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Underestimated Potential

Increase Profitability with Indirect Sales Channels

Saving Costs – For chemical manufactures using indirect sales channels is an economic and strategically logical method for effectively expanding their business. Indeed, many manufactures are reluctant to manage these channels stringently in accordance with their contractual terms, particularly when business is going well. Instead these manufactures readily absorb costs and complexity on their part in order not to strain the relationship with their representatives. However, given the financial crisis company's worldwide need to re-evaluate cost saving potential within their organization. Unfortunately, areas that can contribute towards higher growth rates and



increasing profitability, such as focused management and follow-up of indirect sales channels are regularly neglected.

The term "indirect sales channels" involves the sales and distribution of products to customers, either by means of local distribution organizations or agents, collectively referred to as representatives. In general, it is less cost-effective for typical mid-sized chemical manufacturers to support international customers through a wholly owned sales and warehousing infrastructure.

The advantages of using local distributors or agents are plain to see: They provide access to markets in order to acquire new customers and provide additional turnover. In addition, competent representatives will usually better understand the problems and challenges end-customers are facing in their local markets. As both distributors and agents usually represent numerous manufactures, they are able to develop closer customer relationships and can better assess their needs. For example, an agent in the coatings industry cannot

only offer customers a single paint component, but instead is able to provide a range of components from different manufacturers including binders, solvents, pigments, fillers and additives. This way, an agent can identify new potentials and developments on part of the customer, which in turn he can communicate to the respective manufacturer, thereby creating a competitive advantage

The downside: More often than not, manufactures become highly dependent on their representatives to generate turnover without being able to impose any sort of control over them. This way, many chemical manufactures become other-directed and have unconscious constraints while working with their representatives.

Opportunities for Improving Turnover Performance

Problems usually arise when the turnover volume becomes sizable in the markets serviced through representatives. Chemical manufactures that neglect to adjust their original terms in line with increasing sales, run the risk of absorbing costs originally borne by the representatives. Only manufactures with a tight grip on their sales network can assure the necessary control over markets and profitability.

First weakness: The guidelines and goals originally agreed upon with distributors are ignored on both sides over time. This allows distributors that have contractual obligation to carry a specific range and level of finished goods, to push warehousing costs through to the manufacturer. Thus orders become increasingly short-term and are rarely bundled, thereby defeating the goal of servicing customers via local distribution warehouses.



Second weakness: A lack of market and customer transparency. It will be close to impossible to achieve price increases in line with the market potential, or to obtain critical customer information, if the ground rules have not been specifically laid out. If the manufacturer does not control end-customer prices in his serviced markets, or does not define his information requirements regarding end-customers, he will find it difficult to take over business from his representatives at a later stage.

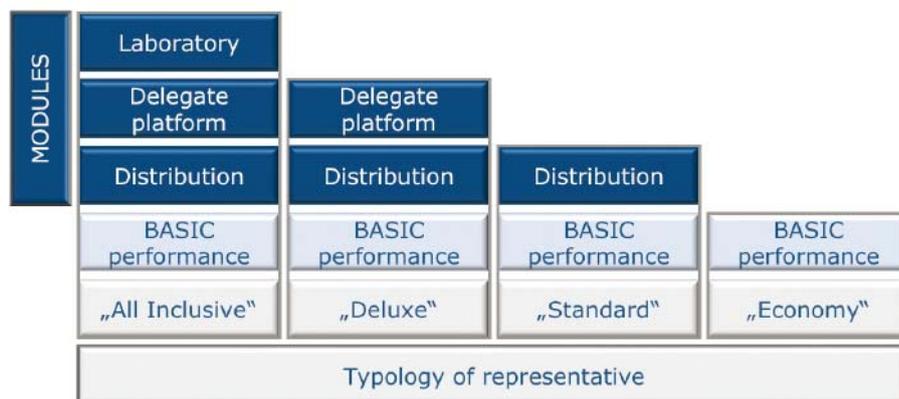
Ambiguous agreements regarding the representative's performance and compensation will inevitably lead to further difficulties. Discount terms for distributors or commission rates for agents are rarely adjusted according to the differing commercial and logistical performance. Therefore, it is important that specific performance goals are developed on which the compensation package should be based and agreed upon between manufacturer and representative. This especially includes commercial goals, such as growth targets linked to the number of customer visits and reports, as well as technical service requirements. Other goals may include logistical requirements such as predefined quantity buying requirements, order intervals, as well as specific lead-times.

Underutilized Potential for Cost Optimization

Manufacturers rarely question the inherent potential for improving the cost structure of their representatives. Both distributors and agents are often seen as an unchallengeable institution and part of the

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manufacturer's organization. For example, it is not unusual for representatives to have exceptional and complex arrangements regarding customers, products or markets, on top of their existing discount and commission structures. This unfortunately leads to a loss of transparency regarding the compensation structure. The manufacturer becomes unable to identify whether the compensation-performance ratio of his representatives is adequate. Only with a transparent commission structure is it possible for the manufacturer not to pay more for services than they are worth.



Scheme of Service Delivery/Performance-Typology of Representative

Another potential for cost reduction involves having representatives pay a share of otherwise free of charge services provided by the manufacturer. This could include free sample shipments, technical training, promotional material or direct sales support. It is not uncommon for these services to account for up to 6% of the overall turnover generated by the representatives, thus amounting to a substantial cost-saving opportunity for the manufacturer.

If chemical manufacturers handle the large account business directly and leave the small customer business to the representatives, they can massively reduce complexity and thus their indirect costs. This type of reallocation requires the readiness on part of the representatives. Manufacturers can certainly not expect, that taking away lucrative business, will gain much support if this involves a collapse in sales for his representatives. Therefore it is crucial to create a win-win-situation for both sides with this type of

and can be categorized into four main groups.

1. The most basic service consists of non-exclusive sales representation usually rendered by agents. The compensation structure is mostly based on commissions.
2. Non-exclusive sales representation with the addition of local distribution warehouses. The compensation structure is mostly based on discounts.
3. Once turnover becomes sizable, representatives may be in a position to provide exclusive commercial and/or technical sales support to the manufacturer. The compensation structure for this dedicated service should be higher than the previous two categories.
4. Finally, by additionally providing local application laboratories representatives can offer a full service package to the manufacturer. This will reduce time consuming shipping of products to the manufacturer for testing and creates a further competitive advantage. Clearly, this service group should receive the highest compensation package on part of the manufacturer.

Only few chemical manufacturers have introduced centralized functions that exclusively manage the performance of the company's representatives. But it is the introduction of this function that is so enormously important for maintaining an efficient and cost-effective representative structure. Only in this way can a chemical manufacturer assure that his distributors and agents will perform optimally and appropriate cost advantages can be realized.

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change. The better representatives must receive alternative incentives in order to provide their support. A territorial consolidation will allow for the elimination of low performing representatives, while incentivizing the better performing representatives.

Also, a structured evaluation of the service components can lead to a fairer compensation structure for more service-oriented representatives, increasing their motivation and optimizing costs for the manufacturer. The compensation structure should ideally be based on specific services rendered by representatives