially in the coming years. Export activity and the non-domestic operations of wholesaler-distributors will also grow. Wholesaler-distributors may also expand their operations to support their suppliers who have started operations abroad.

Countries that have a good distribution infrastructure have good scope for international growth. Wholesaler-distributors can make the best use of their superior operating procedures and policies, capital availability, and information technology to become globally competitive.

SUMMARY

A distribution channel comprises various channel members like wholesalers, retailers, agents etc., who act as intermediaries in the distribution of goods and services from the producer to the end-consumer. Wholesalers form a critical link in the distribution channel and help manufacturers in making their products available to the consumers in adequate quantity at the right time and place. A wholesaler’s functions can be transactional, logistical, and facilitating in nature. These functions involve buying the products from the manufacturer, assorting, storing, and transporting them, extending credit to customers, grading the products according to quality, and making competitive marketing information available to suppliers and retailers.

Depending on the product ownership and services offered, wholesalers can be classified into merchant wholesalers, agents and brokers, and manufacturer's wholesalers. These are further comprised of various types of wholesale organizations.

In the process of distributing the manufacturer's products to other intermediaries, wholesalers have to take several strategic decisions. A wholesaler has to decide on the target market he wishes to serve. This depends on the number and type of customers, demographic factors, etc. The wholesaler also has to take decisions pertaining to the products to offer, product positioning, place, pricing, and promotional activities.

A changing lifestyle, technology, competition, and globalization have changed the wholesaling scenario the world over. Wholesalers have evolved into big corporate organizations due to better regional coverage, customized pricing and credit policies, better service to the customers and erosion of functional boundaries.

The wholesaler has thus evolved from being an intermediary using traditional methods of distribution to one who is IT savvy. There is a critical need for organized and stored information for taking any business decision. Information sharing plays a dominant role in a distribution channel due to the number of intermediaries involved and complexity of the channel structure. Present day wholesalers are keen on using IT to meet their information and communication needs. IT has a profound impact on the way wholesalers conduct their business. The use of IT has not only hastened communication and information sharing but its role in the business processes like assortment planning, new product development, inventory replenishment, order processing, etc., has made these processes faster and efficient.

Wholesalers have overcome various limitations of the past but they still have more challenges to overcome in the near future. Some major areas of concern that can adversely affect the profitability of a wholesaler, if they are not properly planned and controlled, are inventory management, sales management, promotion management, and financial planning and management.

As elsewhere in the world, in India too, there has been a growth in the business of wholesaling. Changes in the business environment after the opening up of the economy have caused wholesalers to adapt to these changes and modify their operations. The future of wholesaling will be dominated by consolidations, and restructuring and will be strongly influenced by e-commerce and Internet technologies.

Chapter 25

Retailing

In this chapter we will discuss:

- Retailing and its importance
- Evolution of retailing
- Classification of retailers
- Strategic issues in retailing
- Trends in retailing
- Future of retailing

Retailing plays a fundamental role in the distribution process. The origin of the word 'retail' is from the French word '*retaillier*', which means to break up or 'to cut a piece off'. Retailing consists of all activities involved in selling goods or services to the end consumer. Being a large employer and a major service sector component, the retail sector plays a major role in the economy of developed nations. Retailers offer consumers the convenience of utility of time, place and possession by providing the right product, at the right time and at the right location.

Although, retailing as a business has existed in India for long, it is only recently that it has witnessed tremendous growth. During the last decade, a host of retailers have begun operations, not all of them successful. Some of the more successful operators are: Shopper's Stop, Lifestyle, Westside, Giant, Big Bazaar, Nilgiris, Food World, Pantaloon and The Home Depot. Shopper's Stop is the leader in the departmental store format, Big Bazaar and Giant in the hypermarket format, Westside in private store labels, Food World and Nilgiris in the supermarket format and The Home Depot in specialty retailing. According to a study by the Confederation of Indian Industry (CII), the present value of the retail sector in India is US $ 180 billion (2003 estimates), with the organized sector representing only two per cent. A.T. Kearney estimates the market will reach Rs 8,00,000 crores by 2005.

In this chapter, we will discuss various aspects pertaining to retailing. We will begin with a discussion on retailing, its importance and evolution. This is followed by a classification of retailers. The chapter then examines strategic issues in retailing followed by a discussion on retailing trends. Finally, we end with a brief discussion on the future of retailing.

RETAILING AND ITS IMPORTANCE

Retailing is the last step in the distribution process. Retailers are the most common means by which products are delivered to customers. Retail distribution is an important economic activity in developed nations. This can be understood from two main aspects. First, it is a means of providing goods and services to consumers and second, it is beneficial to other channel members in the distribution channel. Thus, the importance of retailing can be studied in terms of its value to consumers and to other channel members.

Importance to Consumers

Technological developments in industry and agriculture have increased production levels and reduced their costs. Distribution in general, and retailing in particular, has enabled manufacturers to transfer the cost advantages of technology-based production to consumers, who are extremely fragmented. In underdeveloped countries, where the standard of living is low, retailers are the sole link between manufacturers and consumers. Retailers act as buying agents for consumers. They add value to the distribution process by ensuring that the consumer gets the right product, at the right time and at the right place. As a buying agent, the retailer performs many useful activities for the consumer. These include – inventory management, providing value-added services and product variety, breaking bulk and disseminating information.

Inventory management

Retailers act as a means to transfer goods and services from manufacturers to consumers. They bear the costs of storing products, so that customers do not have to stock essential products and incur resulting costs. Retailers do the stocking in their stores and the consumer can shop at convenience.

Value-added services

Apart from providing consumers this convenience, retailers provide value-added services that benefit them. Examples are free home delivery and facilitating transactions by allowing consumers to pay for products and services through credit cards and by instalments. Retailers also provide loans to enable consumers to overcome temporary financial crunches.

Product variety

Retailers have the advantage of selecting the best products from a range of manufacturers. This enables them to display a wide assortment to suit the needs and tastes of different customers. At the same time, it gives customers an extensive choice in product selection.

Breaking bulk

Another important function of retailers is that they make purchase easier by selling products in small quantities. Retailers purchase goods from manufacturers in bulk and convert them into smaller units to suit consumers. In less developed countries with lower disposable incomes, consumers buy products in very small quantities. The retailers help by breaking bulk into smaller units. This also facilitates easier transportation of goods to the consumer.

Disseminating information

Retailers disseminate information about different products in the market. Advertising through the media is not enough for customers to get sufficient information about products. Retail stores, through in-store displays and sales personnel, disseminate information about new products launched in the market.

Importance to Other Channel Members

Variations in consumer needs and demands mean that manufacturers have to produce an endless assortment of different products. So that this endless cycle can be kept going, it is necessary that there is a continuous flow of products from manufacturer to consumer. Retailers not only make products available to consumers, who are geographically dispersed, but also act as a source of information to manufacturers about consumer requirements. Manufacturers seek retailer's help to gather information about consumer tastes and preferences. They also obtain information on product quality and usage. Manufacturers use this information to modify existing products and launch new products. This information is valuable because retailers enjoy the advantage of having direct contact with consumers. Further, retailers assist manufacturers to streamline and specialize production so that different products can be made available according to changing customer tastes. This helps manufacturers gain higher profits.

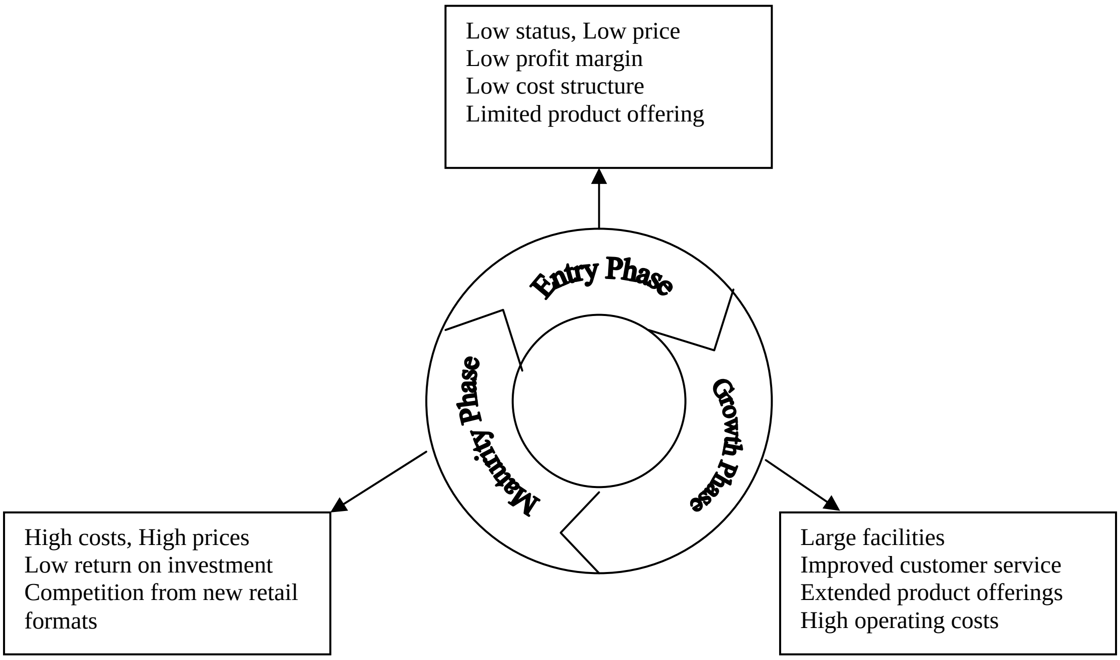
Retailers too share the risks associated with product distribution with other channel members. It includes physical risk to product (due to damage during transportation or storage) and technological risk due to product obsolescence.

Source of Employment

Retailing is a labour-intensive activity and employs a large number of people. It accounts for 15-20 per cent of the total workforce in developed nations. Retailing is also a major employment sector for women. In the European Union, approximately 55% of employees in the retail sector are women.

The retail sector has significantly impacted employment in India as well. The organized retail business in India is worth about $3 billion and is expected to be a fast

Figure 25.1: The Wheel of Retailing



growing business segment. With increasing economic growth and improved standard of living, consumption levels are set to reach never-before levels. This will be a boon for the retail sector.

EVOLUTION OF RETAILING

Retailing started out as the last point in the distribution process. It acted as the sole means of providing essential commodities to geographically dispersed consumers. Over the years, from a modest beginning, retailing evolved into a specialized form of selling products. Presently, there are numerous retailing forms that are difficult to list, let alone comprehend. Malcolm P. McNair, in his pioneering work, 'The Wheel of Retailing', has described the evolution of retailers.

Wheel of Retailing

According to this concept, the retailer's life span is in the form of a cycle. In the first stage, retail innovators (those who initially adopt a retail format) enter and establish themselves as low-status, low-price operators with low profit margin requirements and a low cost structure. Over time, these retailers grow and establish large facilities with increased investments leading to higher operating costs. They focus on offering improved customer service in the form of credit, delivery, shopping ambience and so on. When retail innovators reach the maturity stage, these high cost, high price operators succumb to new retail innovators who enter and start operating at lower costs and prices. This completes the wheel. (See Figure 25.1)

Of the many factors that have influenced the evolution of retailing, some have played a crucial role. These include the Industrial revolution, competition and trade-up, regression, assimilation and innovation.

Industrial Revolution

The different forms of retailing that we see nowadays – the department store, variety store, supermarkets, mail-order firm, discount store and others -- developed over a relatively short period of about a 100 years. The Industrial revolution that took place between the latter half of the 18th and the first half of the 19th century, was a prime mover in the evolution of modern retailing forms. Earlier, the retailing sector had inherited the traditional guild-structure of the 18th century. The guild-structure consisted of manufacturers, merchants and traders arranged in hierarchical groups with a manufacturer(s) selling to a group of traders who then individually sold to groups of merchants. The members of this retail sector were mainly non-experts and people on the look out for a living or quick profits. The Industrial revolution led to manufacturers scaling up production and the retail sector in its present form could not cater to increasing production and changes in the people's living standards. This led to the emergence of new and improved forms of retailing.

Competition and Trade-Up

As retailing modernized, its older forms became extinct, though there was resistance to this. This resistance in fact featured every time there was a change from the old to the new. Competition and the propensity to trade-up are also reasons for the evolution in the retail sector. Older retailers, when threatened by newer forms, began shifting to the newer principles and systems. Similarly, the new retailers tried for an advantage over their peers by adopting some proven methods used by the older retailers. Slowly, such combinations gave rise to newer forms of retailing.

Regression and Assimilation

Regression is a form of evolution where retailers choose to adopt systems and processes contrary to current developments. This response is based on the principle that the latest trends are quickly copied by a large number of players and it is sometimes profitable to stay with traditional forms. For example, when supermarkets upgraded to hypermarkets, it was accompanied by the revival of the small supermarket and drive-in superettes.

Assimilation is a form of evolution in which retailers following traditional methods do not confine themselves to copying modern forms but strive to develop innovative means to enable them to compete even in the future. This pattern was seen in the US, where traditional food chains transformed themselves rapidly into modern supermarkets. Similarly, ready-to-wear stores changed quickly into soft goods discounters.

Innovation

Innovation has had a profound influence on the evolution of retailing. There are manifold instances where innovative technologies have led to the development of new approaches in retailing, thereby changing industry economics.

The first major change took place in the late 18th and early 19th century with the advent of the department store. The development of railroads gave additional impetus to these stores' success. Railroad made it possible for retailers to gather an assortment of products from across a country and also enabled the transport of people from the outskirts of a city to the department stores. The sheer volume of products available and the number of customers meant that the department store could rotate its inventory many times and thus maintain profitability at lower margins. The concept of catalog-retailing also developed at this same time, mainly due to the introduction of free mail delivery to rural areas. As department stores could not provide service to customers in rural areas, catalogue-retailing filled this gap in customer service. Sears (the US-based retailer) started as a catalogue-retailer before expanding into a retail chain.

The increase in the number of automobiles on the roads in the 1960's led to increased mobility of shoppers and brought about the next stage of the retail revolution – malls and discount stores. Malls are similar to department stores but offer more product lines in each category. A discount store is a type of department store offering a wide range of merchandise products including apparel, consumer electronics, apparel and home, health and beauty products at competitive prices.

During this time, the generalist catalog retailers slowly wound up due to the entry of their specialty counterparts, who offered a range of products in a single product category. Ward (a US-based catalog retailer) wound up in 1985 and Sears closed down its catalog operations in 1993. Over time, a new class of retailers emerged -- the specialty discounters. These retailers offered greater depth of products in fewer product categories. Circuit City, Barnes & Noble, Toys 'R' Us and Home Depot are most successful specialty discounters of the United States.

The Internet is the latest innovation in the retailing sector. The Web gives the advantage of starting a virtual store with a miniscule investment. The most important benefit is that the place/location factor gets discounted. Anyone can start a web store irrespective of the place of residence. Companies like Amazon.com have an inventory turnover 25 times a year. This enables Amazon to earn a 125% return on inventory with a margin of only 5%.

A common pattern visible in all stages of the retail evolution is the shift from a generalist format (selling few products of all categories) to a specialist format (selling deeper product lines of a few categories). Another thing observed is the tendency of all retailers to initially sell products that require minimal communication or product promotion. This later evolves to selling products needing exclusive promotion and customer service.

The retailing evolution in India picked up pace in the late 80's and early 90's. Till then, it was a dormant sector. Exhibit 25.1 describes this evolution.

CLASSIFICATION OF RETAILERS

Retailing involves selling goods and services to consumers for their personal or household use. Retailers sell different kinds of products and services. There are retailers who exclusively deal in a particular type of product, for example, food products, hardware or apparel. An awareness of the different types of retailers in terms of size, product diversity and price enables better understanding of retailers and the environment in which they operate.

Retailers can be classified in different ways. We will focus our discussion on retail classification based on type of ownership, type of store strategy, non-store based retailers, non-traditional retailers and retailers classified on goods or services.

Classification based on Type of Ownership

Based on the type of ownership, retail organizations can be classified into organizations that are:

- ✓ Independently owned
- ✓ Chain-owned
- ✓ Franchise-operated
- ✓ Organizations that operate on a leased department format
- ✓ Consumer cooperatives.

Exhibit 25.1

Retail Evolution in India

Retailing in India had its humble origins in 1965 from a non-descript shop in Chennai that sold folding chairs, radios, fans and household appliances. It was called Viveks. Viveks, followed by VG Paneerdas (VGP), was the first consumer durables retailer in India. The first supermarket in India began in the early 1970's in Bangalore – Nilgiri's. Nilgiris however was functioning since the early 20th century. Viveks, VGP and Nilgiri's were the only retailers in India till the late 1970's when shops like Nalli's (Chennai), Charagh Din and Benzer (Mumbai) opened. The retail sector saw a host of changes from the mid-1980's under the Rajiv Gandhi government, when foreign investment was first permitted.

The second phase of the retail evolution took place in the textile segment with the opening of the 'Raymonds' chain of stores all over India. Titan closely followed in setting up retail shops for selling its range of Titan quartz watches.

The next phase of change occurred in the 1990's when more entrepreneurs began to set up retail chains. Manufacturers like Arvind mills, Titan Industries and Coats Viyella led the way. Shopper's Stop, set up in 1992, was one of the first modern departmental store in India. FoodWorld, set up by the RPG group, opened its first outlet in 1996 followed by Subhiksha in 1997. The late 90's saw the expansion of these independent stores into retail chains.

Since, the retail sector in India has witnessed stupendous growth. A host of new entrants have set-up shop. Globus, Lifestyle, Piramyd and Westside are some well-established players. Landmark and Fountainhead in books, and Planet M, Music World and Groove in the music field. India's largest supermarket, 'Haiko' opened in 2000 in Mumbai. The retail sector is presently one of the fastest growing business segments in the country. It employs 8-10 percent of the adult workforce and is set to trigger substantial economic growth.

Adapted from "The ET Knowledge Series- Retail 2000-01," Economic Times Group, 9-11.

Most retailers are small operators and are usually independently owned. Each ownership type caters to specific market segments. In the following section, we will discuss various forms of retail organizations based on ownership type. Vertical marketing systems will not be discussed as it has already been dealt with in Chapter 19 – Channel Integration.

Independent retailers

Independent retailers are the most common form of retailers. They usually operate with a single store and are generally started by entrepreneurs. The advantage of this form is flexibility in operations due to minimal layers of management, low investments, customized product and service offerings, ability to maintain tight control over strategy, personalized service, convenient location and timings, home delivery and financial credit facility. Disadvantages are lack of bargaining power due to small size of operations, absence of economies of scale and limitations in resources, information and planning, as they are dependent solely on the owner.

Chain stores

A retail chain has many outlets under a common ownership, usually with centralized merchandizing and decision-making functions. A retail chain's size is not based on the geographic area of its operations. Hence, a retail chain operating in only a few cities with many units can be considered a large chain. Based on the type of operation, retail chains are differentiated into local, sectional and national chains. The first is a retail chain that operates all its units in and around a particular city. The second is one that operates in a given geographical region. For example, Trinethra Supermarket's operations are limited to Andhra Pradesh. A national retail chain operates in more than one geographical region. For example, Lifestyle and Shopper's Stop, which have outlets in major cities across the country.

A retail chain has several advantages over an independent retailer. These include better bargaining power, ability to advertise and promote products, to undertake long-range planning and the same functional efficiencies as a wholesaler. The disadvantages are lack of flexibility due to large scale of operations and high investments, strategies and operations due to multiple layers of management.

Franchise

The International Franchise Association (IFA) defines franchising as "A continuing relationship in which the franchisor provides a licensed privilege to do business, plus assistance in organizing, training, merchandising and business, in return for a consideration from the franchisee." Franchising is an arrangement between a franchisor (one who gives the rights) and the franchisee (one who receives the rights for a fee). Retailers may adopt a fully franchised system or a mixed system. A fully franchised system is one where all outlets are franchised and a mixed system is one where the retailer operates a combination of company-owned and franchised outlets.

Types of franchising arrangements

There are two types of franchising arrangements: product/trademark franchising and business-format franchising. In the former, the franchisee enters into a contract with a franchisor (suppliers/manufacturers) to sell products under the established name of the supplier. The franchisee operates independently and serves as an authorized distributor for the manufacturer's products. The franchisee is free to decide on store hours, selection of location and store displays and arrangements. Authorized car dealers of General Motors or bottlers for Coca-Cola are examples of product/trademark franchising.

Business-format franchising involves a closer relationship between the franchisor and the franchisee. Besides the right to sell products under the supplier's trade name, the franchisee has access to the franchisor's business system or method of business operations. This includes access to successful accounting systems or management training programmes of the franchisor. McDonald's is the best example of business-format franchising.

Three types of structural arrangements are possible in retail franchising. They are 1) Manufacturer-retailer arrangement, 2) Wholesaler-retailer arrangement and 3) Service-sponsor retailer. In the first, the manufacturer gives an independent franchisee the right to sell products or service. It is the most common form of franchising arrangement seen in India. An example is Bata. The wholesaler-retailer arrangement may be either voluntary or cooperative. In the former, the wholesaler gives licenses to retailers. In the latter, retailers form a group and share the ownership of the cooperative among themselves. They also share operational functions along with the wholesaler. Maruti's True Value is an example of a dealer-owned cooperative. In the third category, the service-sponsor retailer arrangement, the service firm gives retailers the right to offer specific service packages to customers. This is commonly seen in the travel industry. For example, SITA World Travels.

Advantages and disadvantages of retail franchising :

- It allows franchisers to overcome resource constraints. For example, Kentucky Fried Chicken could not have started its first 2,700 outlets but for the $450 million it obtained by adopting retail franchising.
- It reduces monitoring costs. As the franchisees are entrepreneurs who have invested in the business, they have the required zeal and motivation to succeed. Therefore, the need to monitor is greatly reduced.

- Franchising facilitates risk management. While starting a business, its potential and probability of success is difficult to estimate. If a franchisee fails, the company does not lose much. If the franchisee succeeds, the company has the option of bringing it under the company's fold when the agreement ends.
- The disadvantage is that too many licenses may lead to over saturation in a particular region. Also, if the royalty payment arrangement is based on gross sales and not on operating profits accrued, the arrangement may become a burden on the franchisee, as the same royalty has to be paid even when profit margins reduce.

Leased department store

Leased departments or 'shops-within-shops' involves renting space within a department, discount or specialty store to an outside party. Leased departments are used by department stores to expand operations into products and services involving highly specialized knowledge and skills. The leased department offers products that do not fall under regular product lines. They operate in categories like beauty salons, shoes, jewellery, cosmetics, photographic studio and repairs for shoes and watches. However, with increasing competition and interest shown by service firms, traditional service categories have given way to modern services like opticians, travel agents, banks, real estate and financial services. 'Share shops' are common in the American retail sector. Sears Roebuck has popularised share purchases over the counter in its stores with the message "buy your stocks, where you buy your socks". The rapid growth and success of discount stores is primarily due to the leased department store.

Advantages and Disadvantages

The primary advantage of a leased department store is its ability to diversify the product lines of retail stores into segments that require special training and experience. It also reduces store costs because the leased department pays for its inventory, personnel, fixtures and displays besides paying a commission. Leased departments can be used to reposition a retail store and revive a store that is not performing to expectations. Tesco, the UK based supermarket chain, took the help of leased departments to sell a variety of products and reposition itself. The rents paid by the leased department can be utilized to shore-up bottom lines. Excess space in loss-making stores can be utilized.

Leased departments can also get advantages from such arrangements. It can serve as a test marketing tool to gauge consumer expectations. Later, they can set up their own retail stores to sell their products. The retailer's image and publicity helps the leased department to sell its products without incurring heavy initial investments.

The possible limitations of such arrangements include restrictions that may be imposed on the leased department regarding style of operations, store hours and range of products. Bad in-store location and very high rents are other negatives.

One of the most successful users of this arrangement is Debenhams, a department store chain in the UK, which gets one-third of its sales from leased departments. Meldisco, a division of the Melville Corporation, is another leading operator of leased departments in the US. It supplies and sells footwear in all Kmart stores.

Consumer cooperative

Another type of retail organization based on ownership is the consumer cooperative. Consumer cooperatives are retail firms owned by consumers. Here, a group of consumers invest in, purchase shares, elect office bearers, manage operations and share profits. This type accounts for less than one per cent of total sales in the retail sector. The premise behind operating such cooperatives is the belief that better service can be provided than by adopting a for-profit approach. Also, operation costs will be much less than other standard ownership formats discussed.

Store-Based Retailers

Retail organizations can also be classified according to the type of strategy and products handled.Store formats can be primarily divided into food-based retailers and general merchandise retailers. With the advent of retail formats like hypermarkets, the traditional distinction between the food and merchandise store formats has disappeared. Hypermarkets cater to both categories. The various types of store formats that come under these categories are:

Food retailers

Food retailers sell different categories of foodstuffs. Fifty per cent of their total sales comes from food products. The different types of food-based retailers are convenience stores, supermarkets, food-based superstores, combination stores, limited-line stores and warehouse stores.

Convenience store

A convenience store is a conveniently located food retailer kept open for long hours. It carries a limited assortment of products and occupies floor space of around 3000-8000 square feet. The products in these stores have an average or above average price, higher than supermarkets. These stores offer the shopping convenience of not having to search through a maze of shelves or waiting in long queues. Convenience stores sell snack foods, soft drinks, car wash, lottery tickets, courier service, gasoline, ATM services and so on. 7-Eleven in the US and TM Group Inc. in the UK are well-known convenience stores.

Conventional supermarkets

Conventional supermarkets are self-service departmental stores that sell a limited variety of food and non-food items. They are also called ‘mom-and-pop stores’ in the US. They have limited advertising and promotion and products are sold at prices lower than grocery stores in the neighbourhood. Dollar Tree, Family Dollar and ‘99 Cents Only’ are some examples in the US.

Food-based superstores

These stores are larger than conventional supermarkets but smaller in size and product range than   combination stores. They cover floor space of around 25,000 to 50,000 square feet and carry a reasonable stock of non-food items like kitchen appliances, prescription drugs, flowers, video tape rentals and so on.

A variation of a food-based superstore is the ‘conforming’ superstore, which, on an average, stocks over 16,000 products across all major categories in the food and grocery sectors and are mostly self-service. Over 50 per cent of products stocked by these superstores are their own brands. Tesco Plc. gets over 75 per cent of its profits from such ‘conforming’ superstores.

Combination stores

A combination store is a mix of a conventional supermarket and a general merchandise store. They are typically large and cover floor space of around 30,000 to 100,000 square feet. These stores have the advantage of economies of scale and operational efficiencies. This enables them to reduce costs and improve profitability. Wal-Mart, Kmart and Meijer are among the successfully operating combination stores in the US.

A special version of the combination store is the super center. It is the American version of the European hypermarket. Super centres have not succeeded in the US as in Europe.

Limited-line stores

They are also called limited assortment box stores and offer a selective list of items. These stores should not be confused with ‘big box’ retailers like Wal-Mart, CostCo and Home Depot. Limited-line stores are discount stores and offer less services, shorter store hours and selective national brands. A majority of products offered are private brands and perishable goods do not figure on the shelves. This type of retail store originated in Europe in the early 1970s and expanded across that continent, forcing retail giants like J. Sainsbury and Tesco to develop similar economy stores.

Warehouse stores

Warehouse stores are discount food retailers and offer a range of products in a simple and flexible environment. Unlike limited-line stores, these usually cater to national brands. This retail format is favoured by one-stop food shoppers and customers seeking low prices, without concern for service or shopping environment. In terms of size, warehouse stores can be classified into three categories: 1) 15,000 to 25,000 square feet, 2) 25,000 to 35,000 square feet and 3) 50,000 to 65,000 square feet. These stores are also called super warehouses. Home Depot, the American retailer used the warehouse format to expand.

Despite the number of retail store formats, available, no single format has been able to really corner a large share of the market. Retailers like Wal-Mart have adopted all the above-mentioned forms of food retail formats to dominate the retail sector in the US.

General merchandise retailers

Another major category of retail store is the general merchandise retailer. Merchandise retailers have experienced a steady growth of 7 per cent over the years in the US market. They include: specialty stores, department stores, full-line discount stores, variety stores, off-price chains, membership clubs, thrift stores, hypermarkets and the “flea” market. The department store is the most successful among mass merchandisers. Argos and Woolworth are two of the biggest general merchandisers in the UK. A brief discussion on each type of general merchandise retailer follows.

Specialty stores

These stores stock a narrow range of product categories but have an in-depth assortment of products in each category. They cover an area less than 8,000 square feet usually and offer high levels of service. Specialty stores can tailor their strategies to focus on specific customer segments because they carry a limited line of products. They usually operate in apparel, furniture, books and sporting goods. Customers prefer these stores because of the sales personnel’s expertise on the products offered by the store, the smaller store size, absence of crowding and guaranteed availability of the desired product. Specialty stores cater to the affluent as well as the price-conscious.They have maximum sales among all retail formats followed by discount stores. Toys ‘R’ Us is a specialty store retailer catering exclusively to the toy segment. It accounts for almost 40 per cent of all toys and games sold in the US.

A ‘category killer’ store is a variant of the specialty store. It is a very large specialty store that offers a wide range of product lines in selective categories. Because of sheer size and low costs, consumers like to purchase products in a particular category from these stores. Other stores that stock the same products cannot compete in terms of price as well as variety and therefore the name, “category killers”. Home Depot (home improvement) and Sports Authority (sports goods) are considered “category killers”.

Department stores

Department stores carry the maximum product range among all general merchandise retailers. The store is organized into separate departments and each promotes a particular category of products. The departments have their own selling counters, selling area and sales personnel. Products sold in department stores are generally priced above average due to the cost of maintaining an up-market environment, advertising and in-store promotions.

Department stores can be categorized into the traditional department store and full-line discount store. The former have a separate identity unlike shopping centres and malls, which have a standard format. They have the flexibility to introduce new strategies and concepts to improve customer service and needs. Both Wal-Mart and Kmart are predominantly department stores and have captured much of the retail sector in the US.

Full-line discount stores

This offers a wide range of merchandise products such as apparel, consumer electronics, apparel and home, health and beauty products. It is also called a general merchandise discounter. Full-line discount stores have been very successful because of their focus on a variety of products at competitive prices. They do not generally stock premium brands. Discount stores develop special strategies to woo consumers and generate sales in each product category. For example, Kmart has a Pantry program in the food category. It is an in-store grocery concept that offers a complete grocery selection to customers. Giant retailers like Wal-Mart have diversified store operations and opened up discount store chains to cater to larger sections of consumers. Other prominent full-line discount stores in the US are Ames, Bradlees, Caldor, Hills, ShopKo, Target (Dayton Hudson) and Value City.

Some characteristics of full-line discount stores are centralized checkout, a catalogue order service, self-service with little emphasis on customer service, a large percentage of sales from hardware products like lawn and gardening equipment, house ware, automotive products and consumer electronics. These stores carry private brands for non-durable goods and national company brands for durable goods.

Variety stores

These stores started with the objective of selling a variety of products at low prices to consumers and were called the poor man’s department store, “five-cent” stores, or the “dime” store. Variety stores initially operated over an area of 10,000 to 25,000 square feet and grew to cover areas up to 1,00,000 square feet over the years. They evolved into “junior” department stores and later into discount stores. Some well-known variety store chains include F.W. Woolworth Corporation, McCory’s dime store and Variety wholesalers in the US, Marks & Spencer in the UK, Monoprix in France and Kaufhalle in Germany. Following the advent of department stores, specialty stores and “category killers”, the variety store concept has virtually died out in many parts of the world.

Off-price chains

This type sells products like apparel, shoes, cosmetics and house ware at every- day-low- prices (EDLP) in a self-service environment. They purchase goods only when there are special offers or good terms and conditions from manufacturers or wholesalers. Hence, there is no guarantee that the same products will be in stock again. Prices are nearly 30 to 40 per cent less than traditional department stores. The success of these stores lies in their ability to establish long-term relationships with suppliers under favourable purchase conditions. Companies make use of these stores to offload excess stock at the end of the season or when a product has failed in the market. Purchases are on a cash-and-carry basis and not on credit. These stores often buy seconds, cancelled orders and end-of-season stock of department and specialty stores. Some leading variety store chains in the US are TJX, SteinMart, Ross stores and the Burlington coat factory.

Membership clubs

They are also called 'warehouse clubs', 'wholesale cash-and-carry warehouses', 'wholesale clubs' and 'membership discount stores'. Consumers who shop here have to be members of the clubs and pay a monthly or annual membership fee. There are two kinds of memberships, 'wholesale' and 'group'. Wholesale memberships are for small business owners who purchase more than half the merchandise. Group members are generally government or military employees, or members of credit unions and financial institutions. These buyers make up a majority of the members but buy less than the wholesale members.

Membership clubs have blurred the distinction between wholesaling and retailing operations. They mainly sell general merchandise, clothing and food products. They have large storage facilities that double up as the shopping area, hence the name warehouse clubs. They avoid financial hassles by selling most products before having to pay suppliers.

Large warehouse clubs sometimes have an inventory turnover 15 to 18 times a year, which is more than three times that of discount stores. They stock nearly 4,000 to 5,000 items of well-known brands. Food, house ware and appliances account for more than 40 per cent of total sales. Promotional spending is minimal at about one and half per cent of sales. Warehouse clubs operate on a gross margin of 10 to 11 per cent and sell merchandise at prices 20 to 40 per cent below discount stores or supermarkets. Sam's Wholesale Club is the biggest US-based operator in this category. Other major players are Costco wholesale club, Price club and Pace membership warehouse.

Thrift stores

They are also called second-hand stores or second-order retail outlets. They sell second-hand products at a bargain and are generally located in low-income neighborhoods. They include both non-profit and for-profit organizations. Some well-known thrift stores are Goodwill Industries and the Salvation Army (non-profit) and Savers (for-profit). Thrift stores do not emphasize store environment and product displays and are usually situated in basements and downtown locations.

Flea markets

Flea markets are an informal form of retailing and are common in countries like India, though the name originates from the US. They are also called 'Sunday' markets, where vendors gather in makeshift shops to sell a range of products. These markets have something for everyone and cater to diverse consumer tastes. Flea markets are prevalent in developed nations like the US too. Vendors in these markets set up shop on a daily, weekly or seasonal basis. The Rose Bowl flea market in California is the largest of its type in the US. The flea market is considered a part of the underground economy, as taxes, accounts and product quality are not monitored. This gives rise to the possibility of unethical practices, especially in segments like baby food and pharmaceutical products.

Non-Store Based Retailing

Non-store retailing is when strategies that are not linked to the retail store are used to sell products. The traditional concept of location loses its importance in non-store based retailing formats. The last couple of decades have seen the emergence of this form due to the consumers desire to try out alternative channels of retailing. Commonly used non-store forms of retailing include direct marketing, direct selling and automatic vending machines.

Exhibit 25.2

Growth of Direct Marketing

Some reasons for the growth of direct marketing as a form of non-store retailing are:

- With an increasing percentage of women entering the work force, the time to attend to household requirements has gone down. Direct marketing saves the hours taken in traditional shopping and provides the same products at reliable prices and quality.
- The cost of travelling, time spent in traffic jams and parking problems prevalent in developed countries has led to the growth of direct marketing channels.
- The development of better technologies, facilitating ease in communication and purchase of products has also given an impetus to direct marketing.
- The widespread acceptance of credit cards by direct marketers has made transactions through different modes of direct marketing possible.
- Increasing competition among retailers has led to many firms opting for alternative forms of retailing to sell products.

Adapted from "Marketing Through New Media: Peeling the Orange", 22 July 2000, <http://tolearn.net/marketing/retailing.htm>

Direct marketing

Direct marketing has emerged as a powerful non-store communication and distribution medium for selling a host of products to consumers. It is a form of retailing where product selling is targeted at specific customers. Catalog retailing and direct mail are common forms of direct marketing. Over the years, several new forms of selling like telemarketing, direct radio and TV and Internet shopping have gained widespread acceptance. Exhibit 25.2 reveals the reasons for the widespread growth of direct marketing.

Depending on the products they sell, direct marketers can be classified into general direct marketers and specialty direct marketers. The former sell a wide range of products, not restricted to any particular category. Products offered include apparel, toys, gifts, kitchen appliances and house ware. In contrast, specialty direct marketers sell a limited range of products, restricted to certain product lines. In this aspect, they are similar to specialty retailers.

Catalog retailing

Catalog retailing comprises only 3 per cent of the total organized retail business in the world. It is still in a nascent stage in India. Otto Burlington (part of the German consortium of Otto Versand) was the first to venture into catalog retailing in India in 1993. It brings out the well-known catalog 'Otto Burlington'. J.C.Penney (a US-based retailer) has a 1,000 page catalog, covering more than 50,000 products, which is mailed to customers twice a year. The company spends a lot of time in catalog preparation to meet changing customer needs and provide a range of products. Companies have started sending tailor-made catalogs, called 'specialogs' to consumers. 'Specialogs' contain a list of products that vary for different customer segments. Despite its advantages, catalog retailing is expensive due to the enormous costs involved in paper, printing and mailing.

Direct mail

Another common form of non-store retailing is direct mailers. Many companies in India use this route to sell products. Reader's Digest was one of the earliest magazines to be promoted using direct mailers. Mail orders can be segregated into consumer mail order, business mail order and charitable direct response. The first has the largest

Exhibit 25.3

Effective Use of Direct Mail

Companies can enhance their reach of consumers through direct mail by good planning. Some aspects that help create a successful direct-mail campaign are:

- *Attractive headlines:* A well- written heading plays a major role in the success of direct mail. The heading is the first thing to capture the customer's attention. It prompts the consumer to go through the rest of the mail.
- *Presentation of information:* Product information must be presented simply and lucidly. Many pages of information and long sentences will irritate the reader.
- *Use a postscript:* By using a postscript that repeats certain information mentioned in the mailer, the reader will automatically refer back for a clarification. This helps the reader to stay focused on the mailer.
- *Pre-testing:* It is appropriate to pre-test mailers before actually sending them to customers. Pre-testing helps identify variables and areas in the mailer like presentation or headings that need to be modified for effectiveness.
- *Follow up:* Sending a direct mailer about a product or service is not sufficient to obtain an order from the customer. A firm has to follow up with mailers at regular intervals to determine customer response to the direct mail campaign.

Adapted from "Create an Effective Direct-Mail Campaign," Journal of Accountancy, July 2004, Volume 198, Issue 1, 32.

share of sales among the three. The concept of direct mail is slowly growing in India. Companies using direct mail can ensure good sales if they plan their strategies well. Exhibit 25.3 describes ways for effective use of direct mail.

For both catalog retailing and direct mailing, a detailed list of prospective customers has to be prepared. Such a database will also help the company to keep track of customer responses and classify customers based on purchase patterns. Databases played a crucial role in the turnaround of Spiegel, the American catalogue retailer. Databases helped the company to segment customer groups, develop specialty catalogues to target niche segments and update products in short time periods.

Another form of direct marketing is through television and cable TV. Many companies have used this form of retailing successfully. Home shopping TV consists of 'infomercials' that introduce and demonstrate the product through 30/60 minute programmes. The Direct Response Television Market (DRTV) in India is estimated at Rs. 50 crores. The well-established players in this segment are Asian Sky Shop (ASK) and TeleShopping Network (TSN). Though this type of retailing is widely accepted elsewhere, in India, no company has yet set up an exclusive channel for direct marketing because only a few people shop using this medium.

Direct selling

Direct selling is a method of marketing and retailing goods to the consumer. Though direct sellers too use catalogues and some form of advertising, the personal interaction of the salesperson with the customer is the catalyst for the sale. The direct selling industry worldwide has shown tremendous growth. In India, it has a steady 60 to 65 per cent growth rate in sales turnover. Over 200 direct selling companies operate in the country and 70 per cent of them are regional operators. Eureka Forbes was the pioneer of direct selling in India.

A wide range of products like cosmetics, home appliances, educational material, kitchenware, food and nutritional products are sold through direct selling. In India, 68.9 per cent of products sold through direct selling are household goods, while 12.4 per cent are personal care products.

There are three forms of direct selling – person-to-person selling, party plans and multi-level marketing. Women comprise the majority of direct sellers in all these forms.

Person-to-person selling

Here, the salesperson calls upon the prospect at his or her home and discusses the product first-hand.

Party plans

Here, the salesperson arranged to give a product demonstration to a group of consumers. The demo might be in the private residence of consumers or in a public place like a hotel.

Multi-level marketing

This form of direct selling uses one-to-one selling as well as party plans. Multi-level marketing (MLM) has gained tremendous popularity in India due to the flexibility of working hours and ease of operations. In addition, sales personnel are paid a commission or bonus for every new member they recruit to sell the company's products. Companies like Amway, Modicare and Herbalife use multi-level plans.

The advantage of direct selling over direct marketing is the ability to allow consumers to have a touch and feel of the product. The US is the biggest market for direct selling operations and the South-East Asian region the fastest growing.

Automatic vending machines

A vending machine uses computer technology that allows dispensing of products when a coin or card is inserted. . A rudimentary form of these machines is seen at railway and bus stations -- coin-operated weighing machines. Vending machines are also used to dispense products like beverages, cigarettes, food items, newspapers and candy. The vending machine eliminates the need for personnel, gives flexibility of time (it can be used at all times) and convenience of location (at railway stations, airports, hotels, offices and street corners). The major disadvantage is the high costs involved in stocking and servicing the machines.

Non-Traditional Retailing

Non-traditional retailing involves use of computers and information technology to sell goods to consumers. It does not come under traditional or non-store forms of retailing. Some types of non-traditional retailing are use of the Internet, video kiosks and video catalogs.

The Internet

This form of retailing has the advantage of transmitting voice, text, video and pictures, not possible simultaneously in other forms of retailing. The Internet also allows retailers to interact with customers without incurring high costs. Tele-marketing, door-to-door selling and party plan direct selling are the other forms of selling, which enable customer interaction at low cost. The success of non-traditional retailing depends on the extent and type of product information provided to customers. Retailers with a strong image but a regional presence can use this form of retail selling to increase sales and expand operations.

Some advantages of this mode of retailing are:

- The customer can compare the various products available before making the purchase decision. This is not possible with other non-traditional forms of retailing. Product information can also be easily shared using e-mail and newsgroups.
- Digital products like software and video records can be easily sold over the Internet. Electronic catalogs offer the advantage of a detailed list of product range and extensive information.
- Internet shopping saves time and is convenient to customers as it can be done at any time of the day. The customer can check the products available and make the purchase decision without any time constraint as is present in telemarketing.
- This type of selling is non-intrusive as customers browse the Net according to their own free will. It differs from door-to-door selling and telemarketing in this.
- The marketer can track the number of times a customer has visited the website by calculating the number of clicks on the site.

The most common forms of retailing using the Internet are online shopping and e-tailing.

Online shopping

Online shopping or interactive home shopping is a spin-off from the Internet. The consumer uses an interactive electronic system like a computer or a television to make product enquiries and the retailer sends information and graphics directly through the Internet to the customer. Exchange of information is online and once the order is placed and paid for electronically, the goods are delivered to the buyer. This form of business transaction is popularly known as e-commerce. India is far behind nations like the US and Japan in e-commerce. This is because of factors such as low Internet and credit card penetration, hesitation by customers to make online purchases and payments, cultural issues etc. Music audios and videos, greeting cards, books and gifts comprise the largest segment of online shopping in India.

E-tailing

Business-to-Consumer or B2C commerce is another application of the Internet. It is popularly called e-tailing in the retail sector. Many companies have adopted this technology to provide shopping ease for consumers and to reduce operational costs. Retailers use the e-tailing route to enhance the customer’s online shopping experience and give them an alternate way to purchase products offered. E-tailers have increased customer visits to their websites by developing better search and navigational engines and tightening security to protect financial transactions and personal information of customers.

Apparel retailers like Sears Roebuck Co. have used e-tailing successfully. Sears Roebuck Co.’s “my virtual model” allows customers to view a 3-D form of the human body based on the body measurements provided. The model helps customers in clothes selection. Yet another company using e-tailing is Macy’s. It has developed ‘clickable swatches’, which allow a product to change colour according to the swatch selected. The company has also developed better navigational features for their website www.Macy’s.com to enable customers get the desired results with fewer clicks.

Video kiosks

Video kiosks comprise stands mounted with a television monitor or a computer terminal, which use touchscreen technology to display products and related information to customers. Video kiosks have a location advantage and have been widely used by retail giants like Wal-Mart and Kmart for the past decade. HomeDepot, the second largest retailer in the US, uses video kiosks in its self check-out lanes, where customers can bill their products and make payments without help. Video kiosks enable retailers to add value and enhance customer relationships while simultaneously providing an interactive forum to display products. Dell computers has established its kiosks in malls to sell its computer brands. Kiosks in malls are large enclosures that have plasma screens showcasing six to seven Dell products. The kiosks allow customers to place orders on the spot. In India, video kiosks are used for advertising products at supermarkets and shopping centres.

Video catalogs

Video catalogs are a version of catalog retailing. A video catalog consists of a retail catalog in the form of a compact disk that contains product listings in an electronic format. The catalog can be viewed on a computer and based on products available, the customer can order from home. Video catalogs enable retailers to provide product information through multimedia technologies, text and sound clips. It is better than the Internet as, such large amounts of data take a long time to download from the Internet. The use of video catalogs is widely prevalent in the US, but in India, it is in a nascent stage and is confined to the software and music industry. The main reason for this is that the consumer needs a computer with a CD drive facility to view the catalog.

Service Vs Goods Retail Strategy Mix

This classification of retailers is based on the type of offer made to customers. It might be a product or a service. Retailers may be involved only in product retailing or in service retailing or a combination of both. Both product retailers and service retailers can adopt store-based, non-store based or non-traditional retailing formats. In service retailing, the buyer does not purchase any tangible product from the seller, while in product retailing, there is sale of a physical product through transfer of ownership between the buyer and the seller.

Service retailers typically include beauty salons, travel agencies, auto repairs, video rentals etc. They can be classified into three categories: rented goods service retailers, where consumers use a product for a certain period, (example, car and video rental agencies); owned-goods services retailing, where products owned by customers are repaired or serviced (example, automotive repair); and non-goods services, where customers experience a service (example, beauty salons). Service retailing is a big business, even in India. Insurance, travel, and cellular services are examples where service retailing is picking up in this country. Exhibit 25.4 describes a unique non-store service retailing concept launched in Hyderabad, ‘Mana Bazaar’.

STRATEGIC ISSUES IN RETAILING

To ensure successful operations in a dynamic environment, a retailer cannot just concentrate on day-to-day operations but must also keep in mind long-term factors like possible competitive actions by competitors, their reactions to the strategies adopted by the retail organization and routine changes in the planning environment. Awareness of these issues will enable retailers to gain maximum leverage to increase sales. Some strategic issues to be understood in retailing include store location, store size, store image, store promotion and influence of private store brands on retail power.

Exhibit 25.4

Mana Bazaar

Mana Bazaar is the Indianized version of household service retailing, similar to the Neighborhood Assistance Booth in America. This unique concept of non-store retailing has been enormously successful in many countries including Europe and the US. In this type, the service provider arranges to provide all subscribers with their daily or monthly requirement of household items at their doorstep. The service provider also takes care of services like plumbing and payment of electricity bills.

Customers can become members of Mana Bazaar by paying an annual fee of Rs. five. They are then provided an exhaustive product list consisting of 2,000 items. The list describes the quantities, brands and offers available, in English and local languages. Member customers are given a discount of 8 per cent over prices at department stores. It is possible for retailers to offer discounts to customers because products are purchased directly from manufacturers, eliminating middlemen who usually have a 15 per cent margin. Customers also get other benefits like free samples of newly launched products and money-back guarantees. This form of non-store service retailing has immense potential in India, especially with people wishing to avoid traffic snarls and time spent in shops.

Adapted from Souvik Chowdhary, "Groceries at your doorstep", The Hindu Online, 1st July, 2002. <http://www.hindu.com/thehindu/mp/2002/07/01/stories/2002070100920200.htm >.

Store Location

Store location is the most important strategic issue that retailers must consider. It is a long-term decision and involves considerable costs. Unlike other elements in the marketing mix, the location cannot be easily changed. While choosing the store location, the retailer must remember some steps. First, the aspects desirable in a particular location must be decided. Second, the location must be selected from among available alternatives. Finally, the retailer must analyze alternative sites using different methods. It is necessary to follow all steps diligently, as a properly located retail outlet can offer the retailer a significant competitive advantage.

The various considerations to be kept in mind by the retailer while choosing a store location include selecting one that promises maximum returns to the retailer in comparison to competitors, presence of a substantial population base in the area, easy accessibility for the public with good transportation facilities and proximity to suppliers. As the strategic issues of a multiple retail chain differ greatly from that of a single retail outlet, a multiple retail chain should also consider future implications of the store location on its business, besides the current impact.

Retail Store Image

Retail store image is another strategic issue with important implications for the success of retail stores. Store image is the way a store is perceived in the customer's mind. This perception is partly due to the store's 'functional qualities' and partly due to 'psychological attributes'. The functional qualities that influence store image are product and price range, credit policies and store layout. Psychological attributes include a sense of belonging, a feeling of excitement or friendliness and warmth.

The retail store image can act as a source of competitive advantage. The customer's decision on store choice and store patronage is dependent on the store's image in the customer's mind. Thus, it is important for a retailer to understand how the impact of the store's image differs across consumer segments. Creating an appropriate store image attracts customers to stores and makes them stay in the store for a long time, automatically leading to increase in sales.

Store image is influenced by various factors. These include product assortment, service rendered, personnel, customers who patronize the store including their age, store layout and ambience and convenience of location.

Product assortment

The product types that a store stocks influences the store image. The product assortment offered should be of a wide range and in tune with current trends and demand. Further, the products should be of high quality and supported by guarantees.

Service rendered at the store

Service plays a crucial role in establishing the store image. The service rendered can be segregated into general service, service by sales personnel, extent of self-service, delivery service and return of goods service.

Store personnel

Store employees, especially sales personnel, contribute to the store image. Even in stores where there are no sales personnel, for example grocery stores, customers give importance to the behaviour of stock boys and salesclerks while deciding on the store's image.

Customers who patronize the store

The customers who visit the store exert a strong influence on its store image. If people from the economically privileged class frequent a store, this will create an upmarket image for it. For example, retail stores like Shopper's Stop, Pantaloons and Westside have an upmarket image as the elite patronize these stores.

Store layout and ambience

The store layout and ambience creates the environment and influences the customers' perception of the store. The retail environment may include aspects like building architecture, store layout, elevator position, aisle space, décor, lighting, air-conditioning and so on.

Convenience of location

As said, the convenience the store offers to customers in terms of location, proximity to the customers' residence, parking convenience and other factors like credit card payment, phone-in facility and door-delivery play a role in building store image. Thus, the selection of a particular store location must be done keeping in mind the store image sought.

Age of the customer

Another significant factor affects store image is the age of the customer. Studies have shown that age impacts a customer's perception of store image. Human beings age biologically, socially and psychologically, and these three patterns of aging have a different effect on their perception of retail stores. Older customers (30 to 60 years) are not easily attracted to different factors of store image compared to their younger counterparts. Younger customers (below 30) are more influenced by store image like aesthetics, responsiveness of sales staff, quality of merchandise and so on. Normally, older customers prefer stores that have evolved in time along with them. They are usually averse to retail store images based on the latest store formats. In contrast, younger customers are attracted to retail stores that project a trendy image. Older customers may lay special emphasis on service. Therefore, a retailer has to first decide which customer segment he or she wants to cater to and then create the appropriate store image to match that segment. Retailers wishing to cater to customers across all segments must take a balanced approach.

Store Size

The store size also influences profitability and productivity. It plays a crucial role for retailers who operate in different markets and different conditions. The store size that yields maximum store performance depends on the extent to which the retail outlet has established a presence in a particular market. A store's performance is measured by productivity, which is based on sales per square foot. By determining the extent of market presence that leads to maximum store performance per square foot in a given market, the optimum store size needed for various markets can be arrived at. According to researchers, market presence alone is not sufficient for good store performance. Other factors like demand and competitive conditions, demographic factors, location, quality, investment and age of the store also affect performance.

Store size can act as a competitive advantage to a retailer. By increasing store size, a retailer can increase the product range that can be displayed. This increases the product choice offered to customers and enables the retailer to gain economies of scale in pricing and transportation. 'Whole Foods' (the US-based grocery retailer), uses a large store size to display a bigger range of perishable goods like vegetables, fruits and sea-food. It helps bring in more customers, especially men, thanks to the convenience offered of a one-stop purchase point.

A study conducted by PricewaterhouseCoopers states that retailers have started shifting to the small store concept because more and more customers prefer to shop in small stores when they need to purchase only a few items. It saves time and reduces fatigue associated with going around a massive store having a wide product assortment. The number of new large malls and shopping centres have decreased over the years. 'OfficeMax', a superstore in the US, has come out with a PDQ format (pretty-darn quick) that comprises stores that stock around 3,000 to 5,000 SKU's (stock keeping units) and are only around 6,000 to 8,000 sft big. Retailers like Sears Roebuck and Home Depot plan similar small size stores.

Promotion

Promotion of the retail store is another issue that affects its success or failure. Retail store promotion is principally dependent on advertising. Many aspects exert an influence on the mind of a shopper in an advertisement. The customer subconsciously tries to assess the store image while viewing the advertisement. Unless the image projected is congruent with the customer's personality, the advertisement will not appeal to the customer. Hence, the retailer must concentrate on product assortment, price, discounts and other offers given while promoting the retail store. Retail advertising by itself can convey a lot – whether the store is costly, focuses on quality or discounts, has a friendly or intimidating atmosphere and so on. In India, retail advertising is generally done through newspaper inserts and hoardings. Most single-store retailers and regional supermarkets advertise through cable TV in their local regions. Large retailers like Shopper's Stop plan to advertise nationally on TV.

Sales promotion is yet another tool. Sales promotion is generally done through fashion shows, seasonal or festival-based promotions and theme-based promotions. Retailers like Shopper's Stop and Globus have promotions all through the year. Promotional periods are segregated into seasonal promotions like Diwali and Dussehra and special day promotions like Valentine's Day, Mother's Day, etc. Crossroads, a shopping mall in Mumbai, promotes its merchandise through fashion shows. Word-of-mouth publicity, loyalty card schemes for regular customersand personal selling are other modes of promotion used by retailers in India.

Role and Impact of Private Brands on Power of Retailers

Manufacturers have made considerable efforts through consumer and trade promotion to differentiate their brands in the marketplace and encourage consumers to buy. This forces retailers to stock these national brands to meet demand.. However, in developed nations, the domination of private brands has caused the balance of power to shift in favour of the retailer and reduce the manufacturer's control over the retailer. Private brands help retailers to improve the store loyalty of customers and make them shift loyalty from national brands. Private brands also serve as a means of differentiation. They provide retailers with higher margins on products and reduce the manufacturers' bargaining power. Retailers can then negotiate with manufacturers and get considerable gains in terms of prices, terms of supply and other contractual issues. The increase in retail power has forced manufacturers to pay 'slotting allowances' to persuade retailers to stock and display their products.

Private store brands increase the retailer's power on the consumer too; help improve store image and customer loyalty. Greater customer loyalty in turn benefits retailers by increasing sales. An example of private store brands in India is the 'Giant' brand across all product categories, stocked in 'Giant' hypermarkets set up by the RPG Group.

TRENDS IN RETAILING

Over the last few years, there have been marked changes in the retailing industry. Many of these changes result from a dynamic market environment and lead to the emergence of different retailing developments. The trends in retailing include competitive trends, consumer trends, trends in technology and innovation, micro-marketing, new retail formats, global retail operations, quick response and cost reduction and ethnic retailing.

Competition

Over the years, the emergence of a number of stores has led to their fighting for the same turf. Competition between chain superstores and independently owned outlets has shot up. Superstores, with their better bargaining power, economies of scale and modern operations, woo the consumer by offering low prices and a better shopping experience. Competition has also led to the close down and liquidation of numerous stores. In 1995 the closure of around 200 stores in the US by Kmart and the bankruptcy reorganization of Caldor (a Connecticut- based discount store, is testimony to the intense competition. Retailers are ready to grab any opportunity in the market and any change introduced by one retailer is quickly replicated by others. For example, when Wal-Mart made it necessary for its suppliers to adopt the EDI (Electronic Data Interchange) system, other major players followed suit.

Consumers

Consumers have become more and more demanding and have ever-changing needs and desires. Retailers have to be constantly alert to cater to this. Consumers are now better aware of their needs and have become 'smart' shoppers. They are also more educated and plan their shopping trips, demand better service, give priority to shopping convenience and seek a wide range of products to choose from. Increasing market awareness has led to consumers giving priority to obtaining the best bargains. This has led to a decrease in customer loyalty to retail stores. Customers are ready to travel longer distances to shop at a store that offers all benefits. Another noticeable trend is the increase of women in the workforce. This has led to reduction in the time spent on shopping and an increase in preference for convenience foods.

Technology

Retailers depend on technology to achieve efficiency and speed in store operations and to fulfil customer needs. Hardware, software and networking technologies have changed the face of retailing. Technology has led to the concept of e-tailing. It has also enabled retailers to enter into multi-channel retailing formats and has enhanced retailer-supplier relationships. Operational costs have come down, range of merchandise offered has increased manifold and prices have been cut. Technological innovation is also a source of competitive advantage. It has enabled retailers to study consumer behaviour and improve inventory management and stock replenishment. Technology has led to the development of new retailing systems like point-of-sale systems, check-out scanning systems, EDI, electronic funds transfer and emergence of virtual stores.

Micro-marketing

Changing consumer tastes and increase in consumer expectations has led to the emergence of micro-marketing. This involves targeted database marketing and it provides customers with products of their choice at the time and place they want. This requires retailers to get the right product at the right store at the right time. Traditional department stores have adopted micro-marketing to become more focused by eliminating certain product lines like automotive, hardware, consumer electronics etc., from their product portfolio.

Technology and competition are the main reasons for the development of micro-marketing. Many retailers have started using concepts like trade-area analysis, sensitivity pricing, demographics and other sophisticated models to align their offerings with the store location. A discussion on these concepts is beyond the scope of this chapter.

Emergence of new retail formats

New retail forms and combinations are continually emerging. The use of video kiosks in retail stores, installation of ATMs in huge departmental stores and hypermarkets and the establishment of combination stores featuring different retail formats have become the norm. Gas stations housing a coffee shop or a food store alongside has become a common sight.

Global operations

Increasing competition and reduction of opportunities in domestic markets have forced many retailers to look abroad. The global expansion of retailers has also been made possible due to customers' preferences for non-store retailing, which has partially eliminated the concept of store location. Consumers are introduced to new products through TV, telephone, Internet, catalogs, direct mail and compact disks. This has enabled retailers to expand their operations globally, overcoming the limitation associated with store location. Global operations increase profit levels of retailers and help establish credibility among consumers.

Ethnic retailing

Increasing travel and migration of work force has led to the emergence of a new retailing concept – ethnic retailing. This involves catering to the needs of ethnic groups living in the region. Restaurants have always catered to this group of people, but retailers have woken up to this need only recently. Many retailers have started stocking products tailor-made to suit the demands of a particular group of people. Packaging sizes, labelling, shelf displays etc., have been modified to suit the tastes of ethnic groups. Many retail stores nowadays cater exclusively to Asians, Latinos or Africans.

Diversification

Another trend in retailing is diversification. Retailers want to take advantage of their image and brand personality to enter other business areas. For example, Tesco (the UK-based supermarket chain) has ventured into banking, Boots (the UK-based health & beauty products retail chain) into optical tests and supplies, Marks & Spencer (the UK-based retailer of clothes, food, home products and financial services) into mail-order furniture and so on. Though such expansion increases profitability, it is necessary for retailers not to lose hold over their core business area.

Most current trends in retailing have benefited the industry as a whole. They have made retailing an important industry to reckon with in comparison with other traditional industry sectors. Future trends in retailing are discussed in the next section.

FUTURE OF RETAILING

The future of retailing has been a subject of intense speculation, particularly with the advent of direct marketing and Internet shopping. The retail industry will continue to grow and expand and retail giants will continue to dominate the industry. There will be immense opportunities for retailers willing to fulfil the ever-changing needs of consumers. Internationally, the retail trade is becoming more focused and global players are gaining in importance. In many countries, strong private store brands are giving national brands stiff competition. E-commerce has led to many retailers devoting significant efforts to cutting costs from the supply chain.

Global Retailing

In the future, global retailing is likely to be characterized by the following:

- Stronger efforts by retailers to develop a product portfolio tailor-made to suit consumer needs.
- Department stores will face stiff competition from mass-merchandisers as well as specialty retailers.
- Retail formats will have a shorter life span. Newer formats will be copied quickly and will lose their novelty.
- The concept of e-tailing will dominate retail sales largely.
- Consumers will make use of Information and Internet technology to search for information on products and make intelligent shopping decisions.
- Technology advancements implemented in stores will lead to better operational efficiency and employee productivity.
- As retailers expand operations, they will prefer to integrate backward. This will lead to many suppliers facing competition from retailers in the future.
- Retailers will prefer to build their own store brands to attain competitive differentiation.
- More and more retailers will share information with each other and enter into brand-sharing or partnership agreements.
- Manufacturers and suppliers will try to gain access to consumers through direct operations. Many suppliers may venture into the retail sector to reduce dependence on retailers and thereby reap better profits.
- Consumers will start dictating product displays and stores will be compelled to give exceedingly good treatment to their customers.

- Rising costs will make more efficient operations and smarter buying essential for retailing success.
- Retail technologies will grow in importance as competitive tools to produce accurate forecasts, improve control over inventory and facilitate electronic placing of orders from suppliers.

Retailing in India

India has been considered as a nation of shopkeepers having around 12 million retailers, in 2003. Most retailers are small business owners and organized players are limited in number. The potential for the retail sector in India is enormous. The Indian retail sector has a potential to support business worth one billion in the grocery segment, and 0.3 to 0.5 billion in the apparel sector. Only 2 per cent of the retail industry has adopted the modern retail format of department stores and supermarkets. This spells enormous future potential in the organized sector.

Increasing incomes, increasing number of working women, and rise in demand for 'shoppertainment' will fuel the growth of organized retailing. Changes in government policy like creation of uniform taxation policy to eliminate advantages being gained by the unorganized sector, land reforms and real estate flexibility, removal of rigid controls over FMCG chains and liberalization of tariffs will make India an important destination for global retailers. Many foreign players will be able to enter the country after restrictions on direct investment in the retail sector are removed. The latest in retail technology will be implemented in this country as well. For example, Arvind Brands, in collaboration with Wipro, has already begun to experiment with Radio Frequency Identification Tags (RFID) that enable retailers to do away with bar code scanning during payment. Currently, retail giants like Wal-Mart use this technology in their self-check out lanes. Leading retailers like Shopper's Stop and Pantaloons plan to adopt this technology. .

The high potential retail sectors in India are men's apparel, electronics, dry grocery, music, books, furnishing and sports clothing. Sectors still developing include pharmacy, fresh grocery, toys, photos, fast food and women's apparel. Retail sales are expected to grow at 8.3 per cent for the period 2003-2008, faster than consumer expenditure. Modern retailing formats like department stores and hypermarkets will grow rapidly due to the upper classes' liking for shopping convenience, single location purchase and variety. Large format stores are expected to show a healthy growth between 24%-49% during 2003-2008.

Though the country has the capacity to support large retail chains, a lot needs to be done to develop logistics, infrastructure and supply chain management solutions. Due to the large investments involved, it may not be possible for retailers to develop these requirements by themselves. The government must play a major role to realize the immense potential India has in the retail sector.

SUMMARY

Retailing consists of all activities that involve selling goods or services to the final consumer for personal consumption. Retailing is an emerging sector in India and has a lot of potential. Retailing plays an important role in national development. It is a source of employment to many people. Retailing also acts as a means for distribution of essential commodities to people in far- flung areas in under- developed nations. Another important role of retailing is that it acts as a means to provide a range of products to satisfy the ever-changing demands of consumers.

The retail environment has evolved over the years. Many major developments have led to the development of various retail formats. These include the Industrial revolution, intense competition, innovation through technological development and the concepts of regression and assimilation.

Retailers can be classified according to the kind of products and services they sell and the different strategies they adopt. They can also be classified based on extent of ownership, type of store strategy, type of goods and services provided, non-store based retailers and non-traditional retailing. Based on the extent of ownership, retailers are classified as independent retailers, chain stores, franchise retailers, leased department and consumer cooperatives. Based on the type of store strategy, retailers are primarily divided into food retailers and general merchandise retailers. Food retailers include convenience stores, conventional supermarkets, superstores, warehouses, combination and limited-line stores. General merchandisers include specialty stores, department stores, full-line discount stores, variety stores, off-price chains, membership clubs, thrift stores and “flea” markets.

In non-store retailing, traditional retail stores are not used to sell products. Non-store retailers use direct marketing (catalogue marketing and direct mail), direct selling (person-to-person selling, party plans, multi-level marketing) and automatic vending machines to sell products to consumers. Non-traditional retailers use new channels such as the Internet, video kiosks, and video catalogues to promote and sell products. Another type of classification divides retailers into goods-based and services-based retailers depending upon whether they sell merchandise or services to consumers.

Retailers must address certain strategic issues to succeed in the highly competitive retail sector. Store location, store image, store size, promotional aspects and private store branding can be the cause of success or failure.

Over the years, the retail industry has witnessed many trends linked to environmental changes. These include competitive, consumer, technological and economic trends. These in turn have led to other retail trends like micro-marketing, global retailing, ethnic retailing, retail diversification and the emergence of new retail formats. The future of retailing holds a lot of promise for the Indian economy. The Indian retail market is estimated at Rs 8,00,000 crores by 2005. Over the past decade, some retailers have successfully established their operations in India. Market observers predict that the Indian market can easily handle retailers worth $ 1 billion. Due to the enormous costs involved in developing the necessary infrastructure and logistics, the extent of future growth, especially the organized sector, which is only 2 percent of the total industry, depends on the measures and support offered by the government.

Chapter 26

Ethical and Social Issues in Sales & Distribution Management

In this chapter we will discuss:

- Ethics in business
- What is corporate social responsibility?
- Evolution of corporate social responsibility
- Levels of social responsibility
- What influences ethical behavior?
- Management's ethical responsibilities

One of the basic objectives of a business is profit maximization. However, in their attempt to maximize profits, some companies resort to unethical marketing and selling practices. Multinational companies like Nestle, Microsoft, Nike, McDonald's and several others have, at some time or the other, been embroiled in controversies pertaining to the adoption of unethical selling practices. Nestle, for example, sold its infant formula, the product on which the company was built, in developing countries by promoting the belief that using the formula was extremely beneficial for both mother and child. This type of promotion was in violation of the 'International Code of Marketing Breast-Milk Substitutes' of the WHO /UNICEF. Moreover, this was not the first time that the company was caught in a controversy. The company had been castigated several times for using unethical marketing practices to promote its products in developing countries, for selling genetically modified foods without appropriate labeling, and for supporting the use of child labor in some places.

McDonald's is yet another multinational against which accusations of using unethical selling practices have been hurled. Vegetarian groups in India charged that the global fast food giant had been selling its French fries as 100% vegetarian products when they contained beef flavoring.

It is clear from the example of these two companies that ethics is an important aspect of selling that can affect a company's reputation and the goodwill of the people towards it. Although ethical practices are essential both in marketing as well as in selling, personal selling seems to have had more than its fair share of criticism with regard to following unethical practices to achieve sales targets. This could possibly be due to the high visibility of the profession, the direct contact it necessitates with customers, and the ill-repute that a few unethical and dishonest salespersons have brought to the profession. Although ethical concerns should ideally be the responsibility of the headquarters of an organization, it is most often the salespersons and sales managers who bear the brunt of the customer's wrath. The ethical problems faced by sales personnel may pertain to the product quality, pricing, distribution, promotion, bribes, or the service offered to the customer. Further, ethics is closely related to the concept of social responsibility. No discussion on ethics would be complete without talking about social responsibility.

In this chapter on *Ethical & Social Issues in Sales & Distribution Management*, we examine the various aspects pertaining to ethics in selling and the social responsibility of businesses. We begin the chapter with a brief description on ethics in business followed by a discussion on social responsibility. The chapter will then explain the evolution and various levels of corporate social responsibility. Thereafter, we examine what influences the ethical behavior of salespeople. The chapter concludes with a discussion on the management's ethical responsibilities wherein the ethical issues facing a sales manager and those facing a sales executive are discussed.

ETHICS IN BUSINESS

Most people see salespersons as cunning and dishonest people whose only concern is to make the sale. Why is it that people have such a perception about salespeople? Even in movies, it is a negative image that is projected of salespeople. A salesperson is shown either as a street-smart and dishonest person, or as a dumb and foolish person. More often, it is the unethical behavior of a salesperson that gets highlighted rather than ethical behavior.

A salesperson is the representative of a company, the one who directly deals with customers. His ethics will, therefore, have a direct impact on the company's image. So most companies try to instill a sense of responsibility towards society and the need to sell ethically, in their salespersons. Ethics is becoming a subject of growing interest and concern in organizations, particularly in sales and marketing organizations.

Exhibit 26.1

Tata's Corporate Social Responsibility

In a study titled "Benchmarking Corporate Social Responsibility Activities" conducted in 2004 by the Gas Authority of India Limited (GAIL), it was found that Tata Steel, by providing a better quality of life to its employees and the community at large, had set a benchmark in corporate social responsibility (CSR) activities. The company has received a number of awards for its CSR activities, one of them being The Energy & Resources Institute (TERI) Award in recognition of its corporate leadership for good corporate citizenship and sustainable initiatives. It has also received the Global Business Coalition Award for Business Excellence in the Community conferred on it for the work undertaken by it in the field of HIV/AIDS.

Over a period of time, the company has shifted its focus from raising funds for charitable activities to empowering the community through partnerships. This is a crucial step towards community development. Tata Steel is now focusing on providing medical facilities in rural areas, improving women's health, and education. Some of the other activities in its ambit are water harvesting and tribal development, sports, relief and rehabilitation, and income generation activities.

Adapted from "Tata Steel – A Benchmark in Corporate Social Responsibility," <u>*Tata,*</u> *16 March 2004, <http://www.tata.com/tata_steel/releases/20040316.htm>*

So what exactly is 'ethics'? Ethics is defined as the rules or standards that govern the conduct of a person or the members of a profession. It refers to an individual belief system and consists of knowing what is right and what isn't. Social responsibility exemplifies ethical behavior and is defined as an individual's or an institution's concern for the consequences of his/its actions as these might affect the interests of others in society.

Ethical behavior and corporate social responsibility have become the latest mantra in corporate circles. Corporate social responsibility has been defined differently by different sources. According to the World Business Council on Sustainable Development, "corporate social responsibility is the commitment of businesses to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life."

Indian companies are now more concerned with corporate social responsibility than ever before. Most of these companies make contributions to AIDS and cancer research or towards providing education to children living in slums, helping victims affected by natural disasters like floods, earthquakes, famines -- the list is endless. But why is it that companies are now paying so much attention to corporate social responsibility when only a few years ago, they were focusing purely on increasing their profits? The answer lies in the fact that of late, companies have begun to realize that in order to survive in business, it is essential for them to build up trust and value in the eyes of the stakeholders. The stakeholders of a company comprise its customers, employees, suppliers, shareholders, competitors, the government, and the environment in which it operates.

Corporate social responsibility has also been defined by some as the act of companies 'giving back' to society. One of the companies that has excelled and set a benchmark in corporate social responsibility is Tata Steel. Exhibit 26.1 describes the social responsibility activities undertaken by the company.

In the past, companies were concerned more about making profits than anything else. However, over the years, there has been a rise in the consumer movement and an increasing concern for environmental issues. These combined with the United Nations making it mandatory for businesses to curb their exploitative practices, have made companies act more responsibly towards the environment and towards society. In contrast, however, there are still some companies like Enron, which adopt unethical means of doing business to make profits. Exhibit 26.2 discusses Enron's unethical practices.

Exhibit 26.2

Enron's Corporate Liability

The Texas-based company, Enron, has been in the business of purchasing electricity from generators and selling it to customers ever since 1985, the year it was established. The company soon grew into the seventh largest company in terms of revenue in the energy sector in the US. However, financial mismanagement by the top management plunged the company into trouble and it entered into complex partnerships to cover its debts amounting to $500 million and to continue to obtain cash and credit. Company officials even admitted to having overstated the company's profits by more than $580 million since 1997.

In the second half of 2001, the company announced a third quarter loss of a staggering $680 million. This prompted the Securities and Exchange Commission to begin an inquiry into the matter. On December 2, 2001, the company filed for protection from its creditors. The company's share price, which was more than $80 in 2000, had plummeted to less than a dollar in little less than a year. This dealt a severe blow to those who had invested in Enron and many ended up losing their life's savings.

The Enron debacle was the largest case of bankruptcy in American history. Governmental Affairs Committee Chairman, Joe Lieberman, who was investigating the Enron collapse, stated that this was an alarm call to all those in the government to ensure the protection of the markets and also the savings and investments of the Americans.

Andy Fastow, the firm's chief financial officer, was alleged to be the man responsible for misleading the investment community that all was well at Enron despite the company's disastrous financial performance. Enron thus became a classic example of a firm following unethical practices to the maximum extent possible.

Adapted from "Explaining the Enron Bankruptcy," CNN, 13 January, 2002, 16 July, 2004, <http://www.cnn.com/2002/US/01/12/enron.qanda.focus/>, "Press Statement – Lieberman, Levin to Probe Enron Collapse – Hearings Planned, PSI Investigation Underway," 2 January, 2002, 16 July, 2004 <http://govt-aff.senate.gov/010201press.htm> and Thomas A Stewart, "Laughter, the Best Consultant," Harvard Business Review, February 2004: Volume 82, Issue 2, 35-36.

Why is it that some firms fail to do business ethically? We need to answer this fundamental question before proceeding further. Denying their responsibility towards society is one of the reasons for businesses not following ethical practices. These companies claim that business is a game that cannot be played according to society's wishes. In support of their stand, they also say that a business cannot sustain itself for long if it is too ethical. However, both these arguments are unconvincing to say the least, because no game is devoid of rules and also, many companies have proved that it is absolutely possible to survive in business even while being ethical.

Some of the other excuses offered by businesses to continue with their unethical practices are that if others are duped by their activities, it is only because they are foolish enough to be duped. They also claim that it is nothing new for businesses to resort to unethical practices and that they are only following others. The biggest danger with such organizations is that these unethical practices slowly get assimilated into their organizational culture. Businesses following unethical practices need to primarily understand that conducting business by unethical means will not lead them anywhere.

WHAT IS SOCIAL RESPONSIBILITY?

Social responsibility refers to the idea that businesses should not function amorally, but should, instead, contribute to the welfare of their communities. According to Keith Davis, social responsibility refers to "businesses' decisions and actions taken for reasons at least partially beyond the firm's direct economic or technical interest."[1] Companies, over the years, have become more socially responsible, either voluntarily or owing to pressure from shareholders, customers, etc. In fact, companies are now trying to use corporate social responsibility as a competitive advantage rather than viewing it as a societal obligation. Firms have started realizing that conventional methods of differentiating their products from those of competitors on the basis of functional differences such as taste, color, etc., is no longer effective due to the competitive intensity in the business environment. Products can now be easily sold in the market, if they contribute in some way to the benefit of society. For example, when the Times of India (Hyderabad edition) was launched, the company contributed 10 paise from every newspaper sold to the Chief Minister's relief fund.

In the current business environment, almost every firm exhibits some level of social responsibility, but there is a lot of difference between companies that have deeply imbibed social responsibility and made it a part of their mission, and those that adopt it merely to abide by statutory requirements.

Imbibing social responsibility in the corporate stream is by itself not enough. It is also important to create a positive opinion about the company in customers' minds. To do this, three strategies have been suggested. These are:

1) Better communication with the customers – Customers' perception about the company is based on the way it is projected by the media. Quite often, the media do not highlight the positive aspects of the company as much as they do the negative aspects. So the companies have to take the initiative to clearly communicate to their customers, information about their ethical standards and the activities they have taken up from time to time for the benefit of society.

2) Cultivate higher ethical expectations – Customers may view a company as one that does not violate ethics under any circumstances and upholds its integrity at all times. So the company must make an effort to not only live up to these expectations but also to cultivate higher ethical expectations by showing empathy for customers' concerns and constantly improving its performance.

3) The company must measure public expectations -- how they perceive the company and its ethical standards. At the same time, it should do a self-assessment of its ethical performance by conducting an ethical audit.

Exhibit 26.3

CSR in India

The Father of the Nation, Mahatma Gandhi, himself stressed the importance of businesses being involved in social development activities. In 1965, the then Prime Minister of India, Sri Lal Bahadur Shastri, too spoke about the importance of social accountability, openness and transparency, social audits and corporate governance at a seminar attended by policy makers, top businessmen, and trade union leaders.

Traditionally, businesses in India, irrespective of their size, have involved themselves in national development activities. However, this has often been linked to their religious and local commitments. Some Indian companies have been constantly involved in societal development activities, setting up schools and hospitals, providing housing, and so on. These acts, however, have been more of a business necessity than anything else because these companies have had to ensure the availability of basic minimum facilities to their workforce in areas where the government could not provide these facilities.

In recent times, India has changed its policies to attract widespread foreign investment. That it has been successful in its pursuit to a significant extent is evident from the gradual rise that has taken place in foreign investment over the years. Further, globalization has greatly changed the perspective of Indian companies towards social responsibility. Western style corporate social responsibility is influencing Indian companies to a great extent. This can be viewed as a significant move away from the traditional approach to corporate philanthropy in India. The companies are now seeking to measure, manage, and improve all those activities that have an economic, environmental, or social impact. These trends are clearly visible in companies dealing with transnational firms. It is also worth noting that intense global competition is hampering the ability of some companies to make significant contributions towards society, except what is necessitated by statutory requirements.

Adapted from Peter Raynard and Maya Forstater, "Corporate Social Responsibility – Implications for Small and Medium Enterprises in Developing Countries," United Nations Industrial Development Organization, July 2002: 1-75.

for multinationals sets up a governmental process for encouraging socially responsible behavior in business. Global Compact, the CSR initiative by the UN Secretary General, Kofi Annan, ensures corporate social responsibility of businesses across the world in three important areas -- human rights, labor standards, and environment.

The Indian government, recognizing the importance of corporate social responsibility, amended the Indian Companies Act, 1956, through the Companies (Amendment) Act, 1999 making it necessary for companies to conform to certain provisions of this law to ensure corporate responsibility. The Securities & Exchange Board of India (SEBI), through the listing agreement, implemented the recommendations of the Kumaramangalam Birla Committee on corporate governance to emphasize corporate governance practices in companies listed under it.

Although Indian companies have been undertaking philanthropic activities of some kind or the other, there is a much wider scope for corporate social responsibility in the Indian corporate scenario. Exhibit 26.3 discusses the development of corporate social responsibility in India.

Further, after witnessing tragedies such as the Bhopal gas leak (1984) and the Shriram gas leak (1985), the Government of India laid down certain statutory requirements for companies. In 1991, the government amended the Environment Protection Act (EPA) 1986, to lay down stringent laws against air and water pollution by industries. With these developments, a significant evolution has taken place in the corporate social responsibility sector in India. Exhibit 26.4 lists certain reasons for the growing importance of corporate social responsibility across the world.

Exhibit 26.4

Growing Importance of CSR

According to the United Nations Industrial Development Organization (UNIDO), the extensive growth in corporate social responsibility across the world in the last 20 years is due to:

- Globalization of many developing countries and the competition resulting from it.
- Rapid expansion and influence of companies across the world.
- Government policies.
- Intense competition among companies for talent and expertise.
- Growth of global activism pertaining to matters that affect society.
- Increased importance of intangible assets.

Adapted from Peter Raynard and Maya Forstater, "Corporate Social Responsibility – Implications for Small and Medium Enterprises in Developing Countries," United Nations Industrial Development Organization, July 2002: 1-75.

LEVELS OF SOCIAL RESPONSIBILITY

Kenneth Mason, former president of US based The Quaker Oats Company, once stated that making a profit is not the only purpose of a business just as getting enough to eat is not the only purpose in life. The purpose in both cases is far broader and more challenging. In recent times, companies have been operating in an intensely competitive environment. Especially, during the last 20 years, competition has risen significantly due to globalization. More and more developing countries are opening up their economies to multinational firms. In Asia, China and India have significantly benefited from globalization. With the increase in competition, there is growing concern and interest regarding ethical practices and social responsibility of businesses. According to the US Chamber of Commerce, firms may do business at any of the following four levels of social responsibility --- obeying the law, meeting public expectations, anticipating new social demands, and leading the way.

Obeying the Law

Securing profits for the shareholders of the company is not the only objective of firms. Firms have to also obey the laws at the local, state, and national levels while conducting their business. Firms are supposed to strictly adhere to the rules and regulations laid down by the government from time to time. Laws for business are framed taking into consideration the ethical concerns of providing free, fair, and equal opportunity to every individual without any reservations. For instance, in addition to complying with internal rules and regulations, Sony follows strict compliance with the laws of the land in which it operates. It has even established a separate office to ensure the company's compliance with the laws prevailing in the countries in which it operates, in addition to ensuring maintenance of internal standards.

Meeting Public Expectations

Citizens across the world expect that businesses should go beyond making mere economic gains and act responsibly towards society. Majority of people across the world feel that globally, companies should undertake activities that display their sense of responsibility towards society rather than simply contributing to charity and claiming that their social responsibility has been fulfilled. Customers tend to move away from companies that do not fulfill any kind of corporate responsibility and the number of customers who are doing this is increasing significantly the world over. Thus, meeting the public's expectations is extremely important if an organization is to sustain itself in the long run.

A research conducted in 2001 by Environics International (a Canada-based public opinion research organization, renamed GlobeScan Incorporated in November 2003), covering 25 countries and 25,000 individuals, revealed that there is a direct correlation between public expectations and the pressure on companies to show greater responsibility towards society. The study revealed that a majority of shareholders had stated that they would sell the shares of any company whose shares they held, if it were to act in a socially irresponsible manner irrespective of the profits it may be earning. Thus, meeting a shareholder's expectations has become an important issue to be considered by a company that intends to sustain itself in business for a long term. Ethical and socially responsible behavior by a company also helps raise the motivational levels of its internal public (employees) and thereby, increase the output of the company.

Anticipating New Social Demands

Anticipating business risks and new social demands plays a crucial role in the growth of a company. The company needs to develop foresight, to anticipate and effectively meet future social demands. The firm has to constantly monitor its stakeholders' activities and obtain sufficient information to estimate their possible future demands. Obtaining sufficient inputs from environmentalists and social scientists also helps a company significantly in anticipating new social demands. A company's failure to anticipate new social demands can cost it dearly. Shell, for instance, failed to anticipate the demands of environmentalists, and this cost the company dearly.

In 1995, Royal Dutch/Shell had to face intense public protests by Greenpeace activists against its decision to dump one of its obsolete oil storage platforms into the North Sea. The activists protested that the company's move would pollute the environment by releasing toxic radioactive residues into the North Sea. The manner in which the company dealt with these protests gave it the reputation of being insensitive to social issues. The public outrage that resulted caused the company to finally retrace its steps and set up a committee for social activities to act in an advisory capacity to the supervisory boards of the group. This “Social Responsibility Committee” reviewed the policies and conduct of all the companies in the group, with respect to statements of “general business guidelines” and group policy,s and commitment towards health, safety and environment (HSE). Shell also agreed, as a matter of policy, to allow external verification of the HSE reports.

Leading the Way

Very few companies play the role of leaders in corporate social responsibility. These companies lead the way for others in the much needed and highly in demand corporate social responsibility arena. Examples of such companies include the Tata group of companies and the Ballarpur Industries Limited (BILT). BILT believes in corporate social responsibility and actively participates in community development programs in the fields of education, environmental protection, farm forestry, and sustainability initiatives. BILT is one of the few companies in India that has set up a separate department for CSR activities, unlike other companies, which make CSR an additional responsibility of the Human Resources or Public Relations department. BILT’s community development programs aim to benefit the community at the various locations of the company. The company initially conducts a need assessment of the people in these localities and then designs sustainable socio-economic development activities while seeking the participation of the local and state governments.

The company has also initiated the BILT Pratham Project to provide formal education to school dropouts. About six cities in Maharashtra are benefiting from this project. Through this project, the company reached out to more than 30,000 children in Maharashtra in 2002-03. With regard to environmental issues, the company is aiming to obtain the ISO 14001[2] certification for its efforts in environmental conservation -- helping to reduce pollution, installing and maintaining manufacturing facilities strictly in accordance with environmental laws, conserving natural resources, and fostering an environmental conscious approach in its employees. In its farm forestry initiatives, the company has initiated the Velugu project in collaboration with the state government of Andhra Pradesh to grow trees in wasteland areas to cater to the paper pulp requirement of paper companies.

As part of its sustainability initiatives, the company follows the international 3R program stressing upon the three principles for natural conservation – reduce, recycle, and reuse. Following these principles, the company is reducing raw materials usage and managing wastes. The company provides high quality plant stock at subsidized prices along with free technical expertise to farmers. It is also helping to reverse soil erosion in about 16,000 hectares of green area covering six states of India.

WHAT INFLUENCES ETHICAL BEHAVIOR?

No organization can function without individuals. The ethical and moral behavior of individuals in an organization plays a major role in shaping the ethical and moral values of the organization. Most studies on ethics focus on the actions performed, on who has performed them, and on the consequences of these actions. These studies fail to explain the factors that influence ethical behavior. It is important to understand the factors that influence ethical behavior if one has to reinforce ethical behavior or overcome unethical behavior. Thus, it is necessary to understand the process that takes

[2] The ISO 14000 series is a set of international standards primarily concerned with environmental management. It assists companies to implement actions in support of sustainable development. ISO 14001 is the most important standard in the ISO 14000 series.

place within an individual that gives rise to ethical or unethical behavior.

In a sales organization, an understanding of how salespersons and sales managers arrive at ethical decisions and actions helps the sales management to reinforce such behavior.

Individual's Role

In a sales organization, every individual, irrespective of whether he is a salesperson or a manager, has ethical responsibilities. The moral and ethical behavior of every human being is based on the values he inherits from his childhood. Religious background, family upbringing, and personal experiences are some of the factors that govern the ethical behavior of individuals in an organization.

L. Kohlberg in his article "Moral Stages and Moralization: The Cognitive-Developmental Approach," published in 1969 in the book, *Moral Development and Behavior: Theory, Research and Social Issues*, proposed that the stage of moral development of an individual influences the individual's moral decision criteria. According to Kohlberg, an optimal level of moral decision- making can be achieved only when the individual reaches the maturity stage of moral development. Thus, moral decision-making in an individual is largely based on the individual's stage of moral development. According to Kohlberg, an individual passes through six irreversible stages of moral development, which can be grouped into three levels. Each level is further divided into two stages.

- The first level, preconventional level, is divided into two stages – Stage 1 and Stage 2.
    - Stage 1 has an obedience and punishment orientation.
    - Stage 2 is concerned with instrumental purpose and exchange.

Thus, an individual in the first level of moral development behaves and acts purely in his own interests and follows rules only when they benefit him. He may also completely neglect rules and behave unethically if they hinder his development.

- The second level, the conventional level, is divided into stages 3 and 4.

At Stage 3, the individual gives importance to interpersonal accord, conformity, and mutual expectations.

At Stage 4, he gives importance to social accord and system maintenance.

At the second level of moral development, the individual shows a conventional acceptance of the reference group norms. He tries to display stereotypically good behavior by meeting the expectations of those close to him such as family members, co-workers, friends, etc. At this level, the individual shows an orientation towards duty, authority, and social rules.

- At the third level, the individual is principled. This level too is divided into two stages:

At Stage 5, the individual is governed by social contracts and individual rights.

At Stage 6, he is governed by universal ethical principles.

At this level of moral development, the individual is highly ethical and follows ethics at any cost. He even goes to the extent of opposing reference group norms and the majority opinion in order to uphold what he believes is right. Thus, an individual at this level of moral development tries to uphold his values, morals, and ethics under any circumstances.

Among the different levels of moral behavior of individuals in an organization, it is believed that a majority of the individuals operate at the conventional level and a considerably fewer number operate at the first and third levels of moral development.

Organization's Role

If it is true that most individuals are at the conventional level of moral development, then it can be inferred that most of the employees in most organizations follow organizational rules and regulations, even though they may be unethical, for fear of losing their job. Thus organizations are primarily responsible for the ethical or unethical behavior of their employees. These conclusions can be easily drawn by observing the legal judgments that have been made against major corporations in the world (Enron, described earlier in the chapter, is a classic case) and also from the reactions of the society against corporate misdeeds (e.g., protests against Shell Oil). Thus, it can be said that organizations have a significant role to play in developing ethical or unethical values in their employees.

MANAGEMENT'S ETHICAL RESPONSIBLITIES

The management in organizations is largely responsible for the ethical or unethical behavior of its employees. However, employees face ethical dilemmas at times and it is the management's responsibility to deal appropriately with such situations. In order to develop an ethical environment in the organization, the management needs to study the individual ethical concerns of the employees. This can help the management in promoting ethical behavior among the employees. It is the management's responsibility to communicate to it's the employees, especially to the field sales representatives, the company's policies that govern the ethical conduct of employees. It is also the management's responsibility to frame policies in such a way that they are flexible enough for the salespersons to exercise discretion when faced with ethical dilemmas. The policies should be framed in such a way that they are practical enough for the salespersons to implement. Also, the salespersons should not feel the need to circumvent them.

Ethical Issues Facing a Sales Manager

In a sales organization, it's not just the salespersons who face ethical issues; sales managers too have ethical responsibilities. These not only encompass the ethical dilemmas faced by their salespersons but also the ethical aspects associated with their decisions pertaining to hiring and evaluating salespeople, assigning territories, setting quotas and targets, etc.

The ethical issues facing a sales manager may be studied under various heads. These include the sales manager's relationship with his subordinates, the company, customers, and the competitors.

Relationship with subordinates

A sales manager should guide his subordinates in being ethical. He should also be able to resolve their ethical dilemmas. Otherwise, he could end up exposing the company to a risk in terms of a fall in the performance of the salespersons, caused by their mounting frustration and tension. This can have a long-term implication for the company in terms of customer dissatisfaction, resulting in legal hassles, lost customers, and a negative image for the company in the market. It can even result in conflicts between the sales personnel and the management. All these will ultimately lead to a decrease in the sales and profits of the organization.

Another issue concerning the ethical conduct of salespersons is how much pressure the sales managers exert on their field sales force to attain sales targets. The pressure must not be beyond a limit where it forces the salespersons to act unethically. However, these limits are hard to define, as they are normally decided by the management itself. The assignment of territories to salespeople is yet another ethical concern that sales managers face. Salespeople have to be assigned territories according to their capability and based on the attractiveness of the market. The various aspects pertaining to sales territories have been discussed in the Chapter 12-Time and Territory Management. Sales managers are also confronted with the ethical issue of being fair and frank with the salespersons and providing them with genuine feedback about their performance, while telling them the truth about their career options in the firm.

Relationship with the company

A sales manager's relationship with the company brings up various ethical issues. These include following ethical practices in all company matters. Unethical practices could include padding up the expense account, quitting the company to join a competitor, and taking along the most efficient people while quitting, passing on vital information about the past company to a competitor, etc.

Relationship with customers

The sales manager's relationship with customers is another important area leading to ethical issues. A sales manager should not blindly support his sales personnel, when customers raise issues regarding the ethics of the personnel. It is the responsibility of the sales manager to impart necessary skills and provide training for the sales personnel to behave ethically while dealing with customers. The three problem areas in a sales manager's relationship with customers involve information, gifts, and entertainment. A sales manager should be ethical in guiding his salespeople regarding these aspects of a sale.

Quite often, salespeople do not give complete information on a product to the customer. They only provide the information that will help them close the sale. Also, salespeople often try to sell high-priced products that help them obtain a higher commission even though there may be other products available that cost less but fulfill the customer's needs as effectively. Thus, it is the sales manager's responsibility to guide his salespeople to be ethical in their selling approach. They have to convey all the information that the customer needs to know about the product and leave the choice of the product to him rather than influence him to purchase a product that would benefit the salesperson more. Offering gifts to customers is a practice that many companies follow. Giving gifts helps companies build up customer loyalty. However, salespeople often misuse this practice to their advantage. They often offer gifts to their prospects with the intention of converting them into customers. It is the sales manager's responsibility to clearly specify to the salespeople the ethical issues involved in the practice of giving gifts and the situations that warrant the giving of gifts.

Entertaining prospective customers is yet another way for salespeople to close a sale. However, this practice should not be manipulated to suit the salesperson. Sales managers should guide the salespeople on the ethical aspects involved in entertaining the clients as well as the extent to which the clients need to be entertained.

Relationship with competitors

A sales manager should never encourage his salespeople to adopt unfair and unethical means to obtain information about competitors. He should constantly strive to ensure that a healthy competition prevails in the industry. At the same time, he should also ensure that neither he nor his salespeople discuss or communicate information regarding the company's pricing, credit terms, lines of business, etc., to competitors.

Relationship with dealers and suppliers

A sales manager should be ethical in his dealings with suppliers and dealers and should guide his salespeople to behave similarly. He should never encourage salespeople to give gifts to or receive gifts from the suppliers or dealers of the company. Also, the sales manager should make his salespeople understand the unethical dimension of having any discussion or communicating information about the company's pricing, credit terms, lines of business, etc., to its suppliers and dealers.

Ethical Issues Facing a Salesperson

The ethical issues faced by a salesperson are issues with regard to the top management, other sales people and customers. Exhibit 26.5 describes some of the ethical guidelines that a salesperson should follow.

Ethical issues with regard to the top management

There are several issues pertaining to the ethical behavior of salespersons with regard to the top management. It includes misusing the company's assets such as the company vehicle, stationery, etc., money spent on a client's entertainment and sales expenses, issues such as bribing the customers, giving gifts to bag large orders, offering free samples to the crucial decision makers in the buyer's firm, and so on. Such acts on the part of the salesperson may result in future legal complications for the company.

Moonlighting is a major concern that the managements of many companies face. Moonlighting refers to employees taking undue advantage of the lack of supervision to take on multiple jobs.

Some salespeople may even cheat the management by stopping some of the sales orders due in the current month and passing them on to the next month in order to easily meet the targets of the subsequent month.

Exhibit 26.5

Ethical Guidelines for a Salesperson

First and foremost, a salesperson should always remember not to lie to a customer under any circumstances. Truthfulness on the part of the salesperson adds to his credibility and assures the customer of his integrity.

Second, a salesperson should sort out any misunderstanding that may affect the sale. The misunderstanding may pertain to the company or the product. It could even be about competitors of the company and although such a misunderstanding may act in favor of the salesperson, it has to be cleared up because doing so will add to the integrity of the salesperson and lay a strong foundation for a long-term successful relationship with the customer.

Third, a salesperson should always work hard for the company that has employed him. A salesman's job is such that constant monitoring by a superior is impossible. Some salespeople may take advantage of this situation and avoid work by remaining at home while they are actually supposed to be in the field making sales calls. Such behavior is highly unethical and should be avoided.

Fourth, it is necessary for a salesperson to focus on developing a long-term relationship with the customer even if it means foregoing some short-term gains. For instance, if a customer has decided to buy the product based on some misconception he has about it, the salesperson should try to clear the misconception. Even though the salesperson might lose the immediate sale, this will help him build a relationship of trust between him and the client.

Fifth, the salesman should never promise beyond what he can deliver. Despite the temptation to grab the customer's business from a competitor who is indulging in over-promising, the salesman should never make promises that cannot be fulfilled.

Sixth, a successful salesperson should cultivate the habit of returning to society something of what he has received from it. Spending time and money for charitable purposes is a satisfactory activity that a salesperson needs to do, if he is in a comfortable position financially.

Seventh, an ethical salesperson should never forget to recognize and acknowledge the timely help and support extended by people both in office and elsewhere.

Every human being is capable of constantly learning and improving and this applies to a salesperson as well. A salesperson needs to constantly learn new ways and means of improving his performance both for his own benefit, as well as that of the organization.

In order to be successful in his job, the salesperson has to learn some important tricks of the trade. Most important of all, he has to learn not to give up at any stage.

He should desist from speaking ill of others, especially in front of customers. Even for the sake of disqualifying a competitor's product from the customer's mind, the salesperson should never speak ill of the competitor.

Adapted from Dave Kahle, "The Ten Commandments for the Ethical Salesperson," Biz-community, *02 April 2002, 16 July 2004, <http://www.biz-community.com/Article/196/20/502.html>*

Ethical issues pertaining to other salespeople

Salespersons face several ethical dilemmas when dealing with other salespersons of the company. Unhealthy practices such as encouraging salespersons of the same company to compete against each other or treating a particular salesperson badly may result in that salesperson adopting unethical practices in order to prove that he is good or to make an impression on the manager. Some salespersons may even cheat fellow salespeople by snatching business from their account or by faking sales in order to win in sales contests by dumping products on the customer with the assurance that they will take them back later.

Ethical issues in dealing with customers

Salespersons, being the revenue generators in a sales organization, face intense pressure from sales managers to achieve targets in order to meet the organization's short-term sales. This may compel them to adopt questionable sales practices.

The nature of a sales job is such that salespeople who are in the field are physically, psychologically, and socially separated from their office, their managers, and other employees of the organization. Therefore, they are normally unaware of the course to be followed when faced with ethical dilemmas. Also, the remote nature of the job and the lack of direct supervision by the sales manager tend to make them compromise on their values and adopt an unethical approach to selling.

Alan J. Dubinsky et al.[3], in a study conducted on salespeople in three major US electronic firms, obtained the responses of the salespeople to 12 ethical situations that are normally faced in the course of selling. These situations are:

- Magnifying the customer's problem in order to secure a bigger order. For example, a salesman selling vacuum cleaners may claim that not using a vacuum cleaner could expose the customer and his family members to dangerous diseases.
- Asking for low volume business from the customers, even though the sales firm does not serve minor accounts. For instance, an industrial salesperson dealing in computer equipment may ask individual employees to buy computers for their personal use.
- Belittling a competitor's salesperson for gaining the customer's order.
- Trying to elicit information from the buyer regarding the competitor's quotation, in order to quote less.
- Quoting different prices to different buyers. For instance, quoting a lower price to a buyer who has two or more other suppliers apart from the sales organization in order to obtain the account, and quoting a higher price to a buyer who purchases only from the sales organization.
- Offering promotional and other gifts to the buyer.
- Offering free trips, luncheon, and dinner invitations to the prospective customer.
- Utilizing the firm's economic superiority to offer the product at a premium price to customers.
- Asking customers for information regarding competitors.
- Giving special treatment to certain customers based on the recommendations of the top management.
- Giving special treatment to customers who are also suppliers of the company.
- Trying to circumvent the purchase department and directly approaching and influencing other departments, to sell the product.

The company's sales management should deal with these ethical concerns and effectively communicate the company's policies regarding the ethical conduct of salespeople from time to time. A written communication is most effective in guiding salespersons in dealing with the different ethical dilemmas that they may face.

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[3] Alan J. Dubinsky, Marvin A. Jolson, Ronald E. Michaels, Misaaki Kotabe and Chae Un Lim, "*Ethical Perceptions of Field Sales Personnel: An Empirical Assessment*," Journal of Personal Selling & Sales Management, Volume 12, Number 4 (Fall 1992): 9-21.

SUMMARY

Everyone, at some time or the other, must surely have been sold a product that he or she did not need. Selling is a profession that has been widely criticized for the unethical dimensions associated with it. Ethics is the set of rules or standards that govern the conduct of a person or members of a profession. Ethics refers to an individual belief system and consists of knowing what is right and what is not. It forms a very important part of sales and is essential for lending integrity to a salesperson's behavior. No discussion on ethics is complete without a reference being made to social responsibility. Social responsibility exemplifies ethical behavior and is defined as an individual's or institution's concern for the consequences of his/its actions as these might affect the interests of others in the society.

Companies doing business with no regard to social responsibility run the risk of attracting the attention of environmental groups, earning negative publicity, and losing the goodwill of society. Therefore, companies try to instill a sense of ethics in their employees and conduct business in a socially responsible way. Indian companies are now more concerned with corporate social responsibility than ever before. Companies in the past were concerned more about making profits than anything else. But in recent times, firms have realized the importance of corporate social responsibility. Corporate social responsibility has been defined as the commitment made by businesses to contribute to sustainable economic development, to work with employees, their families, the local community, and society at large to improve the quality of life. CSR is a process that helps a firm to function ethically and make a positive contribution to the welfare of society. All companies are expected to imbibe values pertaining to corporate social responsibility in their mission and make CSR a part of the organizational policies. In order to fulfill their social responsibility, companies need to effectively communicate to the public about the company's ethical policies, set high ethical standards for themselves, and evaluate themselves on ethical performance from time to time through means of ethical audits.

Several countries have passed declarations and policies regarding CSR. The Indian Government has amended the Indian Companies Act, 1956, making it mandatory for companies to conform to certain provisions of this law in order to be accepted as responsible corporates. Although Indian companies have been indulging in philanthropic activities of some kind or the other, corporate social responsibility is a totally different field altogether. There is a much wider scope for corporate social responsibility in the Indian corporate scenario with its coverage extending to human rights, labor standards, as well as environmental issues.

Companies in the current scenario are operating in an intensely competitive environment. Especially during the past 20 years, competition has been rapidly increasing due to globalization. According to the US Chamber of Commerce, companies may conduct business on any of the following four levels of social responsibility – obeying the law, meeting public expectations, anticipating new social demands, and leading the way.

The ethical behavior of an individual is influenced by that individual's stage of moral development. An individual passes through three levels of moral development -- preconventional, conventional, and principled.

In organizations, the management is largely responsible for the ethical or unethical behavior of its employees. A sales manager faces ethical issues that cover the ethical dilemmas of his sales people as well as the ethical aspects pertaining to his decisions regarding hiring and evaluating of salespersons, assigning territories, etc. The ethical issues facing a sales manager may be studied with regard to the sales manager's relationship with his subordinates, the company, customers, and competitors. On the other hand, the ethical issues facing a salesperson pertain to the salesperson's accountability to the top management, and his relationship with other salespeople and with customers.

Glossary

A

Achievement tests: They are developed to judge the applicant's job related skills like computing skills, typing skills, analytical skills, book keeping skills and other skills required to perform the job he applied for.

Activity quotas: Objectives set to specify the job-related activities of a sales person which help the sales person achieve his performance targets.

Activity-Based Costing (ABC): An accounting system that measures the cost and performance of specific activities performed in an organization. It breaks down overhead costs into specific activities (cost drivers) in order to more accurately distribute the costs in product costing.

Ad Valorem: Latin for "According to the value". When a shipper wishes to increase the liability of a carrier beyond the liability stated in the terms of the bill of lading, he places the actual value of the cargo, in block 23 of the bill of lading. The carrier is then liable for the value of the cargo and charges a higher rate accordingly based on the value.

Agent: One who negotiates contracts, or acts in the legal capacity of another party.

Agents and brokers: Intermediaries who assist with the marketing of goods and services but who don't assume ownership of products, agents, unlike brokers, usually work long term for products.

AIDA model: An acronym for awareness, interest, desire, and action, which represent the psychological steps a customer goes through on the way toward making a purchase.

Allocating: Breaking accumulated supplies into smaller units that are easier for later intermediaries and customers to handle.

Analog model: It is used to estimate the potential sales of a new store on the basis of the revenues of existing stores in identical areas, the competition at a prospective location, the expected market share of the new store at the proposed location, and the size and density of the primary trade area of the location.

Automatic vending: An impersonal form of non-store retailing in which money- or credit-card-operated machines provide products or services.

B

Balance of payments: A system that accounts for a nation's international financial transactions.

Balance sheet: It is a snap shot of the financial position of the retailer at that moment of time. The balance sheet consists of three components Assets, Liabilities and Owner's equity (net worth). The balance sheet is based on a simple concept, i.e., in order to acquire assets, a firm (retailer) must pay for them with either debt (liabilities) or with the owners' capital (shareholders' equity).

Bar code: A symbol consisting of a series of printed bars representing values. A system of optical character reading, scanning, and tracking of units by reading a series of printed bars for translation into a numeric or alphanumeric identification code.

Barter: An exchange that is not based on monetary prices.

Bill Of Lading: A document signed by the agents or owners of a vessel, furnishing written evidence for the conveyance and delivery of merchandise sent by sea to a certain destination. It is both a receipt for merchandise and a contract to deliver it as freight.

Brand: A name, term, phrase, design, symbol, or any combination of these chosen by an individual or organization to distinguish a product from competing products.

Brand loyalty: The level of commitment that customers feel toward a given brand, as represented by their continuing purchase of that brand.

Brand mark: The portion of a brand that cannot be expressed verbally, such as a graphic design or symbol.

Break-bulk: The separation of a single consolidated bulk load into smaller individual shipments for delivery to the ultimate consignees.

Breakeven analysis: A profit analysis technique that identifies the sales volume at which total cost is equal to total revenue; you'll make a profit if sales exceed this level and suffer a loss if they don't reach this level.

Breakeven point: The sales volume at which a company breaks even.

Broker: One who arranges transportation and/or clearing of cargo without actually performing the transportation

C

Catalog marketing: Marketing of goods and services using catalogs mailed to a select list of customers.

Catalog showroom: A limited-line discount retailer that offers products from a catalog for purchase by mail or in a self-service store.

Centralization: The degree to which authority for taking retailing decisions is delegated to corporate managers rather than to geographically dispersed regional, district, and store managers.

Centralized organization: An organization in which authority and responsibility are concentrated in the hands of relatively few people, usually the higher levels of management.

Channel power: The ability of the channel captain to influence or control the behavior of the rest of the channel.

Cold calling: Calling on potential customer by telephone or in person when there has been no previous contact.

Combination store: A blend of a super market and a general merchandise store, where the general merchandise contributes more than 40 percent of the sales.

Compensation: The total value of returns given to employees in exchange for their membership in the organization and for performing the tasks, duties and responsibilities associated with their jobs.

Competitive advantage: In the context of international business, the ability of a nation's industries to innovate and upgrade to the next level of technology and productivity.

Competitor intelligence: The systematic collection and analysis of data about a firm's competitors, with the goals of understanding the competitors' positions in the market and of formulating strategies in response.

Concentrated marketing: A marketing approach that focuses on a small part of the market with a single or limited line of similar products; it can be used by firms with limited resources or in markets with specialized customer segments.

Consumer's buying behavior: The response and reaction of the ultimate consumer to various situations involved in purchasing and using various goods and services

Convenience products: Relatively inexpensive products that buyers or users choose frequently with a minimum of thought and effort.

Convenience stores: Small stores that are located near residential areas. It cater to customers who prefer 'convenience of buying or shopping' to the price of the product

Conventional supermarkets: Stores that focus on food and household maintenance products. These stores earn very limited revenues from the sale of non-food or general merchandise goods.

Corporate buyers: The companies that either buy the merchandise offered by the retailer for corporate use, or promote sales for the retailer by giving coupons to their employees.

Cost of goods sold: The direct cost associated with manufacturing/procuring the merchandise for the store.

Coupons: The documents that entitle the holder to a reduced price, or a percentage price reduction from the actual purchase price of a product or service.

Cross docking: Cross-docking is the movement of materials from the receiving docks directly to the shipping docks. Goods do not need to be placed in storage, creating a significant cost savings in inventory and material handling. It involves packing of merchandise by the vendor in the quantity required by the store, thus eliminating the need for re-packing by the distributor.

Culture: The beliefs, values, and objects shared by a group and passed on to succeeding generations.

D

Data: The statistics, facts, and opinions that market researchers record and store.

Database: A computerized system that stores and retrieves a variety of data.

Database marketing: Direct marketing that allows advertiser to take advantage of comprehensive information about customers, including purchase behavior, demographics, and life-style.

Dealer: Basically the same type of intermediary as a distributor, although some people distinguish dealers as those intermediaries that sell only to final customers not to other intermediaries.

Decentralized organization: An organization characterized by widespread distribution of authority and responsibility.

Decision-support tools: PC, client or application server-based systems that use memory-based processing to perform rapid simulations using data drawn from business-transaction processing systems such as enterprise resources planning.

Delphi technique: A forecasting method that uses the averaged opinions of inside and outside experts who are allowed to change their predictions after learning the overall results of a first –round forecast; the revised estimate becomes the final forecast.

Demographic segmentation: A way to divide large markets into smaller groupings according to the elements of size, composition, and distribution of the population.

Demographics: The characteristics of populations.

Department stores : Large retail units that offer wide variety and a deep assortment of goods and services.

Direct channels: Marketing channels that lack intermediaries, in which producers and customers interact directly.

Direct exporting: Selling goods or services directly to another country without the use of an intermediary.

Direct selling: Selling that utilizes direct, face-to-face contact between buyer and seller.

Discount retailers: Retailers that offer both high- and low-quality products at prices lower than those of full-price retailers.

Discounts: Direct reductions from the list price.

Distribution: The process of moving products from the producer to the consumer, which may involve several steps and the participation of multiple companies.

Distribution center: A private warehouse specially designed to provide the fast transfer of goods from suppliers to retailers or final customers.

Distribution channel: The path a product follows to be delivered to the end user. This may be through distributors, retail outlets, self service outlets, vending machines, telephone sales, direct mail sales, etc.

Distribution management: Determines optimal quantities of each product to be made at each plant and to be distributed to each warehouse, such that manufacturing and distribution costs are minimized and customer demand is met.

Distributor: An enterprise that purchases products for resale to their customers, who are usually retail outlets. The distributor expects to receive a significant price discount from the supplier for providing the distribution service.

Dual distribution: It is the process whereby the manufacturer sells the products produced by him through its self-operated retail stores as well as private retail stores

E

Economic Order Quantity (EOQ): An inventory model that determines how much to order by determining the amount that will meet customer service levels while minimizing total ordering and holding costs.

Economic Value Added (EVA): A measurement of shareholder value as a company's operating profits after tax, less an appropriate charge for the capital used in creating the profits.

EDI: Electronic Data Interchange is a standard for automated exchange of business documents. Using EDI, purchasers and suppliers can exchange digital paperwork including purchase orders, invoices, and other business documents, and perform electronic fund transfers.

Everyday low pricing (EDLP): A version of customary pricing, whereby a retailer strives to sell its goods and services at consistently low prices throughout the selling season.

Exchange: The transfer between two or more parties of tangible or intangible items of value.

Exclusive dealing agreements: Agreements between manufacturers or vendors and retailers that restrict retailers to sell only their merchandise and not that of competitors or competing vendors.

Expense quotas: Quotas set to control costs of sales units by placing a limit on the expenditure of sales personnel.

Expert system: A computer program that uses knowledge and reasoning techniques to solve problems normally requiring the abilities of human experts.

Export: To sell goods and raw materials to another country.

F

Field selling: The salesperson approaches the customer with prior appointment and tries to make the customer a potential buyer by convincing him/her about the benefits of the product.

Field warehouse: A public warehouse set up at the location of the customer’s inventory.

Financial leverage: The financial ratio which measures the extent to which a retailer is using the outside finances (debt) in its capital. It indicates total asset value in relation to the value of owner's equity.

Flea market: An outdoor or indoor facility that rents out space to vendors who offer merchandise, services and other goods that satisfy the legitimate needs of customers.

Floor-ready merchandise: The merchandise shipped by vendors to retailers with the necessary tags, prices, security devices, etc. already attached so that the merchandise can be cross-docked rapidly through the retailer's distribution centers and sent directly to stores.

Franchise: A business entity licensed to use the trademarks, operations, and other attributes of a business.

Franchise store: A store based on a contractual arrangement between a franchiser (manufacture) and a retail franchisee, which allows the franchisee to conduct a given form of business under an established name and according to a given pattern of business.

Fringe benefits: All benefits offered to the employees other than salaries, bonuses, and commissions for the services rendered to the retail organization.

Fully integrated vertical marketing system: A marketing system wherein only one player manages all the activities (production and distribution), without any help from other channel members.

Functional intermediaries: Intermediaries that, unlike merchants, do not assume ownership of the products they are selling.

Functional organization: An organization structure in which jobs are grouped according to similarity, such as advertising, marketing research, and sales.

G

Generic brand: A nonbranded product that is identified only by its product category.

Geographic organization: An organization structure in which jobs are grouped geographically.

Geographic segmentation: A way to separate large markets into smaller groupings according to country, region, state, city, community, or block divisions.

Global approach: Using the same product and promotion strategies in all markets.

Global corporation: A corporation that has operations in more than one country, exploits the countries similarities to enhance competitive advantage, and operates from a one-world, one-market perspective.

Goods: Tangible products that customers can evaluate by touching, seeing, tasting, or hearing.

Green marketing: Developing products and packages that are less harmful to the environment.

Gross margins: The difference between net sales and the cost of goods sold. It is also expressed as a percentage of net sales.

H

Heterogeneous market: A market in which people or organizations have differing characteristics.

Homogeneous market: A market in which people or organizations have similar characteristics.

Horizontal integration: The integration of intermediaries in one level of the marketing process, such as retail outlets.

Hypermarket: A large retail store that offers products at a low price. It is a combination of a discount store and a food based supermarket.

I

Iceberg principle: The distorting effect on the true sales and profit picture and underlying problems due to averaging, summarizing and aggregating sales data.

Idea generation: Searching for new product ideas that will help firms achieve their objectives.

Ideas: Concepts, philosophies or images that can be exchanged in the marketplace.

Idle time: The time a salesperson spends on the sales floor without being involved in productive work.

Inbound logistics: The movement of materials from suppliers and vendors into production processes or storage facilities.

Independent retailers: Retailers that are not part of large retail organizations, but are owned by one person, two or more partners, or a family.

Independent store: A store which is owned by a single retailer. The entry barriers for setting up an independent store are low, licensing procedures are simple and the initial investment is low.

Independent vertical marketing system: An independent vertical marketing system consists of independent businesses like manufacturers, wholesalers and retailers.

Indirect channels: Marketing channels that rely on intermediaries to move products from producers to customers.

Indirect exporting: Selling goods or services to another country through an intermediary.

Industrial product: A product bought for use in the production of other products or in a business's operations.

Inventory: Raw materials, work in process, finished goods and supplies required for creation of a company's goods and services.

Inventory management: The process of ensuring the availability of products through inventory administration.

Inventory turnover: The ratio of net sales to average inventory. It is the number of times (on an average) inventory is sold in a year.

J

Job analysis: The systematic analysis of an existing or proposed position or group of positions within an organization.

Job description: A clearly written statement that explains the duties, responsibilities, qualifications and performance expectations of a particular retail employee.

Joint venture: Collaboration by two or more companies on a task or product, sharing assets, risks, and profits.

Just-In-Time (JIT): An inventory control system that controls material flow into assembly and manufacturing plants by coordinating demand and supply to the point where desired materials arrive just in time for use.

Just-in-time inventory management: A technique that seeks to decrease costs by maintaining lower inventories of parts and materials.

Kanban: Used as part of a Just-In-Time production operation where components and sub-assemblies are produced based upon notification of demand from a subsequent operation. Historically, Kanban has been a physical notification such as a card (kanban cards) or even an empty hopper or tote sent up the line to the previous operation. Kanban is actually a simplistic means of both signaling the need for inventory as well as controlling the inventory levels (by limiting kanban cards or containers).

L

Lead time: Amount of time required for an item to be available for use from the time it is ordered. Lead time should include purchase order processing time, vendor processing time, in transit time, receiving, inspection, and any prepack times.

Leased department: A department in a retail store that is rented to an outside party.

Licensed brands: Another form of manufacturers' brands. In this type of brands, the owner (the licenser) of a popular brand name establishes a contract with another party (referred to as the licensee) to manufacture and sell the licenser's branded products.

Limited-line retailers: Retailers that restrict their product lines to just a few that are carried in great depth.

Limited-line wholesalers: Full-service merchant wholesalers that carry only a few lines; however, they typically carry deeper selections in their lines than do general merchandisers.

Logistics: A supply chain process that plans, implements, and controls the efficient, effective flow and storage of goods, services, and related information from point of consumption in order to meet the consumers' requirements.

M

Mail-order wholesalers: Limited-service merchants that operate in the same manner as mail-order retailers but focus on retailers and organizational customers rather than consumers.

Marketing audit: A comprehensive, systematic, periodic review of a firm’s marketing environment, objectives, strategies, and activities.

Marketing channel: A system designed to move goods and services from producers to customers, which consists of people and organizations supported by various facilities, equipment, and information resources.

Marketing decision support system (MDSS): A computerized system of accessing and handling MIS data and other data so that marketer can apply analysis and modeling methods and immediately see the results.

Marketing Information System (MIS): An established series of procedures and methods to collect, sort, analyze, store, and distribute marketing information on an ongoing basis.

Marketing intermediaries: People or organizations that assists in the flow of products in a marketing channel.

Marketing research: The systematic collecting, recording, and analyzing of information to support marketing, decision making.

Marquee: It is usually a painted signboard, or a neon light or a glow signboard that carries the store name, along with its trademark and other relevant information like caption.

Mass merchandisers: Retailers that offer wide selections of goods at prices below traditional department store prices.

Materials handling: The physical handling of products and materials between procurement and shipping.

Materials management: Inbound logistics from suppliers through the production process. The movement and management of materials and products from procurement through production.

Merchant wholesalers: Independent businesses that buy products from producers and then resell them to retailers and organizational customers.

N

Need: A felt discrepancy between your actual state and your desired state.

Neighborhood shopping center: A planned shopping center, which aims at providing convenience products that meet the daily needs of customers in a particular neighborhood.

Nondurable goods: Goods that are used or consumed over a short period of time or after one or few uses; examples include food and office supplies.

Nonstore retailing: A retailing method that creates a marketing channel between producers and consumers without physical stores.

O

Order processing: The systems used to receive orders, route them to appropriate supplying functions, and then arrange customer billing.

Organizational buying process: The steps that organizations go through to purchase goods and services.

Organizational market: Group that buys goods and services for use in its operations, for resale, or as raw materials or components for other products.

Organizational structure: A formal definition of people's responsibilities and the allocation of authority in a company.

Outbound logistics: The process related to the movement and storage of products from the end of the production line to the end user.

Outsourcing: The process of getting a function (that has been done in-house in the past) done by some other firm outside the retailer's purview.

P

Performance evaluation: A systematic assessment of how well employees are performing their jobs in relation to established standards and communicating the same to the employees.

Personal selling: A form of paid personal communication, wherein the sales personnel satisfy the customers' needs, by exchanging information through personal interactions.

Point-of-purchase (POP) materials: Advertising, displays, and other materials that are placed in stores to catch shoppers' attention as they are selecting products.

Problem definition: A clear description of the marketing problem being researched.

Problem solver: A retailer who not only understands the inherent problems of retailing but also derives pride/pleasure from solving them is called a problem solver.

Product: A good, service, or idea for which customers will exchange money or something else of value; a product is a bundle of features and benefits designed to meet needs of target customers.

Product development: A type of intense growth strategy that improves present products or develops new ones for the firm's current markets.

Product life cycle: A model that describes the stages that a product or a product category passes through, from its introduction to its removal from the market.

Product line: A group of closely related product items.

Product line depth: The number of products in each product line.

Product line extension: A method of adding products to the product mix by introducing products into an existing product line.

Product line width: The number of product lines in a company's product mix.

Product mix: A company or strategic business unit's complete assortment of products and product lines.

Product portfolio: A combination of products and product lines balanced to achieve the company's profitability goals and to satisfy the needs of the target market.

Product position: How the product is perceived by consumers, particularly in relation to how competing products are perceived.

Product repositioning: Changing the way in which existing products are perceived by consumers.

Product-based organization: An organization structure that uses product managers to handle the marketing mix for each of the products in the firm's marketing portfolio.

Profit margin: The amount of profit left over after expenses have been accounted for, expressed as a percentage of revenue.

Promotion: A variety of techniques, including advertising, sales promotion, public relations, and personal selling, that are used to communicate with customers and potential customers.

Promotional discounts: Discounts given as part of promotional programs, such as when products are put on sale to increase traffic in a retail store.

Promotional mix: A combination of two or more elements of advertising, sales promotion, public relations, and personal selling.

Prospecting the customer: The process of identifying customers who would not only be interested in the merchandise but would also have the ability to pay for the same.

Prospects: Consumers or organizations that are potential customers.

Psychographic segmentation: A way of dividing large markets into smaller grouping according to consumer lifestyles, activities, opinions, and beliefs.

Public warehouse: A public warehouse is a business that provides short or long-term storage to a variety of businesses, usually on a month-to-month basis. A public warehouse will generally use their own equipment and staff, however, agreements may be made where the client either buys or subsidizes equipment. Public warehouse fees are usually a combination of storage fees (per pallet or actual sq. footage) and transaction fees (inbound and outbound). Public warehouses are most often used to supplement space requirements of a private warehouse.

Purchase order: A document used to approve, track, and process purchased items. A purchase order is used to communicate a purchase to a supplier. It is also used as an authorization to purchase. A purchase order will state quantities, costs, and delivery dates. The purchase order is also used to process and track receipts and supplier invoices/payments associated with the purchase.

Pure competition: The ideal competitive structure in which many marketers compete to sell the same undifferentiated product.

Q

Qualified prospect: A prospect who has been identified as being a purchasing decision maker and having the financial resources to pay for the product.

Quality: A measure of how closely a product conforms to customers' needs, wants, and expectations.

Quality circle: A small group of people who normally work as a unit and meet frequently for the purpose of uncovering and solving problems with the quality of the items produce, process capability and control.

Quick response delivery system: A combination of a logistics system and an information system. It is designed to reduce inventory investment, bring down logistics expenses, and increase customer service levels by reducing the lead-time for receiving merchandise from vendors.

Quota: An expected performance objective that is routinely assigned to sales units such as individuals, regions, or districts.

R

Radio frequency (RF): In warehousing refers to the portable data collection devices that use radio frequency to transmit data to host system.

Radio frequency identification (RFID): Refers to devices attached to an object that transmit data to an RFID receiver. These devices can be large pieces of hardware the size of a small book, like those attached to ocean containers, or very small devices inserted into a label on a package. RFID has advantages over barcodes, such as the ability to hold more data, the ability to change the stored data as processing occurs, does not require line-of-site to transfer data and is very effective in harsh environments where bar code labels won't work.

Rebate: In rebates, a portion of the purchase price is returned to the buyer. After making a purchase, the customer has to send the proof of purchase to the manufacturer. Upon receipt of the proof of purchase, the manufacturer mails the rebate to the customer.

Recession: The stage of the business cycle in which unemployment rises and consumer buying power drops.

Recovery: The stage of the business cycle in which the economy moves from depression or recession towards prosperity.

Recruitment: The process, whereby an organization induces suitable people to apply for employment vacancies by making them aware that such vacancies exist.

Reference group: A group that has an influence on a particular consumer.

Regional shopping center: A planned shopping center catering to a geographically dispersed market. It consists of at least one big department store and 50 or more small retailer

Relationship marketing: A strategy to build long-term customer loyalty that is based on becoming partners with customers and doing everything possible to contribute to their success.

Reorder point: The inventory level set to trigger reorder of a specific item. Reorder point is generally calculated as the expected usage (demand) during the lead time plus safety stock.

Reorder quantity: The quantity that is to be ordered when the existing inventory goes below the order point.

Resellers: Retailers who buy merchandise in large quantities at discounted prices from the retailers, and sell them at normal prices in their shops.

Resellers: Establishments in the organizational market that help move goods and services from producers to consumers.

Retail information system (RIS): A tool that enables retailers to collect, aggregate and analyze data from retailing activities.

Retail market: A group of customers who have common or similar needs which can be collectively addressed by a retailer who chose to cater to the same group or customer segment.

Retail selling: Retail selling takes places when a potential customer approaches a retail store. Here, the role of the salesperson is to satisfy the need of the customer with the available merchandise in the retail store.

Retailer: The last entity in the distribution channel. It includes all businesses and individuals who actively participate in the transfer of ownership of goods and services to their end users. They sell to final customers; they purchase goods from wholesalers, or in some cases, directly from producers.

Retailing: A set of business activities that adds value to the products and services sold to the final consumers for their personal, family or household use.

Return on Investment (ROI): A financial ratio indicating the degree of profitability. Net Profit divided by Net Worth.

Return on investment pricing: A method for setting prices based on a desired level of profit; you combine the desired ROI with average total costs to obtain the selling price.

Return on net worth: Net profit after taxes divided by owner's equity (net worth).

Reverse channels: Channels that are used for recycling and repair and that flow in the opposite direction of normal channels.

Reverse logistics: Reverse Logistics covers activities related to returned product, returned pallets and containers, returned materials for disposal or recycling.

Routing: Used in conjunction with the bill of material in manufacturing operations. While the BOM contains the material requirements, the routing will contain the specific steps required to produce the finished items. Each step in the routing is called an operation, each operation generally consists of machine and labor requirements.

S

Safety stock: Quantity of inventory used in inventory management systems to allow for deviations in demand or supply. Safety stock calculations will take into account historic deviations and use a required service level multiplier to determine the optimal safety stock level.

Sales branches: Manufacturer-owned selling locations that perform a variety of marketing functions; distinguished from sales officers by the fact that they carry inventory and usually fill orders from stock.

Sales contests: Sales programs that offer incentives to sales persons for successfully achieving their short-term work goals.

Sales forecast: An estimate of a firm's sales volume in dollars or units for a specified future period.

Sales incentives: Various types of prizes awarded through sales contests.

Sales lead: The name of an individual, organization, or business that might be likely prospect for the company's product.

Sales management: Planning the personal selling effort, organizing the sales personnel, and developing a winning sales team.

Sales officers: Manufacturer-owned selling locations that are similar in many respects to sales branches, except that sales officers don't carry inventory.

Sales potential: The amount of product, in dollars or units, that a firm's entire industry can be expected to sell during some specified future period.

Sales promotion: Techniques that are used to stimulate product demand, including special events and activities such as coupons, celebrity appearances, and contests.

Sales support personnel: Salespeople who generally facilitate the overall selling effort by providing a variety of services.

Selling agents: Agent intermediaries that go beyond manufacturers' agents by taking control of promotion, pricing, and distribution; they are used by producers that don't want to get involved in the marketing of their own products.

Selling time: The time a salesperson spends with a customer time spent while demonstrating the product, writing sales receipts or assisting the customer in other potentially revenue -generating activities

Social responsibility: Marketers duty to enhance the welfare of customers and the general public through their products.

Sole proprietorship: Sole proprietorship is a common and a simple ownership. In this type of ownership, the store is completely owned by a single person.

Specialty products: Those products, while purchasing, which, the consumer is least concerned about the time, effort or expense involved.

Specialty store: A specialty store is a type of general merchandise store that sells limited lines of closely related products or services to a select group of customers

Store image: Image of a store comprises how the consumer feels about the store. Therefore, retailers must be sure about how they want their store to be perceived by the customers.

Strategic profit model (SPM) : A financial tool for planning and evaluating the financial performance of retailers. It combines information from the income statement and balance sheet into a single, comprehensive framework. The strategic profit model establishes a mathematical relationship among net profit margin, asset turnover, and financial leverage. By doing so it arrives at two important performance measures for return on investment- return on assets and return on net worth. This model regards return on net worth as important indicator of the performance of a firm.

Subculture: A group of people who share beliefs, values, and customs different from those of the larger culture.

Suggestive selling: This technique of promoting sales is called suggestive selling Before closing the sale, the salesperson can suggest complementary items that go well with that particular merchandise that the customer intends to buy.

Supermarkets: Stores that sell primarily food items with selections wide enough to meet most customers' grocery shopping needs.

Superstores: Stores that combine food and nonfood items in large retails locations; larger than supermarkets but smaller than hypermarkets.

T

Tariff: A tax imposed by a government on goods entering its borders.

Technical salespeople: Salespeople who contribute technical expertise and assistance to the selling function.

Television home shopping: A nonstore retailing technique in which shoppers watch product displays on special television shows and then order products by phone.

Total quality management (TQM): A philosophy and management system that bases everything an organization does on the pursuit of quality.

Trade area: A geographical area containing the customers of a particular firm or group of firms for specific goods or services.

Trade discounts: A price discount that is available only to some classes of purchasers, like wholesalers or big retailers.

Trade shows: Exhibitions that feature a specific industry's products and bring together buyers and sellers for a short period of time; many industries use trade shows as forums for technical, political, and other issues as well.

Trademark: The name of a product or service that has been legally registered as the property of an enterprise.

Trend analysis: A time series forecasting method that creates an equation to describe the expected behavior of sales in the future using sales data accumulated over some period in the past.

Tying agreements: Tying agreements are those whereby the manufacturer or franchiser demands that the retailer stocks its new brand or non-selling product as a condition to supply the retailer/franchisee with well-established, 'much-in-demand' product(s) of its make

U

Unsought goods: Products that are usually purchased due to adversity rather than desire. For example, coffins, crutches, and medicine are all unsought goods. Another form of unsought goods are products such as life insurance and encyclopedias. They are products that the consumer seldom goes out looking for, therefore, a constant, aggressive selling process is required.

Utilitarian needs: Needs that fulfill a functional purpose.

Utility: The ability of a product to satisfy the customer's wants or needs.

V

Values: Beliefs about what is good or desirable.

Variable costs: The portion of a company's production and marketing costs that are dependent on the level of production.

Variety stores: General merchandise retailers that offer fewer product lines and fewer brand choices than discount department stores at low prices in self-service environments. They offer a large assortment of inexpensive and popular goods like stationery, gift items, women's accessories, house wares etc

Vending machines: Customer-operated machines that distribute products automatically upon payment.

Vendor analysis: Formal evaluation of suppliers.

Vertical Integration: The potential within an enterprise to incorporate all aspects of management, production, sales and distribution into their business operations. In theory, the greater the vertical integration, the less vulnerable an enterprise is to outside forces.The result of vertical integration is called a vertical marketing system.

Vertical marketing system (VMS): A distribution system in which the producers, wholesalers, and retailers act in a unified manner to facilitate the smooth flow of goods and services from producer to end-user.

W

Warehouse club: A general merchandise retailer who offers a limited merchandise assortment with limited service at low prices to consumers as well as small businesses.

Warranty: A statement specifying what the producer of a product will do to compensate the buyer if the product does not live up to its promised level of performance.

Wheel of retailing: A theory that divides the cyclical patterns in retail evolution into three stages innovation, trading up, and vulnerability.

Wholesalers: Intermediaries that perform a variety of marketing channel functions to move goods and services through the channel to retailers and organizational customers.

Wholesaler-sponsored voluntary chain: A type of contractual marketing system that is led by one or more wholesalers.

Word of mouth: Transmission of consumer information from person to person.

80/20 rule: A rule, based on the theory that 20 percent of a company's products account for 80 percent of its sales, that holds that fast-moving products generate a higher level of customer service than slow-moving products.

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