MP-605

Vardhaman Mahaveer Open University, Kota

Sales and Logistics Management

Course Development Committee

Chairman
Prof. (Dr.)Vinay Kumar Pathak
Vice-Chancellor
Vardhaman Mahaveer Open University, Kota

Subject Convener and Coordinator
Prof. (Dr.) P.K. Sharma
Director (School of Commerce and Management),
Vardhman Mahaveer Open University, Kota

Editing and Course Writing

Editor
Prof. (Dr.) Atul Dhingra
Department of Management Studies,
CCS Haryana Agricultural University, HISAR

Unit Writers — **Unit No.**

1. **Ms. Suruchi Sharma** **(1, 2, 4)**
Dehradun Institute of Management,
Dehradun

2. **Prof. (Dr.) Atul Dhingra** **(3, 10)**
Deptt. of Management Studies
CCS Haryana Agricultural University, HISAR

3. **Dr. Shobha Khinwasara** **(5)**
Subodh Institute of Management
Jaipur

4. **Dr. Kavaldeep Dixit** **(6)**
Professor and Dean
IIIM, Jaipur

5. **Dr. Tapasya Julka** **(7)**
Deptt. of Business Administration,
Subodh P.G. College, Jaipur

6. **Dr. Rimjhim Gupta** **(8, 9, 11)**
Asst. Professor,
Pacific Institute of Management, Udaipur

7. **Dr. Shikha Bhargava** **(12, 13, 14, 17)**
Asst. Professor,
Pacific Institute of Management, Udaipur

8. **Dr. Ashutosh Mohan** **(15, 16)**
Asst. Professor (FMS)
Banaras Hindu University, Varanasi

Academic and Administrative Management

Prof. Vinay Kumar Pathak	**Prof. L.R.Gurjar**	**Prof. Karan Singh**
Vice-Chancellor	Director (Academic)	Director (MPD)
Vardhaman Mahaveer Open University, Kota	Vardhaman Mahaveer Open University, Kota	Vardhaman Mahaveer Open University, Kota

Production November, 2014 ISBN-

MP-605

Vardhaman Mahaveer Open University, Kota

CONTENTS

Sales and Logistics Management

Unit – 1: Sales Management

Structure of Unit

1.0 Objectives

After completing this unit, you would be able to:

- Understand the concept, nature, scope and importance of sales management;
- Present a general overview of the sales management model and sales management process;
- Know the objectives, strategies and tactics of sales management;
- Identify the relationship between the functions of marketing and sales;
- Understand Sales Management Operations and cycle;
- Describe sales plan and promotion techniques;
- Describe Customer Relationship Management.

1.1 Introduction

A sale is the pinnacle activity involved in selling products or services in return for money or other compensation. It is an act of completion of a commercial activity. A sale is everything that is done to close the sale and get a signed agreement or contract. The quality of selling is referred to as salesmanship. Sales people must work strategically in different situations. They are like market intelligence team, which works closely with customer and possess information about customer and their behavioral pattern.

1.1.1 Concept

The attainments of sales force goals in an effective and efficient manner through planning, staffing, training, directing, and evaluating organizational resources.

The Definitions Committee of the American marketing association defined sales management as 'the planning , direction and control of personal selling, including recruiting, selecting, equipping, assigning, routing, supervising, paying and motivating as these tasks apply to the personal sales force'.

The above definitions cover two important ideas:

- The five functions of planning, staffing, training, leading, and controlling, and
- The attainment of organizational goals in an effective and efficient manner.

The art of meeting the sales targets effectively through meticulous planning and budgeting refers to sales management and is one of the most important elements of success of modern organizations. It helps to extract the best out of employees and achieve the sales goals of the organization in the most effective ways.

It is a socio-scientific process, involving group-effort in the pursuit of common goals or objectives, which are predetermined. It helps the organization in demand forecasting, territorial redesigning and collecting competitor's information. Although it is a system of authority with co-ordination as its key; harmony is emphasized instead of conflict. Management of the sales force is one of the most important executive responsibilities. In the present scenario sales executives are professionals. The professional approach demands the ability to install, operate, and use control procedures appropriate to the firm's situation and its objectives. The sphere of Sales Management operations include: Managing Sales Force, Managing Sales Targets, Offering Sales Training, Managing Direct sales, Managing Sales Territories, Managing Channel partners, and Managing Sales Promotion.

1.1.2 Nature, Scope and Importance

Sales Management forms a part of Marketing Management. A significantly broader meaning is assigned to Sales Management and it encompasses the following two broader areas: Managing the Sales Functions, and Managing the Sales Force.

The nature and role of sales management has become more professional. The emphasis is on the word 'management'. The duties of the sales manager in the modern company have both broadened and changed in emphasis. Nowadays the sales manager is expected to play a much more strategic role in the company and is required to make a key input into the formulation of company plans. There is thus a need to be familiar with the techniques associated with planning, including sales forecasting and budgeting. The sales manager also needs to be familiar with the concept of marketing to ensure that sales and marketing activities are integrated. The sales manager needs to be able to analyze and direct the activities of the sales force towards more profitable business. In dealing with a sales force, the sales manager must be aware of modern developments in human resource management.

Due to the changing nature of sales management, the job of a sales manager has taken the mixed form of an accountant, a planner, a personnel manager and a marketer. However, the prime responsibility is to ensure that the sales function makes the most effective contribution to the achievement of company objectives and goals.

To help understand the scope of the sales management task, sales management is understood as all activities, processes, and decisions involved in managing the sales function in an organization. Managing a sales force well involves understanding the complexity of selling activities as well as the decisions involved in managing those activities.

The importance and/or benefits of sales management are as follows:

(1) To the Society: If jobs are to be made available for all those, who want and expect them, the economy must continuously expand its production of goods and services, which can only be done by adopting sound government-policies and efficient use of people. Equally important here is the fact, that an economy needs individuals, to sell what is produced. Through their persistent efforts to create and stimulate demand, salespeople could be said to be the life and blood of a productive economic-system.

(2) To the Consumers: Professional people know their product or service, its major uses, limitations and benefits; which helps them to serve their customers, quite effectively. For example, an insurance agent can analyze the hazards and risks that confront a client's business or home-situation, examine existing coverage and offer helpful advice, in order to eliminate the gaps or overlaps in coverage, in addition to saving the client's money. The sales-engineers are qualified to analyze technical-problems, which may be confronting a particular organization and they can give the right recommendations for developing efficient operations.

(3) To the Business Firms: A business firm can be profitable only if its revenues exceed its costs. The prime responsibility of the salespersons is to sell the goods, produced by the organization, at a profit. Companies, salespeople and customers are different levels in the marketing chain; and these stand to benefit by sales-activities. The creative salesperson, tries to penetrate his territory, and adopts suitable means and techniques of profitable-selling of goods and/or services. The salesperson, in the field, is an ideal person, to keep the company abreast, or ahead of competition. He, thus, becomes an important source of field-intelligence by providing important (and sometimes very crucial) information, about the nature of competitive-activities, and also about the changing needs of customers. The sales-force has the additional responsibility of serving the needs of customers that buy the firm's product(s). Most firms cannot survive, only on the basis of one-time sales; repeat-sales are necessary. This is possible only if the customers are served in a professional manner. It is the only function or department in a company that is involved in generating revenue or income for the organization. The financial results of a firm depend on the performance of the sales department. Many sales people are among the best paid people in business. It is one of the fastest and surest routes to enter into the top management bracket.

1.1.3 Marketing and Sales Management

Marketing and sales are very different, but have the same goal. Therefore, it is essential, that sales and marketing be fully integrated. When the marketing plan is written, specific strategies are set, such as achieving a certain profit margin or reaching a specific target audience. A sales plan will use tactics to affect these strategies. For example, if the marketing strategy is to enter the marketplace with a lower price, the company will need high-volume sales because there are lower profits per unit. This will guide the sales department as it determines where and how to sell.

Table 1.1: Difference in Sales and Marketing

Sales	Marketing
Sales starts with seller & is preoccupied all the time with the needs of the seller	Marketing starts with the buyer and focuses constantly on the needs of the buyer
Emphasizes on saleable surplus available with the company	Emphasizes on identification of market opportunity
Seeks to convert products in to cash	Seeks to convert customer needs in to products
Views business as – goods producing process	Views business as – a customer satisfying process
Sales views the customer as the last link in the business	Marketing views the customer as the very purpose of business

The adoption of the marketing concept has in many companies been accompanied by changes in organizational structure, together with changes in the view of what constitutes the nature of selling. Example of the possible organizational implications in a market oriented and a sales oriented company is shown in the figure depicting the organization charts below:

Figure 1.1: Company Organization Chart: Sales-Oriented Company

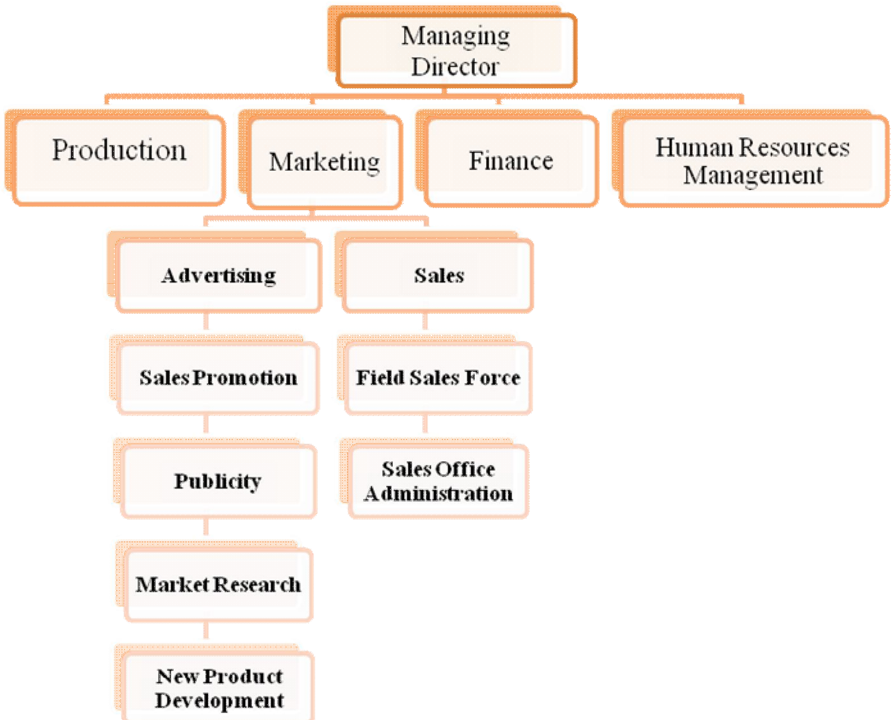


Figure 1.2: Company Organization Chart: Market-Oriented Company

Perhaps the most notable difference between the pre and post marketing-oriented company is the fact that sales in later are seen to be a part of the activity of the marketing function. In the marketing - oriented company, the marketing function takes on a much wider controlling and coordinating role across the range of company activities. The marketing concept, however, does not imply that sales activities are any less important. In addition to changes in organizational structure, the influence of the marketing function and the increased professional approach taken to sales has meant that the nature and role of this activity has changed.

Selling and sales management are now concerned with the analysis of customers' needs and wants and, through the company's total marketing efforts, with the provision to satisfy these needs and wants.

1.2 Functional Elements

Although, sales management consists of separate functions and activities as depicted in the above diagram, they are viewed as having a systematic relationship with each other. All functions and activities are considered as a dynamic process, composed of numerous interrelated parts, aiming to achieve the organizational sales objectives. The following are the different functional elements of Sales Management:

(A) Managerial functions

1. Planning:
   - Forecasting demand,
   - Sales territory planning,
   - Personal selling, and
   - Promotional efforts.

2. Organizing:
    - Structure,
    - Resource allocation,
    - Responsibility assignment, and
    - Delegation of authority etc.
3. Direction:
    - Leadership,
    - Motivation,
    - Communication, and
    - Promotional steps including personal selling.
4. Control:
    - Delegation,
    - Quota fixing,
    - Performance evaluation,
    - Incentives, and
    - Budgets.
5. Co-ordination:
    - Liaison,
    - Integration of various elements internally,
    - Public Relations, and
    - Creating goodwill by contact with customer/general public

(B) Staff functions: This is related to staff functions of sales force such as the following:

1. Recruitment and selection.
2. Deployment and evaluation of performance
3. Training and development.
4. Career development.
5. Compensation and incentives.
6. Motivation and empowerment.

(C) Advisory functions:

1. Product attributes/quality aspects.
2. Pricing policies.
3. Promotional steps and personal selling aspects.
4. Distribution policies and channel selection criteria.
5. Advertisement policies such as media selection and target audience.
6. Transportation and warehousing aspects.

(D) Liaison Functions: Liaison with departments such as the following:

1. Production department.
2. Finance department.
3. Marketing department.
4. R & D department.
5. Distribution network and After Sales Service department

1.3 Sales Management Operations

Sales Operation refers to various activities, which help in the timely achievement of sales targets for the successful functioning of an organization. Sales Operation activities help the sales professionals to meet the sales targets in a systematic and the best possible way. In simpler words sales operation activities help in generating revenues for the organization through meticulous planning, better budgeting and adopting a methodical approach.

1.3.1 Sales Management Model

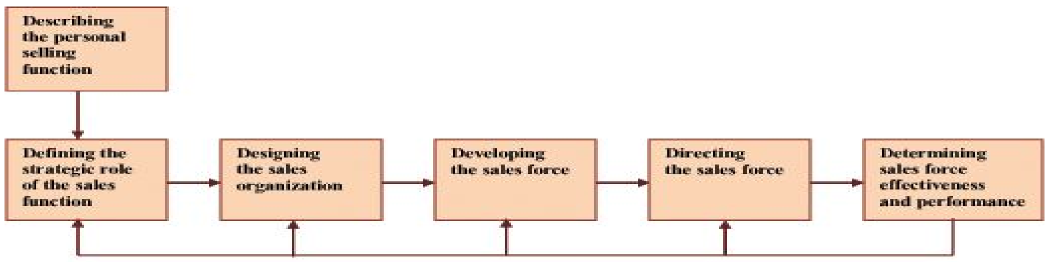
Described below is the model of sales management:

The 1st step - "Describing the personal selling function"

Deals with understanding the job activities and the sales process involved in personal selling.

The 2nd step - "Defining the strategic role of sales function"

Deals with the corporate, business, and marketing level strategic decisions. These typically provide guidelines within which the sales manager and salespeople must operate.



Source: Thomas N. Ingram (1989)

Figure 1.3: Sales Management Model

The 3rd step - "Designing the sales organization"

Deals with the importance of designing an effective sales organization necessary to implement the strategies successfully.

The 4th step - "Developing the sales force"

Highlights the importance of right recruitment and selection methods and the need for proper training of the sales force personnel.

The 5th step - "Directing the sales force"

Hiring the best people for sales is one thing and directing their efforts to meet the sales organization goals and objectives is another. Sales managers spend a great deal of time in motivating, supervising and leading members of the sales force.

The 6th step - "Determining sales force effectiveness and performance"

Deals with monitoring the progress of sales force to determine the effectiveness and performance. Developing forecasts, assigning quotas and budgets provide necessary information for the performance evaluation.

1.3.2 The Sales Management Process

The sales management process involves three interrelated sets of decisions or processes:

1. The **formulation** of a sales program. The sales program should consider the environmental factors faced by the firm. It is essential to do a SWOT analysis of the organization to know its strengths, weaknesses, threats and opportunities. Sales executives organize and plan the company's overall personal selling efforts and integrate these with the other elements of the firm's marketing strategy.
2. The **implementation** of the sales program. The implementation phase involves selecting appropriate sales personnel and designing and implementing approaches that will direct their efforts toward the desired objectives. Identify the target market. Selling techniques and strategies can't

be same for all individuals. Each audience has different needs, interests and requirements. Hire the right individual for the sales team. The sales professionals have a major role in the success and failure of organizations. Those individuals, who are aggressive, out of the box thinkers and nurture the dream of making it big in the corporate world, should be recruited. The sales representatives should be very clear about their roles and responsibilities in the team. Develop a lucrative incentive plan for them. Incentives and monetary benefits go a long way in motivating the sales team.

3. The **evaluation and control** of the sales program. The evaluation phase involves developing methods for monitoring and evaluating sales force performance through appropriate metrics. Evaluation and control allows for adjustment of the sales program or the way it is implemented when performance is unsatisfactory. The management must conduct frequent meetings with the sales team to review their performances and keep a track on their daily activities. The sales team must prepare Daily Sales Reports (DSR) for the superiors to know what they are up to. Besides, one must assess his own performance by recalling the interactions with the clients and analyze the areas of failure, thus, improving for the future.

1.4 Sales Management Cycle

Customers go through a sequence of activities before the product finally reaches them. Such activities are a part of the sales cycle. The sales process yields increased sales if it is broken down into steps or stages. The major stages are similar across the product or service spectrum. This allows the management of the sales staff. It also ensures that the right steps are taken to maximize the chance to turn every prospect into a sale. The entire sales process is nothing but a 'game of patience'.

(A) Interest creation among the prospective consumers - Prospecting & Fact Finding

- A company cannot sell its products until it has someone to sell to - the prospects. Depending on the business, prospects might walk in the door or sales might require visits or calls to potential customers in their homes or businesses. Identifying prospects or prospecting can be the least pleasant stage for the sales staff. The business organizations need to have systems in place to generate a steady flow of prospects through application of different tools like advertising or website etc. In this activity, creating awareness about the brand or product should be the main aim than pushing for sales.
- Sales representatives should prepare their own database. There should be a long list of potential customers. The sales representatives need to go out to visit markets, shopping malls, restaurants to meet potential customers, map them and collect as much information as they can. Interaction with as many individuals as possible helps in meeting sales targets. Questionnaires should be distributed amongst the potential customers to know them better. It really helps if you know something about the client before the meeting. Gaining relevant information about the client definitely helps in preparing the sales pitch**.**
- The next step is to segregate the data according to demographics (i.e. age, sex, income etc.). Classifying the data under various sub heads like working/non

working, middle class/upper class, and employed/unemployed help to understand the customers better and identify the target audience.

- Once there is a prospective customer, the sales person needs to understand the customer in this phase and identify his/her problem and provide the necessary information or documents which the customer may request. The customer needs to be educated about the product/service being offered. It is the job of the sales person to be prepared with the necessary literature, brochures and/or presentations. If the product is technical in nature, the aim of the sales person should be to explain the benefits of the product to the customer and not its technical features. The customer's needs and expectations from the product need to be understood. The buying potential of the customer regarding a particular product needs to be checked;
- The fact-finding stage should also build rapport and trust between the salesperson and the prospective customer. Depending on the type of product, fact finding might involve a few questions or multiple visits to a customer's place of business to determine what features the customer must have from your product.

(B) Pre-purchase Activities – Appointment and Presentations

- Having created interest in the brand/ product in the first activity, it is time for moving on to the next activity by the sales person. The sales people should get in touch with the prospects and seek an appointment at their convenience.
- In this process we assume that the customer is actively considering various product offerings and comparing them. The aim is to describe the product or service features to the extent possible. Much emphasis is laid on demonstrating the capabilities of the company and or the product.
- The sales presentation is the "selling" stage of the whole sales process. The presentation may be a sales pitch that demonstrates the features and benefits of a product. Or it could be a written proposal, listing the features and benefits of the product along with the price. The presentation stage is when a prospective client is shown how the product meets his needs, wants and desires. This stage is considered the most enjoyable for salespeople.

(C) Purchase Activities - Determine Client's Solution/ Written Proposal/ Negotiation/Closing the deal

- Having presented a solution to the customer problems, it is time for the sales person to push for closing. Here a lot of activities happen both, from the sales person's end and the customer's end.
- Sales person's role lies in negotiating, bidding, finalizing the terms and condition of the sale. The customer evaluates various proposals, negotiates and finalizes the payment.
- A sales representative must never lie to the customers. The customer should be suggested the right option and never prompted to purchase what is not right for him. Details about what the product actually offers should be given. It is unprofessional to make false commitments. It is important to maintain transparency. The salesperson should not always think about own targets and incentives, rather care should be taken to think from the customer's perspective as well.
- The needs and expectations of the customers must be understood. The customer needs to understand how the product would benefit him. He should realize how the product is better than the competitor's. The customers should be aware of even the minutest details. He should be given the best deal so that

the customer comes back again to the organization. But, care should be taken not to oversell.

- There should always be room for negotiation in deals. Negotiations should be done with an open mind. Too much rigidity on price and other terms and conditions should be avoided. For higher customer satisfaction, give him the best deal.
- In many types of sales, closing is a separate stage, requiring another set of sales skills. At its simplest, the close is asking the customer to buy your product. Closing also involves taking extra steps or asking more questions to turn a no into a yes when the customer is asked to buy. A sales professional should always aim to close the deal as soon as both the parties accept the terms and conditions. Once the customer decides on the product, he should be presented a proposal with the description of the product, model no, date of purchase, warranty details and other necessary terms and conditions. Some organizations also give bills to the customers. Bills are required when the customer comes for an exchange.

(D) Post-purchase Activities – Delivery After-sales service/Follow-up stage

- After a sale is successfully closed, post purchase activity begins. This phase includes delivery of the product/ service, installation (if required), using or maintaining the products, providing more information about the features and finally collecting the payment. This phase can also include after-sales service and the follow-up process. A process of continual feedback is must.
- The delivery stage is the opportunity to cement relationship with a new customer and turn him into a repeat customer. It is important to make sure that the products are delivered in good and working condition to the customer. The customer should be sent with a positive feeling about the purchase.
- Some functions in this stage like providing information, delivery of product and installation can be done by the company itself or with the help of a reseller.
- After sales service plays an important role in creating the customer loyalty. It can be as simple as addressing the customer problem on the telephone line or may be a personally visiting the customer premises to resolve an issue. In B2B deals, post-purchase activities can include installing the product or service and then providing training for the uses of the product/service of the company until they understand the new product/service.
- Understanding the post-purchase behavior by the sales team is an important task if the company looks for repeated business for a long-term relationship with customer. One should be in touch with the clients even after the deal for higher customer satisfaction, higher customer retention and eventually higher revenues.

1.5 Strategic Sales Management

Planning a sales strategy requires that the sales manager begin with a mastery of the firm’s marketing strategy. Then specific strategies for sales management of the selling organization must follow. Sales managers have the knowledge of defined markets, product mix, what new products are proposed or are in pipeline, what new additions to the business are planned, and what the policies for channels, distribution, pricing, and marketing information will be. These are the questions, the answers to which have to be found out before starting the field sales management strategies.

A well thought-out sales strategy is needed in order to be successful in today's competitive market-place. The following three areas of sales strategy are required:

- A clear picture of the present situation, including the strengths, weaknesses, and problems of the sales and managerial staff, as well as the threats, risks, and opportunities that exist in the marketplace.
- Well-defined strategies covering every major aspect of the selling units or departments, including territory, account, and call-management strategies by product line; this involves developing one year and multiyear plans.
- Income and expense budgets and a profit plan based on sound sales forecasts and knowledge of pricing policy.

1.5.1 Preparation of the Multilayer Strategic Plan

The important step is to develop a long-run, multiyear strategic plan for the sales force. A sales strategic plan includes the following four major questions:

(a) What is the sales department's present condition? This is a final summary of the earlier statements of condition. The summary should not be an essay or a tome but a series of one-line statements of the major internal and external conditions important enough to be included in action plans for the coming years.

(b) What trends are apparent? Here the sales manager looks at the situation and tries to project it into the future. If nothing is done differently, where would the sales force and the organization be in one year? Two years? Five years?

(c) What are the most important objectives? These are missions over the next three to five years, not just next year. They might include such things as increasing salespeople's training, redesigning the compensation program, and developing computer software for field sales managers, plus providing them advanced educational programs.

(d) What are the strategies for getting these objectives accomplished? This might require:
  - Increasing the budget and personnel for the sales training department
  - Having an outside consulting firm overhaul the compensation plan
  - Hiring one or more persons to develop software or contracting an outside vendor

Each strategic statement should then be turned into an operational plan and put into the hands of responsible people who will make commitments to execute the plan. In the competitive times, if the sales department does not adapt, ultimately the company will be a follower instead of a leader.

1.5.2 Financial Planning as part of the Sales Strategy

The sales department cannot do much about certain aspects of profit planning. It has no control, for example, over the cost of goods sold. Manufacturing cost accounting will define that element. It has no direct responsibility for general, administrative, and overhead expenses. Costs of materials and labor for producing the product are accountable elsewhere. Thus, most sales departments have two principal concerns:

- Revenue produced
- Selling expense

The difference between these two is the contribution to the organization's profit from the sales effort. These calculations should be projected into the future, not only for a year ahead at budget time but also for several years in advance as part of the strategic field sales plan.

The accurate forecasting of sales and of the costs, or expenses, required to generate the sales is a major part of the sales strategy plan. The sales manager has to think strategically for the field sales organization and that too in long term, hence, the projection of these revenues and expenses beyond the first year should incorporate the manager's best estimates about the effect of changes in strategy, market plans, product innovations, enlargement in geographic markets, and sales forecasts etc.

When the sales managers begin operational planning for field sales, they should define these in shorter terms, including monthly and quarterly estimates and forecasts for the single year ahead. They should not be unduly worried about the precise accuracy of future years. Managers will do a forecast of three to five years ahead every year and can adjust it on the basis of their learning and experiences in the current year. These multilayer figures will help the firm find its best operating objectives.

1.5.3 Process of Strategic Sales Management

Through strategic sales management, the organization structures its sales mechanism with a view to increasing revenue. The reason why it is necessary for a company to develop a strategic sales management model is because businesses must adapt to the ever-changing requirements of consumers to remain relevant in a competitive market.

1. The first step includes identifying the product/ service. The product/ service is developed as per the company goals and the market needs.
2. The next step towards conducting an effective strategic sales management is analyzing the market. This is where we begin to identify the customer for the product/service.

   An analysis of the market includes an evaluation of the target customers and the market environment. Target customers are those in the demographic that is most likely to buy the product or obtain the service offered by the company. The sales strategy will be formulated with those people in mind. For example, company that makes purses or cosmetics knows that its main consumer base will be women and therefore will target its sales efforts toward women.

   Another part of strategic sales management is an analysis of the market environment. The company must find out how many competitors it has, what their sales plans are like and how their marketing activities affect the success of the company. When the company has this information, it will assess its own business model to determine its areas of strengths and weaknesses in relation to its competitors.
3. Part of an effective sales process is good advertising management to make the presence in the market. This includes taking out television

advertisements and other types of promotion that will appeal to the target demographic while ensuring that it reaches the audience. This includes making decisions about whether to take out expensive spots during prime time, the length of the commercial and the frequency with which the advertisement will run. Another advertising consideration that is related to sales is the manner of presentation of the product or service. The company will have to make decisions about the packaging of the products. The firm also has to provide the support material to the sales people in terms of brochures, literature etc

4. Distribution channels also are important in the development of strategic sales management. This is because the company must have a good distribution network that will ensure that its products reach the target consumer base in an expeditious manner.
5. The sales team must be carefully selected, and it must include driven and highly motivated, result-oriented people.
6. Setting financial targets for the members of the sales team gives them a purpose and can help the organization meets its financial projections for each business cycle.

1.5.4 Sales Strategy vs. Tactics

A sales strategy, in simplest terms, represents an idea or general approach to achieving a particular business goal. A business might set a general goal of capturing more female buyers. If the business operates in an industry historically dominated by male buyers, a possible sales strategy would go something like this: de-masculine or feminize the product or service. A sales strategy often includes the content of marketing messages.

By contrast, sales tactics refer to the specific actions a business takes to carry out the sales strategy. Everything from running a series of TV ads and putting up fliers around the neighborhood to talking to a customer face to face about the benefits of a product constitute sales tactics. These tactics should, on the whole, reflect the overall sales strategy.

Sales strategies differ from sales tactics in that strategies are broad-based “what to do” methods, while tactics are more targeted “how to do it” efforts. Strategies for selling include reviewing your target audience, setting pricing and determining distribution methods. Once you choose your strategies, your sales department can recommend tactics for achieving your goals.

No matter how well trained the salesperson or sales staff, in the absence of a clear sales strategy, the sales tactics they employ will likely result in mediocre sales. The sales strategy offers the people on the ground a clear starting place, as well as a clear message, they can direct at potential buyers. The main components of planning in a company are objectives, strategies and tactics. Their relationship is shown below:

Figure 1.4: Relation between Sales Objectives, Strategies and Tactics

1.6 Sales Professionals

Sales management requires constant practice and learning just like any professional sport; practice makes a manager perfect. Sales Professionals are the face and interface of an organization. Management of sales personnel is both an art and a science. It is an art because many skills cannot be learnt from a textbook. It is also a science, because a growing body of knowledge and objective facts describes sales management and how to attain sales goals. Becoming a successful sales manager requires a blend of formal course learning and practice. There are two opinions regarding the sales abilities:

1. Inborn qualities like gift of gab, pleasing manner, extrovert nature are inborn.
2. Developed qualities like analytical ability, negotiation skills, leadership, can be learnt and developed.

1.6.1 Areas of Coordination – Field Sales Manager

The Field Sales Manager has to coordinate in the following areas:

- **Strategy –** The globalized and competitive world environment changes fast, opportunities and threats appear and disappear very frequently. Top managers engage continuously to scan the environment and suitably amend and modify existing strategies.
- **Planning -** Various activities are listed in terms of "time frame" and "cost frame" Their milestones are prepared along with PERT so that proper sequencing of such activities, along with quantification of resources are determined. Information obtained based on sales forecast, assists market segmentation, territory planning, outlay on other marketing efforts like advertisement, personal selling and promotional steps.
- **Marketing Programme -** Many sales activities are required to be coordinated with other activities of marketing such as advertisement and sales promotion.
- **Sales Force Efforts** - Efforts of sales force must be properly coordinated to avoid functional overlapping/ duplication / gap. Depending on the market conditions, competitors' actions and individual performance, it may be necessary to shuttle around salesmen, re-organize territories & regions or supplement the salesmen.
- **Distribution Network** - Liaison and co-ordination between distributors and retailers becomes very important for timely availability and after sales service. Complaints of transit damages, non-settlement of warranty/guaranty claims by customers etc. needs extensive co-ordination. Sharing advertisement/promotion expenses is another area requiring co-ordination between organization and distribution.
- **Manufacturing -** Very often customers complain against quality, reliability, maintenance and operational problems. Such matters require prompt action by manufacturing divisions. They in turn solicit the services of R & D engineers, if need be, for incorporating modification or re-drafting "Operating and Maintenance Instructions." Many times, distributors complain on non-availability of spares or replacement of item returned for repair. Salesmen

efforts with manufacturing divisions to solve many such problems will yield customer satisfaction and goodwill.

1.6.4 Roles and Responsibilities of Sales Manager

A sales manager plays a key role in the success and failure of an organization. He is the one who plays a pivotal role in achieving the sales targets and eventually generates revenue for the organization. A sales manager must be very clear about his role in the organization. He should know what he is supposed to do at the workplace. Let us understand the roles and responsibilities of a sales manager:

- A sales manager is responsible for meeting the sales targets of the organization through effective planning and budgeting.
- A sales manager can't work alone. He needs the support of his sales team where each one contributes in his best possible way and works towards the goals and objectives of the organization. He is the one who sets the targets for the sales executives and other sales representatives. A sales manager must ensure the targets are realistic and achievable.
- The duties must not be imposed on anyone, instead should be delegated as per interests and specializations of the individuals. A sales manager must understand who can perform a particular task in the most effective way. It is his role to extract the best out of each employee.
- A sales manager devises strategies and techniques necessary for achieving the sales targets. He is the one who decides the future course of action for his team members.
- It is the sales manager's duty to map potential customers and generate leads for the organization. He should look forward to generating new opportunities for the organization.
- A sales manager is also responsible for brand promotion. He must make the product popular amongst the consumers. A banner at a wrong place is of no use. Canopies must be placed at strategic locations; hoardings should be installed at important places for the best results.
- Motivating team members is one of the most important duties of a sales manager. He needs to make his team work as a single unit working towards a common objective. He must ensure team members don't fight amongst themselves and share cordial relationship with each other. Develop lucrative incentive schemes and introduce monetary benefits to encourage them to deliver their level best. Appreciate whenever they do good work.
- It is the sales manager's duty to ensure his team is delivering desired results. Supervision is essential. Track their performances. Make sure each one is living up to the expectations of the organization. Ask them to submit a report of what all they have done throughout the week or month. The performers must be encouraged while the non performers must be dealt with utmost patience and care.
- He is the one who takes major decisions for his team. He should act as a pillar of support for them and stand by their side at the hours of crisis.
- A sales manager should set an example for his team members. He should be a source of inspiration for his team members.
- A sales manager is responsible for not only selling but also maintaining and improving relationships with the client. Client relationship management is also his KRA (Key Responsibility Area).

- As a sales manager, one should maintain necessary data and records for future reference.

1.7 Sales Plan and Promotion

A sales plan sets the direction, objectives and expectations for the sales force.

a) Components of a sales plan - The following are the key components of a sales plan:

1. **Objectives -** The sales plan sets objectives for the sales force. If a company wants to increase revenue and profit, it can either focus on winning new customers or expanding the business with existing customers. The plan must give the preferred strategy for growth and assign responsibility for developing new or existing business to different members of the team. The plan must also identify any competitive threats to existing business so the sales team can act to protect vulnerable accounts.
2. **Targets -** A sales plan sets targets and quotas for individuals and the team. The targets must be specific, such as increasing revenue by 5 percent. Sales plans also include quotas for sales activities, such as making 50 new business phone calls each week, visiting six customers per week or making presentations to three prospects per week.
3. **Territories -** For companies that structure their sales force geographically, the sales plan allocates territories to each representative and sets objectives for each territory. Companies that have strengths in specific markets, such as engineering, financial services or health care etc., may structure their sales force according to market sector, appointing representatives with specialized knowledge to deal with key accounts.
4. **Products -** The sales plan describes the targets for sales of specific products and outlines any product-related incentives available to the sales force. The plan also provides details of new products that the company aims to launch in the next financial year and indicates the type of customers and prospects they may appeal to.
5. **Marketing Support -** The plan outlines how marketing activities are going to support the sales force objectives. An advertising campaign, for example, can generate leads for the sales force to follow up.
6. **Training -** To ensure that the sales force has the skills to meet its objectives, the sales plan should include information on training programs that are available. If a company is planning to enter new market sectors or launch new products, training programs should cover essential market and product knowledge. If the company wants to increase business from existing customers, it should offer training in customer relationship management.

b) Sales Promotions - Sales promotions are a common component of a company's promotional strategy. Sales promotions involve a wide variety of sales strategies, including contests, product giveaways, catalogs, coupons, discounts and more. Marketing events, such as trade shows, also fall under the category of sales promotions. Sales promotions often target either consumers or wholesalers and retailers. These are short-term strategies that 'pull' shoppers with incentives to 'buy now'. A major trait of sales promotions is their short-term orientation. The purpose is to attract customers and create higher levels of sales than would be achieved at regular price points. In comparison, long-term brand advertising is used to gradually generate a sense of worth for the company's products.

Companies use sales promotions for a variety of reasons like attract a new customer base; disrupt competitor promotions, increase revenue and cash flow quickly and to clear out excess inventory.

Sales promotion strategies and tactics should be carefully planned, along with advertising and other promotional efforts. Overuse of sales promotions instills a low-price orientation in customers, making it difficult to ever get them to pay a higher price. One also suffers missed revenue and profit if those products are discounted that customers would pay regular prices for in the near future. Additionally, errors in marking down prices or in signage, as well as confusing the details of deals, can alienate customers.

A few types of Sales Promotion tools are discussed below:

- **Discounts -** The most simple sales promotion format is a percentage or rupee-off discount. The offer may be a product for something like 20 percent off or Rs. 10 off the original price. A customer may perceive the product as more worthwhile at the reduced price. The use of eye-catching colors on the shelves to clearly designate a product as on sale can psychologically convey a better deal.
- **Coupons -** Coupons are similar to discounts in that a customer is offered a reduced price for redeeming the coupon. The biggest difference is that only coupon holders have access to the discount opportunity. This particular promotional tool is most useful when you have a large base of customers willing to pay a premium regular price, yet you also want to attract customers who are more price-sensitive with a coupon. This tool is also used to motivate a customer to try your product or switch from another brand.
- **Loyalty Programs -** Loyalty or frequency programs are a very unique type of sales promotion in that they have a long-term focus. Loyalty programs are ongoing incentives to loyal customers who purchase at certain levels. Typically, customers receive points or bonus coupons when they reach certain spending increments.
- **Free Stuff/Trial -** A number of sales promotional programs include a mix of free promotional inducements. One type is a product premium. This is where you get a free gift or additional item with a purchase. Buying a pack of coffee and getting a coffee mug free is an example. Free product samples and trial offers are used to take the risk out of trying a new product. These garner exposure for the product or service.
- **Rebates -** Rebates are a unique promotional tool where a customer receives a check or payment from a manufacturer or reseller after a purchase. Electronics retailers, for instance, often offer big-ticket items that come up with manufacturer or retailer rebates. Normally, you have to submit a receipt, and application, and the rebate takes several weeks to process and pay out. Redemption rates overall are low, because customers don't always redeem small offers.
- **Contests and Sweepstakes -** These are the prize giveaways used to build interest of customers regarding any product or service.
- **Business and Trade Market -** Business and trade market promotions are deals offered to business buyers and trade resellers. Businesses receive many of the same types of promotional offers as consumers with the objective of luring them into buying. Trade resellers are offered promotional incentives so manufacturers and wholesalers can get their immediate customer to buy and

carry products. Simple discounts, promotional allowances and refunds are examples of trade promotions.

1.8 Customer Relationship Management (CRM)

It refers to the study of needs and expectations of the customers and providing them the right solution. CRM originated in early 1970s.Customer relationship management, or CRM, is a systematic approach to marketing that relies on database technology for more targeted marketing and effective sales and service. From a sales perspective, sales companies and employees use CRM for the following:

- **Pipeline Management -** This is sequential status updates on leads as they move from prospects to customers. During the sales process, a prospect's status commonly moves from lead to initial contact, to presentation, to sale and, finally, to follow up. Salespeople normally can create reports that show what customers are in each stage at any given point.
- **Suggestion Selling -** Part of the point of CRM is to enable salespeople to get more business from top customers. They do this by identifying those customers that purchase significant amounts consistently. Customer profiles and recommendation tools help salespeople know when to offer additional products, accessories and services related to a single purchase, and when to recommend unrelated purchases to a key buyer.
- **Relationship Building -** Salespeople want to build long-term relationships with customers that allow for ongoing and building business over time. They also can optimize relationships by asking for referral business.

Discussed below are a few benefits of CRM for various activities or departments:

(A) Sales Department: Improved sales planning and management, automating lead system, managing sales opportunities effectively, streamlining account management, boosting sales productivity, enhancing sales pipeline management, simplifying workflow processes, mobility in accessing real-time customer data, analytics for improved decision making.

(B) Customer Care: Improved account handling, managing customer cases efficiently, simplifying contract management, knowledge management(storing staff experiences as repository), streamlining schedules, automating workflows, mobility features for data, analytics for customer service.

(C) Marketing Department: Streamlining campaign planning, managing events efficiently, improved response management, automating workflows, analytics for marketing, instantly segmenting prospects, managing data effectively, user – friendly.

1.9 Summary

Sales manager/director is the key person to plan, co-ordinate, and control and motivates all the selling-activities of a business-concern. His job is multi-purpose and he has to face, all the odds and difficult situations. A sale is the pinnacle activity involved in selling products or services in return for money or other compensation. It is an act of completion of a commercial activity. The quality of selling is referred to as salesmanship. Sales management is defined as the planning, direction and control of personal selling, including recruiting, selecting, equipping, assigning, routing, supervising, paying and motivating as these tasks apply to the personal sales force. The art of meeting the sales targets effectively through meticulous planning and budgeting refers to sales management and is one of the most important elements of success of modern organizations. It is a socio-scientific process, involving group-effort in the pursuit of common goals or objectives, which are predetermined. It helps the organization in demand forecasting, territorial redesigning and collecting competitor's information. Sales Operation refers to various activities, which help in the timely achievement of sales targets for the successful functioning of an organization. Customers go through a sequence of activities before the product finally reaches them. Such activities are a part of the sales cycle. The sales process yields increased sales if it is broken down into steps or stages. Sales promotions involve a wide variety of sales strategies, including contests, product giveaways, catalogs, coupons, discounts and more. Marketing events, such as trade shows, also fall under the category of sales promotions. Sales promotions often target either consumers or wholesalers and retailers. These are short-term strategies that 'pull' shoppers with incentives to 'buy now'.

1.10 Self Assessment Questions

1) Write a detailed essay on the field of sales management.
2) Throw light on the nature, scope and importance of sales management.
3) Explain various functional elements of sales management.
4) Explain the importance of CRM in creating a customer centric organization.
5) Provide a detailed account of sales plan and promotion.

1.11 Reference Books

- Anderson, R.E., J.F. Hair, and A.J. Bush, 'Professional Sales Management' McGraw Hill Publications, 3rd edition, 1999, New Delhi.
- Lancaster G. and D. Jobber, 'Selling & Sales Management' Pearson Education, 8th edition, 2009, New Delhi.
- Churchill, G.A., N.M. Ford, and O.C. Walker, 'Sales Force Management', McGraw Hill Publications, 2009, New Delhi.
- Cundiff, E.W., R.R. Still, and N.A.P. Govoni, 'Sales Management – Decision, Strategies and Cases', Pearson Education, 5th edition, 2009, New Delhi.
- Manning, G.L., and B.L. Reece, 'Selling Today – Building Quality Partnerships', Pearson Education, Inc., 8th edition, 2002, New Delhi.
- Spiro, R.L., W.L. Stanton, and G.A. Rich, 'Management of a Sales Force', Tata McGraw Hill Publishing Co. Ltd., 11th edition, 2003, New Delhi.
- Tyagi C.L., and A. Kumar, 'Sales Management', Atlantic Publishers and Distributors, 2004, New Delhi.
- Saxena, R., 'Marketing Management' Tata McGraw-Hill Publications, 3rd edition, 2006, New Delhi.

Unit – 2 : Sales Organization

Structure of Unit

2.0 Objectives

After completing this unit, you would be able to**:**

- Explain the need for sales organization;
- Describe the process of designing a sales organization;
- Differentiate between the basic types of sales organization;
- Define the various concepts of sales organization i.e. specialization, centralization, span of control etc.;
- Understand the specialization within the sales organization, and alternative organizational approaches for major accounts;
- Explain how to determine the appropriate sales organization structure for a given selling situation;
- Know the newer forms of organizations.

2.1 Introduction

Organizing is the process by which managers establish the structure of working relationships among employees to allow them to achieve stated organizational goals or objectives efficiently and effectively. It is the job of management, to integrate and co-ordinate all its constituents. An organization is simply an arrangement of activities involving a group of people. The goal is to arrange these activities so that the people involved can act better together than they can individually. So, we can say that a sales organization is a structural body or an organization of individuals either working together for the marketing of products and services manufactured by an enterprise or for product that are procured by the firm for the purpose of reselling. The basic types of organizational structures and designs are used to define work relationships between sales personnel and their superiors. The ideal sales organization has a built in adaptability allowing it to respond appropriately in fluid and diverse marketing environments.

2.1.1 Elements of an Effective Sales Organization

These can be briefly enumerated as below:

1. Defined lines of authority, responsibility and accountability.
2. Effective lines of communication.
3. Information flow and key interfaces
4. Control activities of sales:
    a. Sales management functions
    b. Sales force management functions.
    c. Bridging the gap between market demand and productive capacity of the firm.
5. Strategy execution
6. Leadership roles and motivation
7. Performance measures and rewards
8. Decision making and governance
9. Critical skills and capabilities
10. Permit the development of specialist
11. Achieve cooperation, coordination and balance
12. Economize on executive time

2.1.2 Need for Sales Organization

Execution of the sales plan largely depends upon the nature of the sales organization. Sales organizations vary widely over firms because every enterprise has its own objectives, resources, and corporate plans to achieve those objectives. The structure of the sales organization reflects this diversity. Sales organization is essential for many reasons. Some of them include the following:

1. **Defines line of authority -** It is important to define and identify the flow of authority, indicate where responsibility lies and specify who is to be held accountable to whom.
2. **Determining span of control -** At a time, there may be a large number of employees working in the sales department. It is very important to enforce proper supervision of the sales force. Hence, there is a need for determining which employee is under the control of which manager.
3. **Defines the decision making process -** Sales organization also helps in identifying who can take the decisions related to the sales and the customer accounts. There are two main ways of assigning the power to make decisions regarding the sales and the customer accounts. They are centralized decision making and de-centralized decision making.
4. **Assigning specialties -** A set of activities are put under a role which the sales representative is expected to specialize in. This is needed to establish a sales routine in the business unit. For an entry level, middle level and the top level position, the set of activities and specialties are defined by the sales organization.
5. **Making a career path -** The personnel in the sales department look at the organizational structures as one of the indications of the direction in which their future careers may grow. Sales field has been a remarkable career maker for innumerable people in the past and has even more potential to do so in the time to come.

6. **Motivating the employees -** Since the career path is well known to all the employees, they try to work hard and with dedication to reach higher levels according to the organization structure. This helps in integrating the individual in the organization.
7. **Coordination and balance -** By clearly delineating formal relation between different positions in the sales department; the sales organization reduces confusion about the individual's role and responsibility in the organization.
8. **Economizes on executive time -** As operations and activities in the sales department increase in number and complexity, delegation of authority becomes imperative. A sound organization design allows effective use of specialization so that executives may spend less time in operations and more on planning.

2.2 Principles of Sales Organization

The main principles of a sales organization can be summarized as below:

a) Degree of Specialization - The degree to which individuals perform some of the required tasks to the exclusion of others is known as degree of specialization. Individuals can become experts on certain tasks, leading to better performance for the entire organization.

With regard to specialization, the continuum of responsibilities for members of the sales force runs from a generalist at one end to a specialist at the other end. An absolute generalist would be allowed and expected to engage in all types of sales activities for all of the company's products and to sell to all of the company's customers. On the other hand, an absolute specialist would have a much narrower focus and would be restricted to engaging in a limited set of selling activities for only a portion of the company's products and would be constrained to selling only to a certain group of customers.

b) Degree of Centralization and Decentralization - One of the key decisions in sales management is related to the degree of centralization or decentralization of the various sales functions. The degree to which important decisions and tasks performed at higher levels in the management hierarchy is called centralization or in other words, centralization is said to be a process where the concentration of decision making is in a few hands or the degree of centralization and decentralization will depend upon the amount of authority delegated to the lowest level. Centralization is the systematic and consistent reservation of authority at central points in the organization. Under centralization, the important and key decisions are taken by the top management and the other levels are into implementations as per the directions of top level. Authority and responsibility are placed at higher management levels.

The top management may or may not consult the respective sales team and the managers before taking the decision. All the important decision and actions at the lower level, all subjects and actions at the lower level are subject to the approval of top management. This type of centralized decision making organization works well when the size of the company is small. A recent development, which has affected the centralization/decentralization choice, is the increased use of computers to process and handle sales data. As computers can process vast amounts of sales information at lower costs and speedily, this has encouraged centralized decision-making.

Decentralization refers to the systematic effort to delegate to the lowest level of authority except that which can be controlled and exercised at central points. Decentralized means field sales managers are empowered, enabled and held responsibility for performing these activities. Decentralization is a systematic delegation of authority at all levels of management and in all of the organization. In a decentralization concern, authority in retained by the top management for taking major decisions and framing policies concerning the whole concern. Rest of the authority may be delegated to the middle level and lower level of management.

Decentralization is not the same as delegation. In fact, decentralization is all extension of delegation. Decentralization pattern is wider is scope and the authorities are diffused to the lowest most level of management. Delegation of authority is a complete process and takes place from one person to another, while, decentralization is complete only when fullest possible delegation has taken place.

The degree of centralization or decentralization in sales organization may depend on:

- Size of operation costs,
- Managerial philosophy towards control and delegation
- Trend towards computerization
- Effectiveness, and
- Competitive necessity

A number of other factors must be considered in determining the appropriate degree of specialization and centralization in the organizational structure for sales activities. Three considerations are useful:

- Level of uncertainty in the business environment in which the selling activities will occur,
- Degree to which the tasks performed by salespersons are routine or repetitive, and
- Whether the performance objective for salespersons is adaptability or effectiveness.

In general, when salespersons are working under high environmental uncertainty the appropriate organizational structure should be more flexible since tasks tend to be non-routine and salespersons need the latitude to adapt to the circumstances in front of them and make decisions based on their specialized expertise and experience. On the other hand, when the business environment is relatively stable the activities of salespersons become somewhat repetitive and the focus of the organizational structure will be on ensuring that salespersons discharge their duties efficiently, which means that a centralized structure - with authority at the top of the hierarchy and minimal discretion at the lower levels – will be the preferred organizational approach.

Two additional factors especially relevant in determining the appropriate levels of specialization for salespersons are:

- Complexity of the products, and
- Variability of customer requirements.

Assuming that a salesperson is working with a relatively simple product and that the requirements of each customer are similar it is appropriate for salespersons to be organized geographically (i.e., geography-driven specialization); however, the sale of simple products to the customer universe that may have different needs calls for organization against market lines (i.e., market-driven specialization). On the other hand the sale of complex products to customers with similar requirements should be done using product specialists (i.e., product-driven specialization) while the sale of those type of products to customers with different needs will require the highest level of specialization with salespersons being segmented along both product and market dimensions.

c) Span of Control - It is the number of subordinates who are supervised by each individual manager. Typically this involves assigning 1-10 people to each manager. The optimal span of control at a particular level in the organizational hierarchy will depend on a variety of factors and two managers with similar or identical titles may have different responsibilities with respect to the number and type of salespeople reporting to them. For example, if a sales organization has divided its customer base into commercial and government accounts it may have district sales managers that oversee the activities of salespersons selling to commercial and government accounts in defined geographic areas. The span of control for district sales manager for commercial accounts may be narrower than for the district sales manager for government accounts because commercial accounts require more frequent decisions regarding terms of transactions and the manager will need to schedule more visits to customers to assist salespersons in the sales activities. In contrast, the government accounts may have a longer sales cycles and the manager in that area can easily monitor a large number of salespersons. As a result, the average number of salespersons reporting to district sales manager for commercial accounts may be only five or six while district sales manager for government accounts will usually have eight to twelve salespersons reporting to them.

d) Unity of objectives - This principle states that within an organization there needs to be a unity of objectives. An organization may have several sales sub-organizations depending upon the product and the selling method. Every sale sub-organization has a set of objectives that it wants to achieve for the organization. Hence there would be several sales objectives within an organization. The principle states that all the objectives of the sales sub-organization must be linked to the main objective of the organization. If the main objective of the organization is to grow at least by 12% every year, then all the objectives of different sales sub-organization has to work to attain the main objective.

e) Coordination - In an organization, the sales organization structure should provide a framework where it can easily integrate itself to various other departments within the organization. This ensures the timely delivery of products/ services to the customer.

f) Parity of authority and responsibility - This principle states that if an employee is given a set of tasks to perform, he/she must be given the required level of authority to perform those tasks. For example, if a pre-sales executive is asked to prepare the company competitive advantages presentation for the client to present in the sales meetings, and then he/she should be given the access to the knowledge management system of the company. Every company has the Knowledge Management systems which are the repository of all the previous projects executed successfully by the company. Hence the authority has to be given that is required for the task to be completed.

g) Flexibility - This principle states that there can be many external and internal factors which might affect the organizational operations. Hence the sales organization structure should be flexible enough to accommodate any required changes in future.

2.3 Developing a Sales Organization

In order to convert formulated sales plans into operations there has to be a sales organization. Primary to the development of a sales organization is the identification of the expectations that the top management has in respect of the sales function and the place of the sales department in the total organizational structure. The steps of developing a sales organization are as under:

1. Defining the sales organizational objective in the light of the main corporate objectives.
2. Set both quantitative(short-run) objectives as well as qualitative(long-run) objectives
3. Qualitative objectives are indispensable for long-range planning, thus, kept in mind in short range planning also.
4. Quantitative objectives are required as operating guides posts.
5. Delineating the necessary activities.
6. Determining the necessary activities & their volume of performance is based on qualitative & quantitative objectives.
7. Also helps in determining which activities to be performed in what volume. The analysis of the type and volume of activities needed to be performed will lead to an assessment of how many executive and operating positions would be required, and their inter-relations. Though the general sales activities to be performed may be similar in most companies, the relative volume and the emphasis that a firm may put on a particular group of activities will differ.
8. Grouping activities into ‘jobs’ or ‘positions’:
    - Activities identified are allocated to different positions.
    - Activities are grouped so that closely related tasks are assigned to same positions.
    - Each position must also contain some variations.

   Each position should have adequate challenging and motivating tasks to perform. The number of the different types of activities assigned to a single position would depend upon the degree of specialization associated with each position. The place of an activity in the hierarchy would depend upon the relative importance of that activity for the sales department. The higher the money involved and risk associated, the more the decision power lies with higher levels.
9. Assigning personnel to positions: Once the different positions and the activities associated with them have been decided upon, the positions have to be assigned to personnel. The organization may get the required personnel by:
    - Building positions around individuals, to take advantage of the special capabilities of a particular individual, or

    - Recruiting individuals specifically to fill in the identified positions.

    Organizations generally prefer to let individuals adapt to, or acquire skills for particular position rather than build positions around individuals.

10. Providing for coordination and control:
    - Sales executives require means to control their subordinates
    - To coordinate their efforts they should not be overburdened nor should have too many subordinates.
    - Coordination & control is obtained through both formal & informal means.
    - Formal instruments of organizational control include:
        - Written job description, job objectives, duties & responsibilities.
        - Reporting relationships in the form of Organizational Chart (clarifying hierarchy). Reduces confusion about an individual's role and delineates formal relationship
        - Performance measurement methods
        - Organizational manuals are extension of organization chart which contain detailed working procedures for both the company & the various departments.

2.4 Sales Organization Design

Organizational design is the process by which managers make specific organizing choices that result in the construction of a particular organizational structure. It refers to the formal, coordinated process of communication, authority and responsibility for sales groups and individuals. Organizational Design is the process of consciously defining and aligning structures, processes, management systems and cultures with a well-articulated strategy. It can significantly impact competitive advantage and is a powerful way to position organizations for sustainability. In other words, effective organization design helps build strategic capability.

According to contingency theory, managers design organizational structures to fit the factors or circumstances that are affecting the company and causing them the greatest uncertainty. Thus, there is no one best way to design an organization. Sales force organization structures tend to be left alone during stable economic times, when the companies are doing well. They are more apt to come under scrutiny when times are not good or the company is facing some significant change.

2.4.1 Strategy Driven Organization Design Some key benefits of strategy-driven organization design are as below:

- It provided greater ability to carefully allocate resources (people and money) to specific areas to drive strategy.
- It ensured that the right information was reaching right people at the right time.
- It provided greater transparency in the financial performance of its key products and technologies that in turn enabled it to track the effectiveness of its strategy.

- It enables the development of a high performance culture.

There are several situations in which creating a new design or restructuring is self evident. These include:

- Startup of a new business, subsidiary, or venture.
- Significant growth, or conversely contraction in the business.
- Shift from a domestic to global company.
- Merger or acquisition.
- Spin-off or divestiture of products and businesses.

However, organization redesign is often needed during the normal course of implementing business strategy. Existing organization designs can lose relevance as market conditions change, leadership changes, and processes change to increase efficiency. These changes can occur slowly, and accumulate to the point where a redesign is needed. The main problem lies in timely recognition of the need by the leaders. Some typical signs that necessitate an organizational redesign include:

- Slowdown/difficulty in meeting business plan targets.
- Disconnects in key processes as they flow across different departments. High levels of conflict within and between organizational units.
- Difficulty obtaining and sharing resources across the organization.
- Lengthy, cumbersome decision-making processes.
- Role confusion.
- Metrics are hard to define or overly complex.
- Productivity declines.
- Starting to lose chief or major clients.
- Continue to suffer revenue declines associated with recession.
- Struggling to return to previous levels of profitability.
- Face disruptive changes.

2.4.2 Key Design Principles

Sales activities are an essential concern of senior management and great care must be taken in designing the appropriate organizational structure to support the activities of the sales group. The key design principles when designing the sales organization structure include the following:

- The structure should be built around the most strategically appropriate marketing dimension such as geography, products, market, types of sales activities or specific large customer accounts.
- The skill set and allocation of human resources within the organizational structure should be driven by the necessary activities and the level of sales effort need to achieve success with the target accounts.
- The structure should reflect the proper balance between the need for centralized authority and providing managers and salespersons at lower levels with sufficient latitude to make decisions needed to close sales transactions within acceptable parameters.
- Spans of control within the organizational structure should be reasonable and allow for adequate managerial support.
- The structure should include processes for coordinating activities among different sales groups working on common projects or types of accounts.
- The structure should be stable and transparent yet provide for flexibility that allows the sales organization to quickly adapt to changes in the market place.

2.4.3 Factors Affecting Organizational Design

The following five factors are the most common. They are as follows:

1. **Organizational size -** The larger an organization becomes, the more complicated it becomes. If the organization is very small, it may not even have a formal structure. Small organizations are usually organic systems. Large organizations develop formal structures as tasks are highly specialized and detailed rules and guidelines dictate work procedures. That is the reason larger organizations are often mechanistic.
2. **Organization life cycle -** Organizations, tend to progress through stages known as a life cycle having four stages: birth, youth, midlife, and maturity. The older the organization and the larger the organization is, the greater the need for more structure, more specialization of tasks, and more set procedures and rules.
3. **Strategy -** How an organization is going to position itself in the market in terms of its product is considered its strategy. A company may decide to adopt a differentiation strategy, or it may decide to follow cost-leadership strategy. Each of these strategies requires a structure that helps the organization reach its objectives
4. **Environment** – It can be either stable or dynamic. In former, the customers' desires are well understood and probably will remain consistent for a relatively long time. In a dynamic environment**,** the customers' desires are continuously changing. Organizations operating in stable external environments find mechanistic structures to be advantageous while those operating in volatile and frequently changing environments are more likely to find an organic structure.
5. **Technology** – Advances in technology are the most frequent cause of change in organizations since they generally result in greater efficiency and lower costs for the firm.

2.5 Sales Organization Structure

Nowadays all companies are trying to find ways to make the entire organization customer oriented. This approach allows more flexibility and responsiveness in today's competitive global environment. Every company wrestles with the problem of organization. Reorganization is often a necessity in order to reflect new strategies, changing market conditions, or innovative production technologies. Organizing is important because it develops from strategy. Strategy defines what to do; organizing defines how to do it. Organizational structure is a tool managers use to harness resources for getting things done. The right organizational structure does not guarantee results but the wrong structure can definitely worsen the results. The structure of sales organization differs from company to company. The structure of the sales-organization usually depends upon the following factors:

- Nature and size of the firm
- Departmental functions and strengths
- Organization related factor
- Marketing mix(product, price, place, promotion, packaging) related factor
- External factor

- Selling-policies of the firm
- Financial conditions of the firm
- Personalities & abilities of various sales personnel
- The customers
- The practices of competitors

Organizational structure is the relatively fixed, formally defined relationship among jobs within the firm. A strategy's success is often determined by the strategy's fit with organizational structure. Structure is reflected in an organizational chart. Thomas (2009) defined two types of sales organization structures depending upon the span of control and the number of management levels. They are as below:

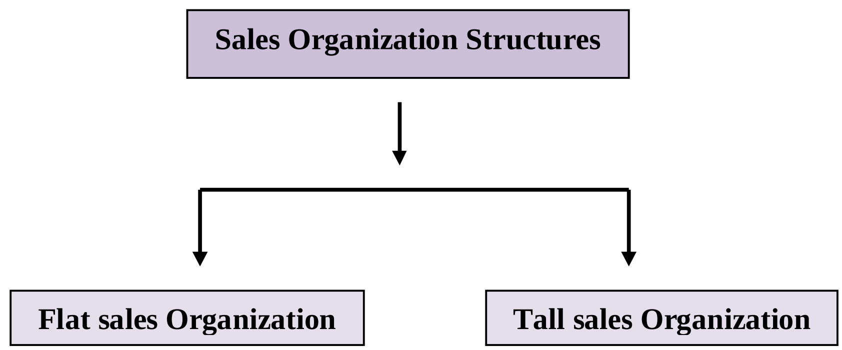


Figure 2.1: Organizational Structures, Thomas (2009)

Let us understand them in detail:

a) Flat sales organization - In a flat sales organization structure the number of management levels tend to be less while compared to the tall sales organization structure. The organization structure is explained by the following diagram:-

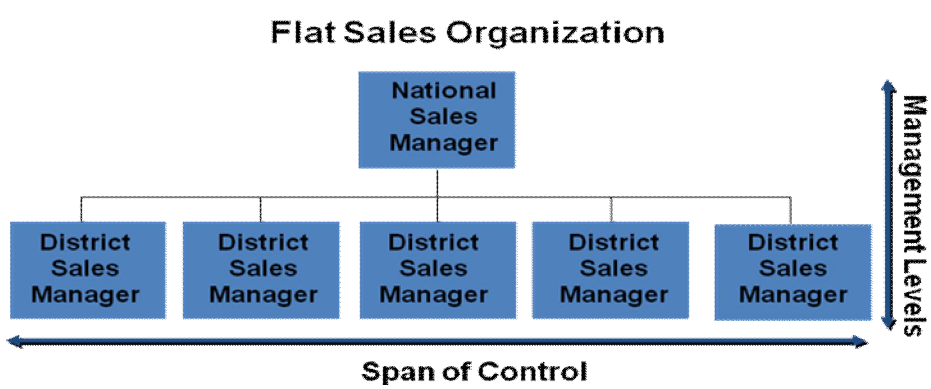


Figure 2.2: Flat Sales Organization

In such a structure the span of control is large for each sales manager thereby creating a de-centralized system. Since the management levels are less, the reporting structure is also less complicated. Lot of companies try to have a flat sales organization structure where they can decentralize the system and give more authority to the employees at the lowest level to take most of the decisions without the influence of the higher authorities at the head office. There are several advantages and disadvantages of this sales organizational structure. Some of the advantages include:

- **Increased speed of operations:** Since most of the decisions can be taken at the branch level and doesn't require the higher authority permission, the day to day activities can be done efficiently.
- **Better communication channels:** Since the number of levels between the top management and the middle management are less, this leads to a better and faster way of communicating the information in the organization
- **Decreased costs:** Since the number of levels is reduced, the number of employees to manage the organization also decreases. This leads to the lower wages to be paid and fewer resources like office space, computers etc. would be required.

Some of the disadvantages include:

- **Lesser control over employees:** Due to decentralization, lesser control would be there on the decision making process which may affect the entire organization.
- **Lesser promotion levels:** Due to the decreased number of levels, the employees at the bottom level have to work hard to earn a promotion. Several employees work hard and stay in their current positions as there are no vacancies in the higher posts. This might become a de-motivating factor for the employees at work place.

b) Tall sales organization - In a tall sales organization structure, the number of management levels tends to be more while compared to the flat sales organization structure. The organization structure is explained by the following diagram:-

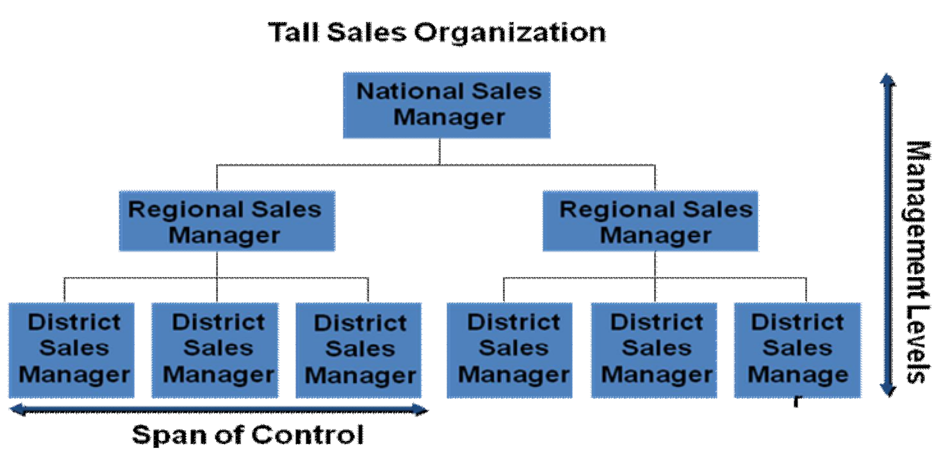


Figure 2.3: Tall Sales Organization

A tall sales organization has more levels, a centralized control of decision making and takes a longer time carrying out daily operations due to more hierarchy. Some of the advantages of the tall sales organization are:

- **More promotion levels:** Due to more management levels the employees can have a clear idea of which level they will be promoted next. This leads to greater satisfaction levels and motivates the employees to work effectively and efficiently.
- **Increased responsibility and control:** Due to lower span of control each employee knows clearly the manager and the manager knows clearly which employees or sales representatives they have to take care of and control. The tasks are defined clearly to the employees who will be responsible for the outcomes.

Some of the disadvantages include:

- **Increased costs:** Due to the more management levels, more employees need to be hired and hence more costs would be incurred to the organization.
- **Decreased speed of operations:** Since the decisions have to approved by the higher authority due to centralized decision making process, the operation might take place slowly when compared to the flat organizational structures
- **More supervision for employees:** From the employee point of view more supervision may become a de-motivating factor.

Defining Roles - Generalists or Specialists: The first step is to determine the organization's current placement on the organizational life cycle. Generalists are typically deployed in organizations that are either in their infancy, or trying to cut costs in the decline phase of their life cycle. Specialists are initially deployed to increase revenue during the growth phase and are typically more effective. Sales forces specialize in three different ways:

- By product,
- Selling activity, and
- Industry vertical.

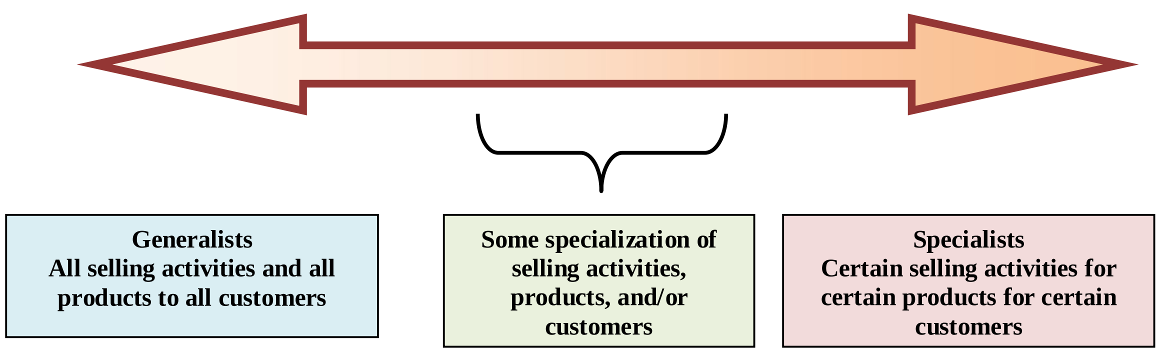


Figure 2.4: Sales Force Specialization Continuum

Product specialization is most effective when vast knowledge is required to sell the product or service in the market; for example in High-tech and medical fields. Specialization by selling activity is found in many industries. It takes place in two ways – first is focusing on new client acquisition and second is cultivation of current customer relationships to drive revenue growth. Specialization by industry vertical is recommended when a sales professional with deep industry knowledge represents a competitive advantage over a generalist representative with similar offerings. Generalists sell every offering to all the customers and prospects in a given geographic area.

Table 2.1: Specialization V/s Generalization

Specialization	
Advantages: • Typically more effective • Knowledge of a product, activity, or vertical • Strategic Focus • Clarity of role • Strong customer Focus	Disadvantages: • More costly • Increase travel time • Customer confusion
Generalization	
Advantages: • Geographic knowledge • Limited travel costs • No duplication of effort • Sales rep owns market	**Disadvantages:** • Less effective • Risk of misplaced focus

The grouping of activities into positions and the charting of relationships of positions causes the organization to take on structural form. No two firms would have identical sales organization as their needs and expectations, markets, products, company size and marketing mix elements differ from each other. There are many forms of sales organization structure and to find the right one can be both difficult and challenging. The main characteristics, advantages, and disadvantages of each type of sales organization shall be discussed in subsequent sections.

2.6 Line Sales Organization Structure

The main characteristics of a pure line sales organizational structure are as following:

- The line sales organization is the oldest, simplest and most basic of all the sales organizational structures.

- It is widely used in firms that are smaller in size or with small numbers of selling personnel or cover a limited geographic area, or sell a narrow product line.
- The chain of command and lines of authority run vertically down through the structure.
- All executives have line authority over their subordinates who in turn are accountable only to their immediate superior.
- This is the reason for calling this organization as scalar organization which means scalar chain of command is a part and parcel of this type of administrative organization.
- Responsibility is definitely fixed, and those charged with it also make decisions and take action.
- Theoretically, there is no cross communication between persons on the same level.
- Contacts between persons on the same level are indirect and are affected through the next higher level.
- Since lines of authority run vertically in this structure, executives at each level are generally independent of all others at the same level.
- The line sales organization sees its greatest use in companies where all sales personnel report directly to the chief sales executive.
- In these companies this executive often is preoccupied with active supervision and seldom has much time to devote to planning or to work with other top executives.
- Specialized and supportive services do not take place in these organizations.
- Unified control by the line officers can be maintained since they can independently take decisions in their areas and spheres.
- In this type of organization, the line of command flows on an even basis, bringing efficiency in communication and resulting in co-ordination and stability to a concern.

The figure below shows the hierarchical structure of a typical line sales organization structure:

Figure 2.5: Line Sales Organization

The merits and demerits can be outlined as below:

Table 2.2: Merits and demerits of line sales organization

Merits	Demerits
• Lines of authority and responsibility are fixed, logical and clearly delineated • Difficult for individuals to shift or evade responsibilities	• It place great demands on the time and abilities of the top sales executive. • With all the field reporting finally coming to

• Definite placement of authority and responsibility saves time in making policy changes, in deciding new plans, and in converting plans into action. Decisions are made rapidly and communicated quickly • Executives who come up through a line organization are frequently strong leaders. • As the typical line sales department has few organizational levels, administrative expenses are low. • The control is unified and concentrates on one person and therefore, decisions can be taken independently, thus, discipline and control are better • Simplicity makes it easy for executives to develop close relations with salespersons. • There is unity of command as superior-subordinate relationship is maintained and scalar chain of command flows from top to bottom. • There is a co-ordination between the top most authority and bottom line authority. • Since the authority relationships are clear, line officials are independent and can flexibly take the decision. This flexibility gives satisfaction to line executives. • Salespeople tend to feel they make a major individual contribution to the firm.	him/her through his/her subordinates/area sales manager, most of the time would be taken up by the task of sales supervision and direction leaving him/ her with little time for planning and policy making. • The chief executive is sometimes forced to take decisions on issues without adequate planning which yields unsatisfactory results. • As the line organization has no support from subordinates who have specialized knowledge / skills, the top sales executive needs to be a person with outstanding ability and all round knowledge of every facet of the sales function. • Since, everyone is jack-of-all-trades; lack of specialization can hinder the firm's growth. • In this type of organization the key people are difficult to replace • Line organization becomes inappropriate in case of rapidly growing organizations or those with large sales staffs, as growing departments necessitate additional layers of executives to be added. • Sound organizational practice dictates that trained under studies be ready to step into the shoes of their superiors. But more often than not, chief sale executive in line sales organizations fail to groom their own replacements. • Offers little opportunity to subordinates to acquire management skills

2.7 Line and Staff Sales Organization Structure

The main characteristics of a line and staff sales organizational structure are as following:

- Line and staff sales organization structure usually results as the size of the operations grow.
- Line and staff organization is a modification of line organization and it is more complex than line organization. It is more complex than line concern.
- There are two lines of authority which flow at one time in a concern:
- Line Authority b) Staff Authority
- It is characteristically found in medium and large firms with sizeable staff selling diversified product lines.
- According to this administrative organization, specialized and supportive activities are attached to the line of command by appointing staff supervisors and staff specialists who are attached to the line authority.
- These specialists are experts in their own fields which could be sales training, service, sales analysis and planning, dealer relations, sales promotion, and sales personnel development and so on.
- While staff executives and assistants do not have the line authority to command, they advise the line executives through recommendations and provide the benefit of specialization in the organization.
- The inclusion of the staff component frees the line executives from the burden of detail.
- By delegating problems involving in depth study or detailed analysis to staff specialists, the top executive gets more time for strategizing, policy making and planning.
- A pool of experts becomes available for providing advice and assistance in specialized fields. The activity of planning can also be subdivided and assigned to staff specialists.
- More information is also made available for better decision making.

The figure below shows the hierarchical structure of a line and staff sales organization structure.

Figure 2.6: Line and Staff Sales Organization Structure

The merits and demerits can be outlined as below:

Table 2.3: Merits and demerits of Line and Staff sales organization Structure

Merits	Demerits
• The line executives can concentrate on the execution of plans and they get relieved of dividing their attention to many areas. • The line and staff organization facilitates expert advice to the line executive at the time of need. • There is benefit of specialization in the form of staff specialists in diverse areas of organizational concern. • Line and staff organization through specialization is able to provide better decision making and concentration remains in few hands. This feature helps in bringing better co- ordination in work as every official is concentrating in their own area. • Due to the advice of specialized staff, the line executives get a wide scope to bring innovations and go for research work in those areas. Thus, the benefits of research and development are reaped. • The presence of staff specialists and their expert advice serves as ground for training to line officials. • The relationship between line and staff automatically makes the line official to take better and balanced decision. • Due to better and detailed analysis of a problem, there is scope of better marketing decisions resulting into superior sales performance	• The staff executives tend to overstep their advisory authority and try to, and sometimes succeed in assuming the authority to issue orders and directions. This presents the difficulties of dual subordination and may create confusion. It has been observed that to a large extent these problems can be minimized if all areas in which line and staff executives have to share authority and responsibility are specifically written down as components of the job description. • The line official gets used to the expertise advice of the staff. At times the staff specialist also provides wrong decisions which the line executive has to consider. This can affect the efficient running of the enterprise. • The problem that arises with line and staff organization is basically one of coordination. The work of the staff needs to be actively coordinated with the operations of the line department and generally a lag develops as reports and recommendations take time to compile. • Line and staff organization also sometimes generate problems of interpersonal relations. • The fact that staff executives do not share direct responsibility for results is also resented by some line executives. • The organizations have to maintain the high remuneration of staff specialist. This proves to be costly for a concern with limited resources. • The higher returns may be considered to be a product of staff advice and counseling which results in the line officials feeing dissatisfied.

2.8 Functional Sales Organization Structure

The main characteristics of functional sales organizational structure are as following:

- The concept of Functional organization was suggested by F.W. Taylor who recommended the appointment of specialists at important positions.
- It is a complex form of organization compared to the first two detailed above.
- The entire organizational activities are divided into specific functions such as operations, finance, marketing, personal relations etc. Each functional area is put under the charge of functional specialists and he has got the authority to give all decisions regarding the function whenever the function is performed throughout the enterprise.
- A functional sales organization divides managers and salespeople into groups based on specific and distinguishable categories of sales activities.
- Functional sales organization is aimed at using the principle of specialization to the fullest extent**.**
- The functional organizational structure gives all executives, each a specialist in his or her own field, a direct authority to command and issue orders; at a time, there are three authorities existing - line, staff and function.
- It simply means that at any given time, a salesperson could be under instructions from a number of executives and are accountable to different executives, on different aspects of their work.
- Principle of unity of command does not apply to such organization.
- The top sales executive has the coordinating responsibilities in respect of the action of functional heads.
- Functional organization is suitable for large firms with stable operations and with opportunity for considerable division of labor
- A functional organizational structure is best suited to the situation where the company is active in only one small territory and has a narrowly defined group of relatively similar accounts.

General Manager Sales

Manager **Manager** **Manager** **Manager** **Manager**
Manager

Planning & Sales Territory Sales Distribution
After

Coordination Training Development Promotion Channels
Sales Service

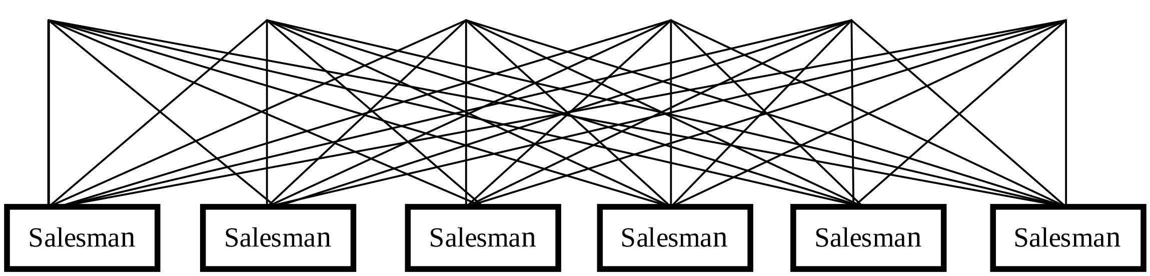


Figure 2.7: Functional Sales Organizational Structure

The merits and demerits can be outlined as below:

Table 2.4: Merits and demerits of Functional Sales Organization Structure

Merits	**Demerits**
• The outstanding advantage claimed for the functional sales department is improved performance as this allows companies to be more efficient with respect to performance of specific activities relating to the sales process. • Better division of labor takes place • Specialized activities are assigned to experts, whose guidance should help in increasing the effectiveness of the sales force. • Management control is simplified as the mental functions are separated from manual functions. • Checks and balances keep the authority within certain limits. • Specialists may be asked to judge the performance of various sections. • Greater efficiency is achieved because of every function performing a limited number of functions. • Specialization compiled with standardization facilitates maximum production and economical costs in case of large firms. • Expert knowledge of functional manager facilitates better control and supervision.	• In larger firms where the size of the sales force is substantial, the degree of centralization necessitated by the functional organizational structure renders the operation inefficient. • Smaller and medium sized firms on the other hand find the system expensive because of the high degree of specialization. • Managers in different functions may find it more difficult to communicate and coordinate with one another. • Functional managers may become so preoccupied with supervising their own specified departments that they lose sight of organizational goals. • Disciplinary control becomes weak as a worker is commanded not by one person but a large number of people. Thus, there is no unity of command. • Due to multiple authorities, it is difficult to fix responsibility. • There may be conflicts among the supervisory staff of equal ranks. They may not agree on certain issues. • Maintenance of specialist's staff of the highest order is expensive for a concern. • Another weakness of the structure is that burden of coordinating the activities of highly diverse specialists is placed on a single individual. In case that individual is not capable enough in this regard, the whole structure is likely to become cumbersome and ineffective. As the company grows however the amount of potential geographic and customer duplication increases significantly.

2.9 Geographic Sales Organization

The main characteristics of a geographic sales organizational structure are as following:

- Many large corporations are organized by geographic territory.
- With this structure, each territorial unit can be treated virtually as a separate company or profit center.
- The sales manager of a given territory often has complete responsibility for meeting that unit's sales objectives.
- The unit can be called a division, region, branch, or district.
- Salespersons assigned to a specified geographic area responsible for all types of accounts in a particular geographic territory (e.g., a town, city or country) and generally are permitted and expected to promote and sell all of the company's products to those accounts.
- Sales personnel are, and will sell only to customers in that area.
- When the sales organization is organized geographically the responsibilities of the managers and salespersons will be defined by reference to particular geographic areas. For example, the leader of a geographic sales organization may be the national sales manager and he or she may have regional sales managers for two or more parts of the country, each of whom report to the national sales manager. Each regional sales manager may divide his or her territory into two or more zones, each of which has a zone sales manager reporting to the regional sales manager. These zones may be further subdivided into districts that are overseen by district sales managers accountable to the applicable zone sales manager. At the bottom of the hierarchy would be the non-managerial salespeople who are given their goals and objectives by, and report to, one of the district sales managers.
- It is possible to create a generic sales training program that can be used with all salespeople regardless of where they are located and thus the appropriate placement for the leader of the sales training initiative is near the top of the organizational hierarchy where training activities can be easily be coordinated with the national sales manager and then mandated downward to the various regions, zones and districts.
- The marketing plans are adjusted to local needs.
- Each geographical unit is given the same support by the home office, and each has its own performance goals passed down from higher management.
- Geographically-based sales allow salespeople to know their markets and develop appropriate approaches to an area.
- It also can prevent salespeople from bumping into each other if their maps and territories are well defined.
- Industries that use this approach include direct cosmetic sales, telecommunications; print advertising etc.
- Geographic organization is generally more effective when the product line is not too wide or consists of relatively simple, non-technical products and the requirements of each customer are similar.
- Geographic organization is often combined with other methods of organization.

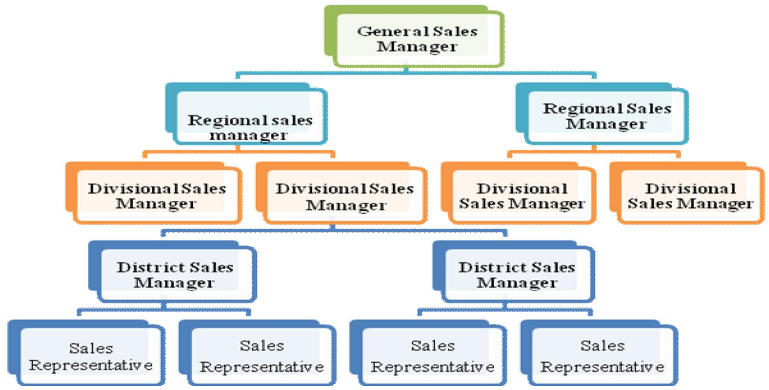


Figure 2.8: Geographic Sales Organization Structure

The merits and demerits can be outlined as below:

Table 2.5: Merits and demerits of Geographic Sales Organization Structure

Merits	Demerits
• A major advantage which characterizes the geographic organization is that the sales personnel usually have a smaller area of operation than in the other organizational schemes and over a period of time get to know their customers and markets intimately which can lead to intensive market cultivation. • The organization becomes equipped to quickly sensitize local needs and give timely response to local conditions and competition. • The geographic organization is generally a flat rather than tall organization and the shorter lines of communication make for greater effectiveness of supervision and control. • The travel time and expenses can be reduced if call patterns are properly devised. • A geographic structure is generally considered to be cost effective and avoids the duplication of resources since a single salesperson is responsible for communicating with an account rather than a different salesperson for each major product line. • The use of such a structure also avoids the need for supporting multiple salespersons in each territory. • Allow for more rapid and efficient decision processes. • There is better market coverage and customer service. • It is possible to have more control over sales force.	• On the other hand, geographic organizational structures limit access to the advantages of other specialization structures • Make it difficult to for senior management to emphasize investment of resources in particular products or types of customer accounts. • The disadvantage with geographic specialization is that the sales persons need to be responsible for the entire product line in their territory and they may not be equally knowledge about all products, hence, there are limited or few real experts in the field. • Each salesperson must understand how to sell every product in his assigned region and if product line requires specialized knowledge, training the salespeople could get expensive. • On the other hand, because multiple offices are set up, administrative expenses and the burden of coordinating the sales activities of a widespread organization become heavy. • Further within the territory, salespeople may choose to concentrate on products and customers that are easy prospects. • This structure does not provide any benefits from the division and specialization of labor.

2.10 Product Sales Organization

The main characteristics of a product sales organizational structure are as following:

- When the sale organization is organized by product the responsibilities of the managers and salespersons will be defined by reference to a particular product or a related group of products. For example, a consumer electronics products company might have product groups for laptop computers, desktop computers, monitors and mobile communication devices.
- The entire company may be organized by product with separate sales, advertising, marketing, a separate support staff created for each product and so on; though some functional units may remain centralized (for example advertising).
- These sales divisions are treated as a separate company or profit center, just like geographic divisions are.
- Large companies quite commonly use a combination of product and geographic departmentalization.
- In fact, it is difficult to find medium to large companies organized solely by product.

Product specialization is necessary or at least useful when: The products are very technical or of a complex nature. A large number of similar but separate products exist. Products are relatively simple but completely different. Product lines are distributed through entirely different trade channels. Different products are sold to similar markets. When any combination of these factors is present, a company needs to explore the possibility of product specialization of the sales force. This is especially true with products that are highly technical or which are sold to professionals. Medical device and equipment sales, for example, require a salesperson to have an in-depth understanding of his product.

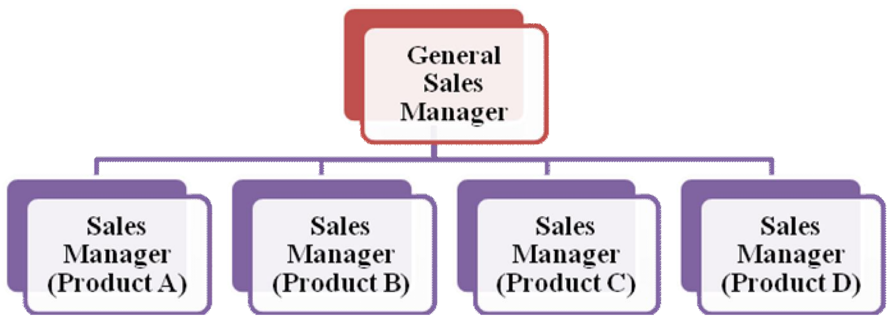


Figure 2.9: Product Sales Organization Structure

The merits and demerits can be outlined as below:

Table 2.6: Merits and demerits of Product Sales Organization Structure

Merits	Demerits
• The obvious advantage associated with a product organizational structure is the opportunity for product-based specialization where salespersons acquire and dispense expertise in particular product applications. It leads to development of product experts. • Having salespeople become experts in a specific product or product line can make them stronger sellers. • It is consistent with market driven strategy. • The advantage of product specialization is that each product receives close attention from the salesperson responsible for selling it. In case of complex products, the salesperson can master the necessary information to sell the product effectively. • The advantages of an organization based on geographic specialization also apply. • It puts divisional managers close to their customers and lets them respond quickly and appropriately. • By organizing the sales force so that each salesperson is responsible for selling only the products she knows best, the effectiveness of the whole sales force is increased. • It enables closer cooperation between sales and production. • This structure enables sales management to control the selling effort across the company's various products.	• This type of structure tends to be more costly than a geographic structure since there needs to be product specialists in each territory. • In addition, efficient servicing of particular customer accounts becomes more problematic, especially for larger customers purchasing different groups of products, since two or more product specialists will be calling on those accounts and there may be confusion within the customer's buying function as to who they should be dealing with inside the company's sales function. • A company organized by product specialization will often have different sales personnel calling on the same customers trying to sell them different products. This costs for the company time for repeated calls by the sales people and costs the customer time spent with each salesperson resulting in higher cost and customer dissatisfaction. • The disadvantage of this approach is the potential for redundancy and scarcity. As consumer demand shifts from one product to another, one might end up with too many specialized salespeople in one area and too few in another. • The drawbacks of product specialization are also similar to those of geographic specialization.

2.11 Customer Sales Organization Structure

The main characteristics of a market or customer sales organizational structure are as following:

- A market structure (also called customer structure) is an organizational structure in which each kind of customer is served by a self-contained division.
- In this case, the manager group sales force according to the type of customer buying the product.
- When the sales organization is organized by markets or customers, the responsibilities of the managers and salespersons will be defined by reference to a particular group of customers. For example, to oversee sales activities to identifiable groups of customers, such as commercial, government and retail accounts.
- It allows managers to be responsive to the needs of customers and allows them to tailor an organization's products to each customer's unique and changing needs.
- It is desirable when customers are classified by type, user industry, or channel.
- Salespeople carry out all activities for all products only for specific customer groups
- As is the case with a product sales organization, each market-based manager may divide his or her area of responsibility into geographically based areas.
- Each market based manager should be given some latitude regarding how he or she organizes the various levels of the hierarchical structure that the manager oversees. For example, when one of the markets is much larger than the others there may be more levels in the organizational structure for that market. In this way the market based manager can increase or reduce the number of reporting relationships that he or she needs to handle to a manageable number.
- It is clear that different sales strategies are required when dealing with different customers or markets.
- Companies with several separate and distinct markets accounting for major portions of their sales often organize based on these markets or customers.
- Further sub divisions within market orientation are structures such as major/ named or national account management (NAM) or global (GAM) account management
- Firms frequently shift from the product organizational structure to a structure based on customers. Markets then become the major sales emphasis. This seems to be the best specialization method for firms today.
- Sales people are more effective when they become experts in a particular type of client and can develop sales techniques which fit a particular type of target.
- Market or customer specialization enables the sales persons to become more knowledgeable about the unique problems and needs of each group of Customers.
- A Customer oriented sales force is consistent with the marketing concept with its increased emphasis on consumer satisfaction.

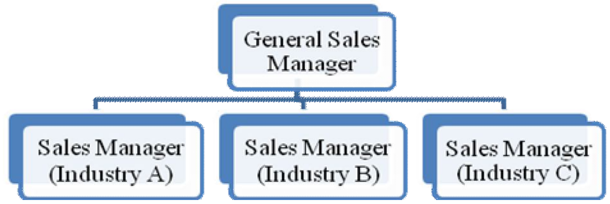


Figure 2.10: Organization structure by type of Industry

Figure 2.11: Organization structure by type of Customer

The figure below shows the hierarchical structure of a customer sales organization structure:

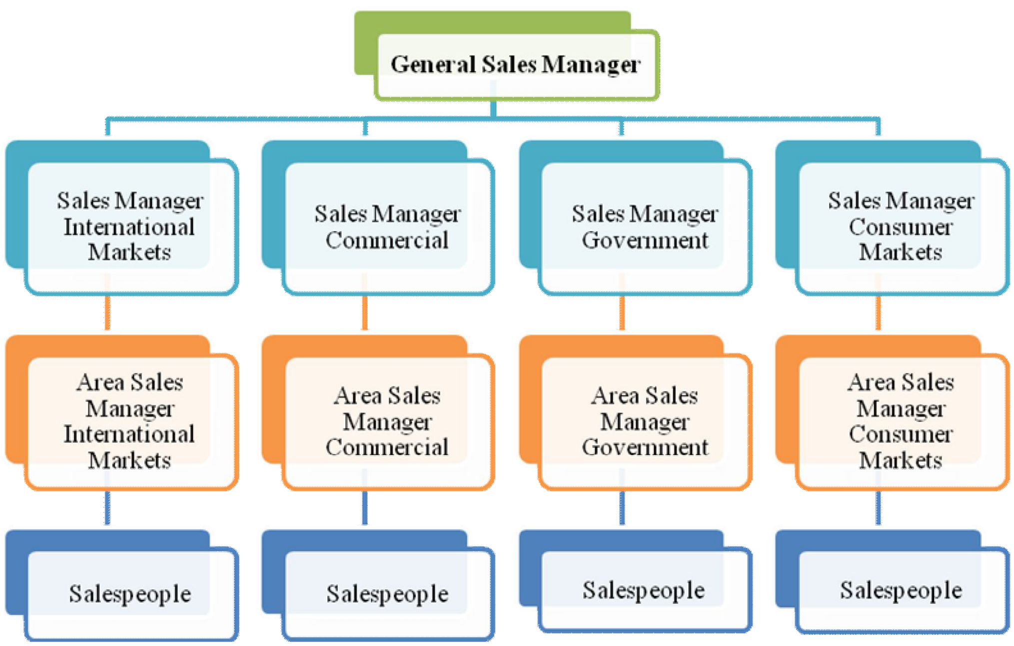


Figure 2.12: Market (Customer) Sales Organization Structure

The merits and demerits can be outlined as below:

Table 2.7: Merits and demerits of Market/Customer Sales Organization Structure

Merits	Demerits
• Give a better understanding and an ability to meet the needs of specific customer groups. • Implements customer-centered philosophy of the company. • One major advantage to this structure is having industry/solutions experts. • Another advantage to a client-based approach is that clients often feel like they have more of a relationship with their sales representative and get the sense of greater customer service since the sales effort is designed around them. • The greater market specialization developed as a result of constantly working with the same set of consumers imparts a degree of professionalism to the sales task and has been found to result in lower turnover of sales personnel. • Market organizational structures promote great understanding of the unique customer requirements and allow companies to efficiently allocate managerial resources among customer markets. • Easier to train for different selling approaches for different markets. • Leads to new and innovative product/ service ideas. • Better ability to control selling effort across different markets.	• Each section of the sales force needs broad knowledge to sell the product properly. • The main disadvantage of this form of specialization is that geographical territories may typically overlap. • There may be a number of the company's representatives covering the same geographical area, but serving different customers, often resulting in higher costs.

2.12 Committee Sales Organization

The main characteristics of a committee sales organizational structure are as following:

- It is a method of organizing the executive group for planning and policy formulation while leaving actual operations, including implementation of plans and policies, to individual executives.
- In committee sales organization the committee is never the sole basis for organizing a sales department.
- Thus, many firms have a sales training committee (comprised of the general sales manager, his or her assistants, the sale training manager, and perhaps representative divisional or regional sales managers) that meets periodically to draft training plans and formulate sales training policies.

- Implementation of these plans and polices, however is the responsibility of the sales training manger, if the company has one, or of the line and or staff executives responsible for sales training in their own jurisdictions.
- Other committees found in sales organization include customer relations, operations, personnel, merchandising, new products etc.
- Co – ordination is of utmost importance in committee sales organization.
- For committees to operate effectively, other precautions are necessary.
- The agents must be planned and controlled to avoid wasting time of executives not directly interested in the topics considered.
- The chairperson should not dominate. Chairpersons should guide discussion within specified bounds, but they should not force their opinions on others.

The merits and demerits can be outlined as below:

Table 2.8: Merits and demerits of Committee Sales Organization Structure

Merits	Demerits
• The use of committees in the sales department is advantageous since before policies are made and action is taken, important problems are deliberated by committee members and are measured against varied viewpoints. • Committee meetings, where ideas are interchanged and diverse opinions are present, promote coordination among members of the executive team. • When problems are aired in the give and take of committee meetings, cooperation is likely to be better than under any other organization plan.	• However, unless decision-making and policy formulation are left to specific individuals, it is impossible to fix responsibility. • Committees render their most important service in providing focal points for discussion and for the making of suggestions; so many companies prohibit committees from making decision or formulating policies. • There is a risk of a committee developing in to a vehicle for the evasion of responsibility.

2.13 Combination or Hybrid Sales Organization

The main characteristics of a combination or hybrid sales organizational structure are as following:

- One way to minimize disadvantages and maximize advantages of specialization organizations overcome the disadvantages associated with a particular form of sales organizational structure is to implement some version of a hybrid structure that uses two or more of the basic structural dimensions.

- Large companies commonly begin with a functional structure, develop geographic departments, split along product division lines, and end with a customer focused structure. Typically, a combination of these structural methods is used.
- The figure given below depicts the multiple design factors. It illustrates a company with production, marketing and engineering functional specialists; the firm sells both consumer and industrial goods in both India and Foreign markets. The consumer goods division sells three categories of products through three geographically organized sales force divisions.

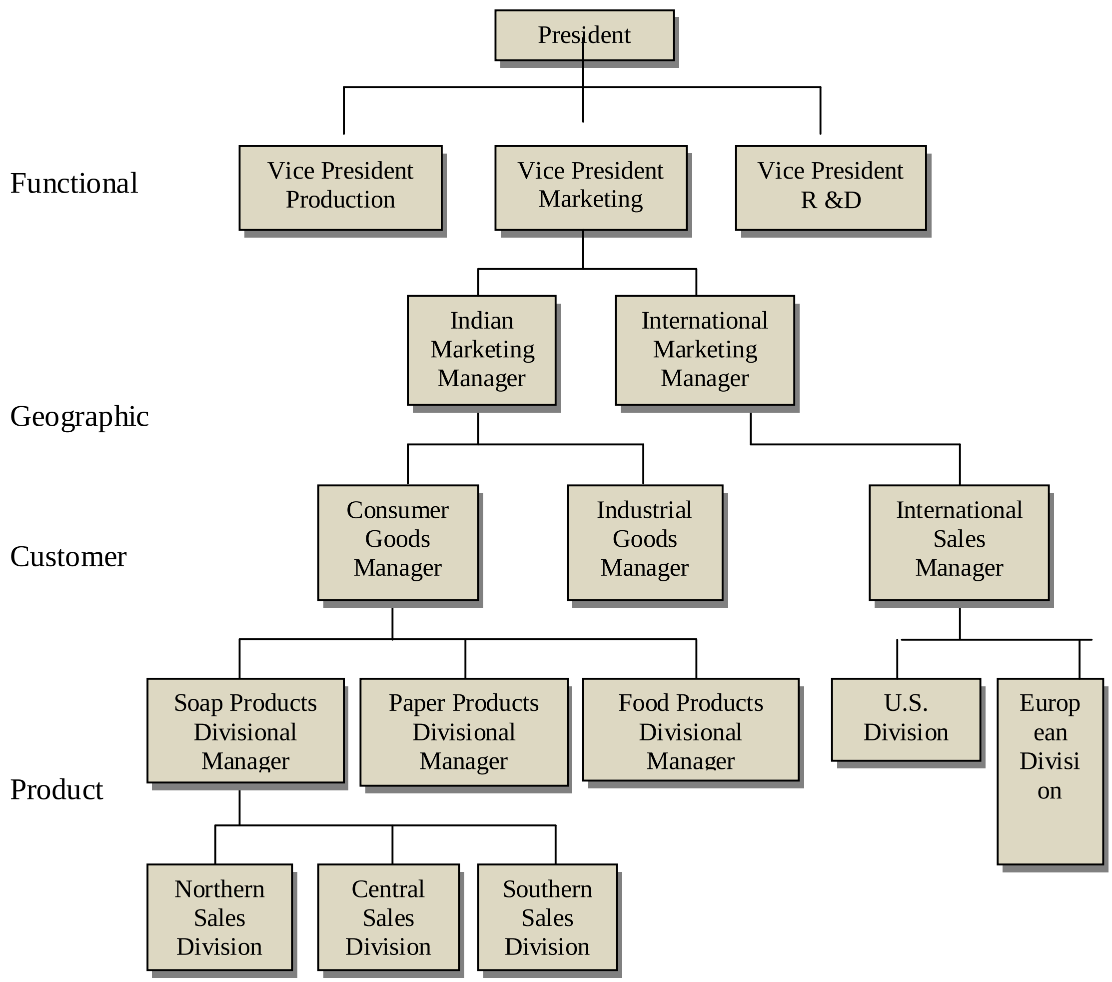


Figure 2.13: Multiple Design Factors

Figure below shows combination of geographic and market specializations:

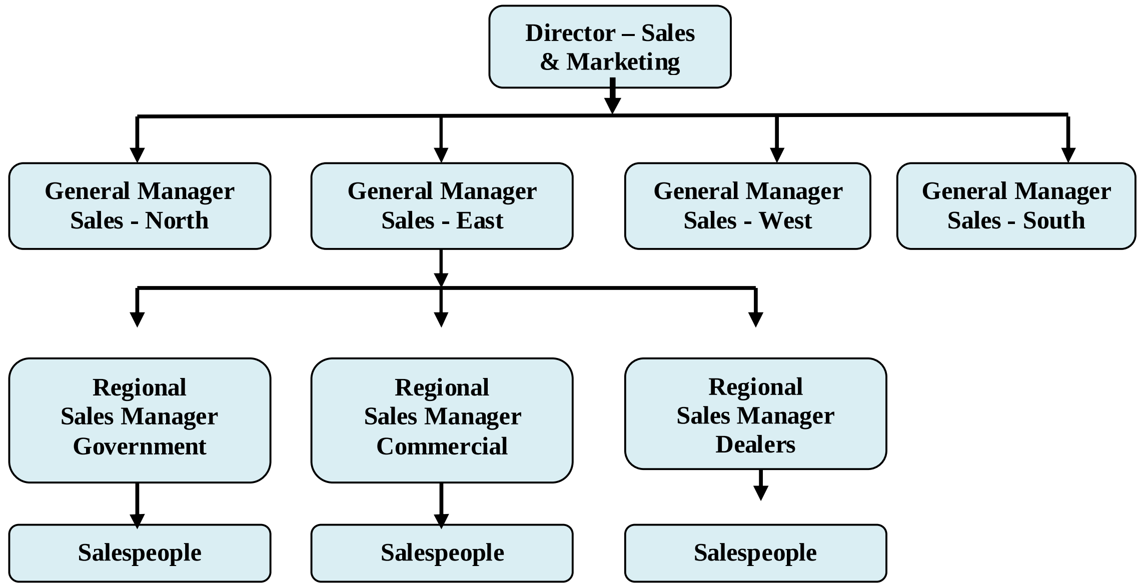


Figure 2.14: Combination Sales Organization

2.14 New Forms of Sales Organization

Recently, increasing globalization and the use of new IT has brought about innovations in organizational architecture. In response to changing demands and new strategic requirements, new organizational forms are emerging. All represent efforts to become more responsive to customers. The new concepts include:

- **Strategic Alliances -** A strategic alliance is a formal relationship created with the purpose of joint pursuit of mutual goals. In a strategic alliance, individual organizations share administrative authority, form social links, and accept joint ownership. Such alliances are blurring firms' boundaries. They occur between companies and their competitors, governments, and universities. Such partnering often crosses national and cultural boundaries. It commits two or more companies to exchange or share their resources in order to produce and market a product. Companies form strategic alliances to develop new technologies, enter new markets, and reduce manufacturing costs. Alliances are often the fastest, most efficient way to achieve objectives.
- **Business to business network structure -** A business to business network structure is a series of global strategic alliances that one or several organizations create with suppliers, manufacturers, and/or distributors to produce and market a product. Network structures allow an organization to manage its global value chain in order to find new ways to reduce costs and increase the quality of products, without incurring the high costs of hiring managers to complete these tasks.
- **Matrix Design -** When the environment is dynamic, changing rapidly, and uncertainty is high, even a divisional structure may not provide enough flexibility. Matrix design is one of the most flexible types of organization structures. In a matrix structure, managers group people in two ways

simultaneously: By function, and By product. The result is a complex network of reporting relationships that makes the matrix structure very flexible. Each person in a product team reports to two bosses: a functional boss, who assigns individuals to a team and evaluates performance, and the boss of the product team, who evaluates their performance on the team. Teams are empowered and team members are responsible for making important decisions, to keep the matrix structure flexible. Matrix structures have been successfully used for years at high-tech companies where new product development takes place frequently and the need to innovate quickly is vital to the organization's survival.

- **Product Team Structure -** The dual reporting relationships of a matrix structure have always been difficult for managers and employees to deal with. To avoid these problems, managers have devised another way of organizing people and resources in the form of a product team structure. The product team structure differs from a matrix in that: It does away with dual reporting relationships and two-boss managers, and Functional employees are permanently assigned to a cross-functional team. In this, a group of managers brought together from different departments to perform organizational tasks. They report only to the product team manager. Increasingly, organizations are making empowered teams an essential part of their organizational architecture to help them gain a competitive advantage in fast-changing organizational environments.
- **Team-Based Organizations -** Many organizations are more responsive to their environment because they use work teams as their basic building blocks; that is they are team based organizations. Teams are made of different functional units, such as manufacturing, technical support, marketing, and sales. These cross-functional teams are composed of a defined group of individuals bringing together expertise from different parts of the supplier organization to capture, retain, and increase business with customers. Cross-functional teams operate separately from traditional, vertical lines of authority. Moreover, cross-functional teams often are short lived. Teams form, complete their tasks, disband, and then new teams form. People may be members of more than one cross-functional team simultaneously.

2.15 Key Account Planning

Companies do realize the need to pay special attention to and take extra care of their major customers. Most of the organizations have about 60-80 percent of sales coming from their major customers. Companies refer to these major customers with different terms such as house accounts, corporate accounts, headquarter accounts, key accounts, or national accounts. Irrespective of their names, the loss of such customers would substantially affect a company's sales and profits. It is far easier to sell to an existing account than it is to open a new account. A company's customers are their most critical asset and planning for their successful retention is critical. Revenue concentration, whereby a small number of accounts contribute the majority of the revenue, is the norm in today's marketplace. These key account revenue streams need to be defended and expanded. Key accounts need more service than smaller accounts (80/20 Rule). As a result, some organizations have special organizational structures set up specifically to deal with key accounts.

Identification and Staffing of Major Accounts - Companies should establish criteria for identifying major accounts that might warrant special accommodation in the sales organizational structure. One simple method is to evaluate two dimensions –

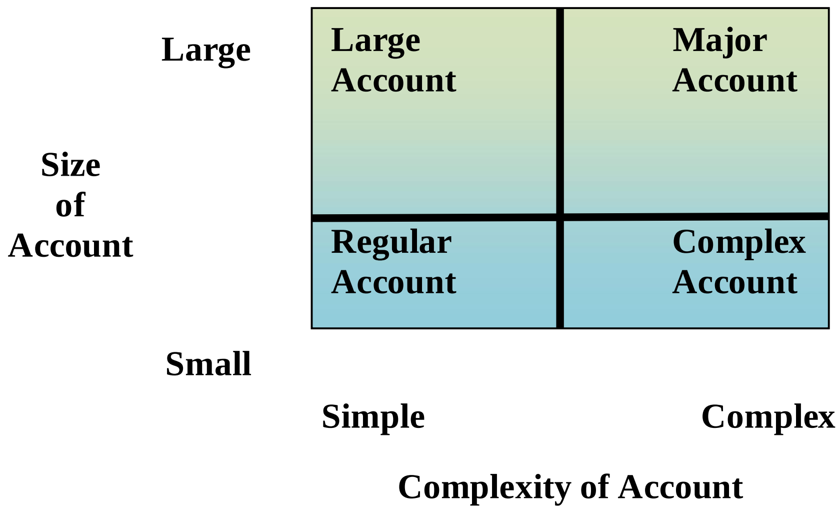


Figure 2.15: Identifying Major Accounts

An account that is small and simple is likely to be categorized as a regular account while an account that is large and simple would be categorized as a large account. An account that is small yet complex would be classified as a complex account. Finally an account that is large and complex which generally means it will require substantial returns on any required investment would presumably meet the criteria for designation as a major account. Once the company has an idea of which accounts qualify as 'major', they need to decide how those accounts will be serviced. Key Account Planning is focused on:

- Determining an account's attractiveness score,
- Performing an account opportunity assessment,
- Recruiting the identified customers into a key account program, and
- Growing the revenue, profits, and satisfaction levels with this set of customers.

Key Account Programs Produce the following Benefits:

- Higher customer loyalty
- An increase in revenue from key accounts
- Lower customer churn
- Better product mix

Generally, companies use four basic methods to organize their sales forces to serve key accounts shown in the figure below:

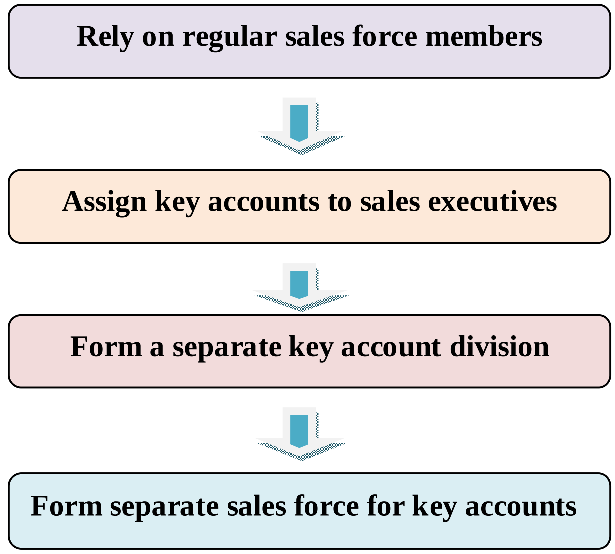


Figure 2.16: Ways to serve key accounts

Rely on regular sales force members – The advantage is that there is no additional administrative or selling expense. While the disadvantage is that the major accounts often require more detailed and sophisticated treatment than smaller customers.

Assign key accounts to sales executives – the advantage lies in here that important customers are serviced by people high in the organization who have authority to make important decisions. On the other hand, the disadvantage is that:

- Managers sometimes allocate too much of the firm's resources to their own accounts to the detriment of smaller, but still profitable customers.
- Assigning selling tasks to managers takes time away from their management activities.

Separate key account division – The advantage is that it allows for the close integration of functional areas, while, the disadvantage is that there is:

- Duplication of effort, Tremendous additional expense and Risky

Separate sales force for major accounts – The advantages are as follows:

- Account managers can become familiar with their customers' needs and provide a high level of service to them
- The firm can select its most competent sales people to become members of the national account sales force
- Provides an internal benefit to the selling company (i.e., motivation mechanism)

2.16 Summary

Sales management performance depends upon the effectiveness of the sales force organization. The organizing process seeks to accomplish three basic tasks, namely - Identifying sales force goals and objectives; Assignment of specific tasks and responsibilities; and Integration and coordination of these activities with other functions. Organizing is the process by which managers establish the structure of working relationships among employees to allow them to achieve stated organizational goals or objectives efficiently and effectively.

Organizational design is the process by which managers make specific organizing choices that result in the construction of a particular organizational structure. It refers to the formal, coordinated process of communication, authority and responsibility for sales groups and individuals. Nowadays all companies are trying to find ways to make the entire organization customer oriented. This approach allows more flexibility and responsiveness in today's competitive global environment. Reorganization is often a necessity in order to reflect new strategies, changing market conditions, or innovative production technologies.

2.17 Self Assessment Questions

1. Explain various sales organization structures highlighting their respective advantages and limitations.
2. Discuss a few principles of sales organization.
3. Discuss the factors that affect sales organization design.
4. What are the relative advantages of a line sales organization and line and staff sales organization?
5. Discuss the process of developing a sales organization.
6. Discuss why some firms are beginning to organize around their key or major accounts.
7. Strategy and structure go hand in hand. Elaborate.

2.18 Reference Books

- Anderson, R.E., J.F. Hair, and A.J. Bush, 'Professional Sales Management' McGraw Hill Publications, 3rd edition, 1999, New Delhi.
- Lancaster G. and D. Jobber, 'Selling & Sales Management' Pearson Education, 8th edition, 2009, New Delhi.
- Churchill, G.A., N.M. Ford, and O.C. Walker, 'Sales Force Management', McGraw Hill Publications, 2009, New Delhi.
- Cundiff, E.W., R.R. Still, and N.A.P. Govoni, 'Sales Management – Decision, Strategies and Cases', Pearson Education, 5th edition, 2009, New Delhi.
- Manning, G.L., and B.L. Reece, 'Selling Today – Building Quality Partnerships', Pearson Education, Inc., 8th edition, 2002, New Delhi.
- Spiro, R.L., W.L. Stanton, and G.A. Rich, 'Management of a Sales Force', Tata McGraw Hill Publishing Co. Ltd., 11th edition, 2003, New Delhi.
- Tyagi C.L., and A. Kumar, 'Sales Management', Atlantic Publishers and Distributors, 2004, New Delhi.
- Saxena, R., 'Marketing Management' Tata McGraw-Hill Publications, 3rd edition, 2006, New Delhi.
- Vashisht, K., 'A practical approach to sales management', Atlantic Publishers and Distributors, 2006, India.
- Honeycutt, E.D., Ford, J.B., and A. C. Simintiras, 'Sales management: a global perspective', Rutledge, 2003, New York.

Unit – 3 : Personal Selling

Structure of Unit

3.0 Objectives

After completing this unit, you would be able to:

- Understand the relationship between sales management, personal selling, sales force management, and salesmanship;
- Understand the importance and hurdles for personal selling;
- Know the types of personal selling and sales jobs;
- Understand the personal selling process;
- Understand professional selling over last 100 years;
- Know the changing patterns in personal selling;
- Learn how to sell effectively.

3.1 Introduction

"Everyone lives by selling something". This statement is just as true today as when Robert Louis Stevenson said it over 100 years ago. Personal selling occurs in nearly each and every human interaction. It is involved when a student buys a Hero Motor Cycle; a store sells a dress to a woman, a preacher talks to a group of students to encourage them to attend church services, and also when a political leader addresses a rally before elections. Personal Selling is an ancient art, which has spawned a large literature and many principles. Selling today is a profession that involves mastering and using a whole set of principles and techniques. In the absence of personal selling, organisations will find it difficult to dispose off their products and services. It is the most important component of promotion mix in attaining the goal of all marketing efforts, i.e. to increase profitable sales by offering want satisfaction to consumers over the long run. This lesson is all about personal selling. It is focused on the definition, nature, scope, importance, and process of personal selling.

3.2 Conceptual Framework

Let us first clarify a few important terms and concepts associated with personal selling. Sales management, management of sale force, sales force management, personal selling, salesmanship, well an outright confusion, unless and until we examine all, one by one. Once getting started, things become simpler and same is the case here. Sales management is the broadest term. It is divided into two broader concepts, management of sales force and personal selling. Sales management directs the personnel-selling effort which, in tern, is implemented largely through salesmanship.

Sales management, originally referred exclusively to the direction of sales force personnel. Later, the term look on broader significance – in addition to the management of personal selling, "Sales management" meant management of all marketing activities, including advertising, sales promotion, marketing research, physical distribution, pricing and product merchandising. Then definition committee of American Marketing Association defined sales management as "the planning, direction and control of personnel selling, including recruiting, selecting, equipping, assigning, routing, supervising, paying and motivating as these tasks apply to the personal sales force".

Management of sales force or sales force management refers to recruitment and selection, training and development, administration, motivation, and control of field sales force. In a way it is the application of personal management concepts to the sales personnel.

Personal selling is defined as the oral presentation in a conversation with one or more prospective purchasers for the purpose of making sales. Salesmanship is the art of successfully persuading prospects or customers to buy products or services from which they can derive suitable benefits, thereby increasing their total satisfactions. Personal selling requires salesmanship or the art of successful persuasion. Besides salesmanship, it includes negotiation and relationship building. In managing personnel selling, the sales executive must understand the many activities comprising the sales person's job, know the problems sales personnel face and suggest solutions. The executive also has to negotiate with the prospective customer to clinch the deal and also has to make good relations that are very important for repeat purchase.

3.3 Hurdles for Personal Selling

Effective personal selling is sine-qua-non for success for every organization. However, there are lots of hurdles for in this field. Importance and hurdles for personal selling are discussed below:

Personal selling is useful for almost every product or service. It is particularly important when:

- The market is concentrated either geographically or in a few industries, or in a few large customers.
- The produce has a high unit value, is quite technical in nature, or requires a demonstration.
- The product requires to be fitted to an individual customer's need, as in the case of securities or insurance.
- The product is in the introductory stage of its life cycle.
- The organization does not have enough money for an adequate advertising campaign.
- Personal selling is the individual, personnel communication of information, in contrast to the mass, impersonal communication of advertising, sales promotion and other; promotional tools. This means personal selling is more flexible than other tools.

- Sales people can tailor their presentations to fit the needs and behaviour of individual customers.
- Personal Selling can usually be focused or pinpointed on prospective customers, thus, minimising wasted effort.

3.3.1 Hurdles for Personal Selling

Although personal selling is essential for any company but there are certain limitations like:

- A high cost involvement is a major limitation even though personal selling can minimise wasted effort, the cost of developing and operating a sales force is high.
- The company is often unable to attract the quality of people needed to do the job. At the retail level, many firms have abandoned their sales forces and shifted to self-service selling for this very reason.

3.4 Types of Personal Selling

Discussed below are different types of personal selling and sales jobs:

3.4.1 Types of Personal Selling

There are two major kinds of Personal Selling:

Across the counter selling is one where the customers come to the sales people. It primarily involves retail – store selling. In this kind of selling, those sales people are also included who are with catalogue retailers or who take telephone orders. The other kind of Personal Selling is where sales people go to the customers. These people sell in person at a customer's place of business or home. These are termed as outside sales force.

3.4.2 Types of Sales Jobs

The types of selling jobs and the activities involved in them cover a wide range. People who sell are called by various names: salesmen, sales representatives, salespersons, account executives, sales consultants, sales engineers, field representatives, agents, and marketing representatives. Given below is the classification of sales jobs by Robert Mcmurry:

(a) Driver sales person (Deliverer) – In this job the sales person primarily delivers the product. For example, soft drinks, bread and milk salesman who deliver the respective products to retailers and/or other customers. In these types of jobs, selling responsibilities are secondary. Actually, few of these salesmen originate sales.

(b) Inside order taker – This is a position in which the sales person takes orders at the seller's place of business. Most of the sales persons visit grocery shops and general stores to take orders for various items.

(c) Outside order taker - In this position the sales person goes to the customer in the field and accepts an order. Most of the sales person who takes orders by visiting various colonies and residential localities falls in this type of category.

(d) Missionary sales person - This type of sales job is extended to build goodwill, perform promotional activities, and provide information and other services for the customers. This sales person is not expected to solicit an order. Medical representatives calling on doctors fall in this category.

(e) Sales engineer (Technician) - In this position the major emphasis is on the sales person's ability to explain the product to a prospective customer, and also to adapt the product to the customer's particular needs. The products involved here are complex, technically sophisticated items. A sales engineer usually provides technical support, and works with another sales representative who calls regularly on a given account.

(f) Creative sales person – an order getter - This involves creative selling of goods and intangibles – primarily services, but also social causes and ideas (do not use drugs, stop smoking, and obey speed limits). This category contains the most complex, difficult selling jobs – especially the creative selling of intangibles, because you can not see, touch, taste, or smell, then customers often are not aware of their need for a seller's product, or they may not realize, how that product can satisfy their wants better than the product they are now using. Creative selling often involves designing a system to fit the needs of a particular customer.

The above six types of sales jobs fall into three groups –

1. Order taker – (Categories 1,2 & 3)
2. Sales support personnel (Categories 4 & 5)
3. Order getter (Category 6)

3.5 Personal Selling Process

Many persons have developed models for personal selling. Some say that it is nothing but SPANCO (finding SUSPECTS, reaching PROSPECTS, APPROACH, NEGOTIATION, CLOSE, AND ORDER TAKING) other say that it is SPIN (SUSPECT, PROSPECT, INTERVIEW, and NEGOTIATION). Research studies, summarized by Schuster and Danes (1986) have shown that successful selling is associated with:

1. Asking questions.
2. Providing product information, making comparisons and offering evidence to support claims.
3. Acknowledging the viewpoint of the customer.
4. Agreeing with the customer's perception.
5. Supporting the customer.
6. Releasing tension.

However, in order to understand personal selling process we will distinguish nine phases. First two phases may be executed in the office itself and may be called the homework. Next seven phases are executed in the field and are termed as field work. Let us try to understand each one of these phases:

(a) **Suspecting** – This phase calls for preparing the list of existing as well as prospective customers. This is a kind of homework where you collect the names, addresses, and phone numbers etc. of all probable customers. Actually, a salesman has to prepare himself first. He has to locate the customers. For this, he has to decide the profile of prospects which is the next phase of selling process. List of suspects can be prepared after discussions with existing customers, retailers, wholesalers, suppliers etc. Computer data bases and websites may also be scanned for this purpose. Yellow pages, directories etc. may also help in this phase.

(b) **Prospecting** – The probability of selling an item increases if you approach the right kind of prospect or customer. This phase calls for zeroing on those prospects or customers to whom probability of selling a product is more. List prepared as a result of suspecting is reduced and customers or prospects, to which it is easier to sell, are considered first. Phone calls may help in zeroing on the potential customers.

(c) **The Approach and the Opening** – This is the first phase of field work. Salesmen approach the prospect and start selling work. Initial impressions can cloud later perceptions, and so it is important to consider the ways in which a favourable initial response can be achieved. There is a saying that first impression is the last impression you get. Buyers expect sales people to be business – like in their personal appearance and behaviour. Untidy hair and a sloppy manner of dress can create a lack of confidence picture. Further the sales person who do not respect the fact that the buyer is likely to be a busy person, may cause irritation on the part of the buyer. Sales people should open the sales call with a smile, a handshake and, in situations where they are not known to the buyer, introduce themselves and the company they represent.

(d) **Need and problem identification -** Most salespeople have a range of products to sell. A car salesman has many models ranging from small economy cars to super luxury top-of-the range models. The computer salesperson will have a number of systems to suit the needs of different customers. In each case, the sellers' first objective will be to discover the problems and needs of the customer. Before a car salesperson can sell a car, he or she needs to understand the customer's circumstances. What size of car is required? Is the customer looking for high fuel economy or performance? What kind of price range being considered? Having obtained this information the salesperson is in a position to sell the model which best suits the needs of the buyer.

This "need analysis" approach suggests that early in the sales process the salesperson should adopt a question-and-listen posture. In order to encourage the buyer to discuss his/her problems and needs, salespeople tend to use 'open' rather than 'closed' questions. An open question is one which requires more than a one-word or one-phrase answer. For example, "Why do you believe that a computer system is inappropriate for your business?" A closed question on the other hand, invites a one-word, a one-phrase answer. In practice, a wide variety of questions may be used during a selling process. Salesperson should avoid the temptation of making a sales presentation without finding out the needs of their customers.

(e) **The presentation and demonstration -** Once the problems and needs of the buyer have been identified, the presentation follows as a natural consequence. A given product may have a range of potential features that confer benefits to customers, but different customers place different priorities on them. Having identified the needs and problems of the buyer, the presentation provides the opportunity for the salesperson to convince the buyer that he/she can supply the solution. For example, a car salesman may claim that 'this model is equipped with overdrive (product feature) which enables you to reduce petrol consumption on motor ways' (customer benefit).

Many sales situations involve risk to the buyer. No matter what benefits the sales person discusses, the buyer may be reluctant to change from the present supplier or change the present model because to do so may give rise to unforeseen problems – delivery may be unpredictable or the new model may be unreliable. Risk is the hidden reason behind many failures to sell. How can a salesperson reduce risk? There are four major ways:

- Reference selling - It involves the use of satisfied customers, in order to convince the buyer of the effectiveness of the sales person's products. During the preparation stage a list of satisfied customers, arranged by product type, should be drawn up. Letters from satisfied customers should also be kept and used in the sales presentation in order to build confidence. This technique can be highly effective in selling, moving a buyer from being merely interested in the product to being convinced that it is the solution to his/her problem.
- Demonstrations - There is a Chinese proverb – "Tell me and I'll forget; show me and I may remember; involve me and I shall understand." This proverb is very important in a sales call. Demonstrations reduce risk because they prove the benefits of the product. Car salespeople allow customers to test drive cars. For all but the most simple of products, it is advisable to divide the demonstration into two stages. The first stage involves a brief description of the features and benefits of the product and an explanation of how it works. The second stage entails the actual demonstration itself. There are several advantages of demonstrations. They add realism to the sales routine in that they utilize more human senses than mere verbal descriptions or visual presentation. When a potential customer is participating in a demonstration, it is easier for the salesperson to ask questions in order to ascertain buying behaviour. Customer objections can be more easily overcome if they can be persuaded to take part in the demonstration process. There are advantages to customers in that it is easier for them to ask questions in a more reliable way in order to ascertain the product's utility more clearly and quickly. Purchasing inhibitions are quickly overcome and buyers declare their purchasing interest sooner than in face-to-face selling/buying situations.
- Guarantees - Guarantees of product reliability, after sales service and delivery supported by penalty clauses can build confidence towards the salesperson's claims and lessen the costs to the buyer should something go wrong. Their establishment is a matter of company policy rather than the salesperson's discretion but, where offered, the salesperson should not under estimate their importance in the sales presentation.
- Trial orders - The final strategy for risk reduction is to encourage trial order, even though they may be uneconomic in company terms and in terms of salespeople's time. Buyers who habitually purchase supplies from one supplier may recognise that change involves unwarranted risk. It may be that the only way for a new supplier to break through this impasse is to secure a small order which, in effect, permits the demonstration of the company's capability to provide consistently high

quality products promptly. The confidence thus, built, may lead to a higher percentage of the customer's business in the longer term.

(f) **Dealing with objections** - Objections should not always be viewed with dismay by salespeople. Many objections are simply expressions of interest by the buyer when the buyer is asking for further information because he or she is interested in what the salesperson is saying. The problem is that the buyer is not yet convinced. Objections highlight the issues which are important to the buyer. The effective approach for dealing with objections involves two areas: the preparation of convincing answer, and the development of a range of techniques for answering objection in a manner which permits the acceptance of these answers without loss of face on the part of the buyer. Some of the suggestions while dealing with objections are as follows:

- Listen and do not interrupt - Interruption denies the buyer the kind of respect he/she is entitled to receive and may lead to a misunderstanding of the real substance behind the objection. The correct approach is to listen carefully, attentively and respectfully. The buyer will appreciate the fact that the salesperson is taking the problem seriously and the salesperson will gain clear and full understanding of what the problem is.
- Agree and counter - This approach maintains the respect salesperson shows to the buyer. The salesperson first agrees that what the buyer is saying is sensible and reasonable, before putting forward an alternative point of view. It, therefore, takes the edge off the objection and creates a climate of agreement rather than conflict. The use of reference selling technique can be combined with agree and counter method to provide a powerful counter to an objection.
- The straight denial - This method has to be handled with a great deal of care since the danger is that it will result in exactly the kind of antagonism which the salesperson is wishing to avoid. However, it can be used when the buyer is clearly seeking factual information.
- Question the objections - Sometimes an objection is raised which is so general but difficult to counter. For example, a customer might say he/she does not like the appearance of the product, or that the product is not of good quality. In this situation the salesperson should question the nature of the objection in order to clarify the specific problem at hand. Another benefit of questioning is that, in trying to explain the exact nature of objections, buyer may themselves realise these are really quiet trivial.
- Forestall the objection - With this method the salesperson not only anticipates an objection and plans its counter, but actually raises the objection as part of his or her sales presentation. There are two advantages of doing this. First, the timing of the objection is controlled by the salesperson. Second, the buyer is not placed in a position where, having raised a problem, he/she feels that it must be defended. The danger of using this method, however, is that the salesperson may highlight a problem the buyer had not thought of.
- Turn the objection into a trial close - A trial close is where a salesperson attempts to conclude the sale without prejudicing the chances of continuing the selling process with the buyer. The ability of a sales person

to turn the objection into a trial close is dependent upon perfect timing and considerable judgment. Usually it will be attempted after the selling process is well under way, and the salesperson judges that only one objection remains. When dealing with objections the salesperson should remember that heated arguments are unlikely to win sales as buyers buy from their friends, not their enemies.

Not all prospects, however, state their objections. They may prefer to say nothing because to raise an objection may cause offence or may prolong the sales interaction. Such people may believe that staying on in friendly terms with the salesperson and at the end of the sales call stating that they will think over the proposal, is the best tactic in a no-buy situation. If a salesperson believes that a buyer is unwilling to reveal his/her true objection, he/she should ask specific questions.

(g) **Negotiation** - In some selling situations, the salesperson or sales team have a degree of discretion with regard to terms of the sale. Negotiation may, therefore, enter into the sales process. Sellers may negotiate price, credit terms, delivery times, trade-in values and other aspects of the commercial transaction. The deal that is arrived at will be dependent upon the balance of power and the negotiating skills of the respective parties. The buyer's needs, the competition that the supplier faces, knowledge about the buyer's business, and the pressures upon him/her should be estimated. However, there are a number of guidelines to aid the salespeople actually engaged in the negotiation process.

- Start high but be realistic - There are several good reasons for making the opening stance high. First the buyer might agree to it. Second, it provides room for negotiation. A buyer may come to expect concessions from a seller in return for purchasing. This situation is prevalent in the many industries especially those. It is unusual for salespersons in these industries not to reduce the advertised price to cash purchaser when considering how low to go, the limiting factor must be to keep within the buyer's realistic expectations, otherwise he/she may not to willing to talk to the seller in the first place.
- Attempt to trade concessions for concession - Sometime it may be necessary to give a concession simply to secure the sale. A buyer might say that he/she is willing to buy if the seller drops the price by some amount. If the seller has left himself negotiating room, then this may be perfectly acceptable.

Buyers also have a number of techniques that they use in negotiation. Sellers should be aware of their existence, otherwise sometimes their effect can be devastating.

It is important in all situations to know when to negotiate, Lee and Dobler have listed following circumstance where negotiation is an appropriate procedure for concluding a sale.

- When many factors bear not only on price, but also on quality and service.
- When business risks cannot be accurately predetermined.
- When a long period of time is required to produce the items purchased.

- When production is interrupted frequently because of numerous change orders.

The above discussion about negotiation leads us to conclude that negotiation involves preparing a strategic plan before meeting the other party and making good tactical decisions during negotiation session.

(h) **Closing the sales** - The skills and techniques discussed so far are not, in themselves, sufficient for consistent sales success. A final ingredient necessary to complete the process is the ability to close the sale. A major consideration at the closing is timing. A general role is to attempt to close the sale when the buyer displays heightened interest or a clear intention to purchase the product. Salespeople should look out for such buying signals and respond accordingly. Purchase intentions are unlikely to grow continuously throughout the sales presentation, they are more likely to rise and fall as the presentation progresses. The salesperson should attempt to close at a peak and which peak is to be chosen comes with experience. There are a number of closing techniques which the salesperson can use.

- Simply ask for the order - The key for using this technique is to keep silent after you have asked for the order. The salesperson has asked a closed question implying a yes or no answer. To break the silence effectively lets the buyer off the book. The buyer will forget the first question and reply to the salesperson's later comment.
- Summarise and then ask for the order - This technique allows the salesperson to remind the buyer of the main points in the sales argument in a manner which implies that the moment for decision has come and that buying is the natural extension of the proceedings.
- The alternative close - This closing technique assumes that the buyer is willing to purchase but moves the decision to whether the colour should be red or blue, the delivery should be Tuesday or Friday, the payment in cash or credit etc. In such circumstances the salesperson suggests two alternatives, the agreement to either results in closing the sale:
    - 'Would you like the red one or blue one.'
    - 'Would you like it delivered on Tuesday or Friday.'
- The objection close - It involves the use of an objection as a stimulus to buy. If the salesperson is convinced that the objection is the major stumbling block to the sale, he/she can gain commitment from the buyer by saying. 'If I can convince you that this model is the most economical in its close, will you buy it?' A positive response from the buyer and reference to an objective statistical comparison by the seller effectively seals the sale.
- Action agreement - In some situations it is inappropriate to attempt to close the sale. For many industrial goods the sales cycle is long and a salesperson who attempts to close the sale at early meeting may cause annoyance. In selling pharmaceutical products, for example, salespeople do not try to close a sale but instead attempt to achieve 'action agreement' whereby either the salesperson or the doctor agrees to do something before their next meeting. This technique has the effect of helping the doctor – salesperson relationship to develop and continue.

- The concession close – This involves keeping one concession in reserve to use as the final push towards agreement. 'If you are willing to place an order now, I am willing to offer an extra 5% discount".

(i) **Follow-up** - This final stage in the sales process is necessary to ensure that the customer is satisfied with the purchase and that no problems with such factors as delivery, installation, product use and training have arisen. Salespeople may put-off the follow up call because it does not result in an immediate order. However, for most companies repeat business is the hallmark of success and follow–up call can play a major role in showing that a salesperson really cares about the customer rather than only being interested in making sales. The follow-up call can also be used to provide reassurance that the purchase was right one.

The phases of personal selling process are not watertight compartments and need not occur in the order. Objections may be raised during presentation or during negotiation, or a trial close may be attempted at any point during the presentation if buyer interest is high. Furthermore, negotiation may or may not take place and may occur during any of the stages.

3.6 Professional Selling over last 100 years

Prior to industrial revolution, organizations were small and selling was not a complex activity. Owner himself used to sell what he was producing. Post industrial revolution, selling has come a long way. We have seen tremendous development in this field in the last hundred years or so.

We can divide the past 100 years into 3 distinct eras. During the 1920s and 30s, the world was in a production mode. Industry was focused on making things. The sales culture during this period is perhaps best characterized by Henry Ford's statement, "You can have any color car you want, as long as it's black." When people want a product that's in short supply, you don't have to be "customer sensitive" to make a sale, and the Ford Company's success proves it

From the late 30s to the early 50s, production began catching up with demand. The biggest problem companies had was getting their products to customers. As a result, the traveling salesman was born, and the era has become known as the Sales era. To be successful during this era, a salesperson needed only transportation and some motivation to get products in front of people who wanted them. Follow-up or service after the sale was not concerns for the salesperson of the Sales era. They just moved on to the next town. Sales training consisted of memorizing a pat script that was to be delivered to as many people as possible. The assumption being that upon hearing these same persuasive words, some percentage of people would buy. Brushes, pans, vacuum cleaners and encyclopedias were some of the most popular products pitched during the sales era. The Advertising era began in the mid-50s with the proliferation of television sets. Distribution networks taking products to customers were becoming well established. Now, a company could create huge demand for their product by simply running a commercial on television. The fast-talking salesman still existed in niche and specialty markets, but their time had gone past.

The Marketing era was started in the 70s-80s. This era is characterized by an over-abundance of products and services from which customers could choose. This era has given birth to the consultative salesperson. A salesperson can truly make a difference, differentiating one offering from another and matching customer needs to product features. They must have a good knowledge of what they sell, and must understand customer needs, but most important, they must create customer confidence and trust.

In last few years, many companies have changed their sales people's titles to "Account Executive" or "Customer Service Specialist" to distance them from the past. But no matter what you call them, the most successful sales people today are professional, respected and most of all, trusted. They are experts at listening to customers, uncovering their needs and solving their problems.

3.7 Changing Patterns in Personal Selling

Traditionally, personal selling was a face-to-face, one-to-one situation between a sales person and a buyer. This situation existed both in retail sales involving ultimate consumers and also in business-to-business transactions. In recent years, however, many different selling patterns have emerged. These new patterns reflect a growing purchasing expertise among consumers and business buyers, which, in turn, has fostered a growing professionalism in personal selling. Let's discuss four of these emerging patterns:

(a) Selling centers – Team Selling - To match the expertise on the buying side, especially in business markets, a growing number of firms on the selling side have adopted the organizational concept of a selling center. This is sometimes called a sales team or team selling. A selling center is a group of people representing a sales department as well as other functional areas in a firm such as finance, production, and research and development (R&D). Procter & Gambler, for example, has selling teams comprised of sales people plus representatives from finance, distribution, and manufacturing. Each team is assigned to cover large retailers. When AT&T sells to a large multinational firm then AT&T will send a separate selling team to deal with each of other companies' major divisions. Team selling is expensive and is used only when there is a potential for high sales volume and profit.

(b) Systems Selling - The concept of system selling means selling a total package of related goods and services, a system, to solve a customer's problem. The idea is that the system, the total package of goods and services, will satisfy the buyer's needs more effectively than selling individual products separately. Xerox, for example, originally sold individual products, using a separate sales force for each major product line. Today, using a systems-selling approach, Xerox studies a customer's office information and operating problems. Then Xerox provides a total automated system of machines and accompanying services to solve that customer's office problems.

(c) Relationship Selling - Developing a mutually beneficial relationship with selected customers over time is relationship selling. It may be an extension of team selling, or it may be developed by individual sales representatives in their dealings with customers. In relationship selling, a seller discontinues the usual territorial practice of covering many accounts. Instead seller attempts to develop a deeper, longer-lasting relationship built on trust with key customers, usually larger accounts. Unfortunately, often there is not much trust found in buyer-seller relationships, neither in retailer–consumer selling nor in business-to-business selling.

How do you build this trust? The following behavioral traits in selling can be effective trust builders:

- **Candor** –truthful in what you say.
- **Dependability** – behave in a reliable manner.
- **Competence** – display your ability, knowledge, and resources.
- **Customer orientation** – place your customers' needs and interests on a par with your own.
- **Likability** – seek a similarity of personality between you and the customers, and a commodity of interests and goals.

(d) Telemarketing -Telemarketing is the innovative use of telecommunications equipment and systems as part of the "going to the customer" category of personal selling. Telemarketing is growing because: (i) many buyers prefer it over personal sales calls in certain selling situations, and (ii) many marketers find that it increases selling efficiency. Buyers placing routine reorders or new orders for standardized products by telephone or computer use less of their time than in-person sales calls. (iii) Sellers face increasingly high costs keeping sales people on the road; selling by telemarketing reduces that expense. (iv) Also, routine selling by telemarketing allows the field sales force to devote more time to creative selling, major account selling, and other more profitable selling activities. Here are examples of selling activities that lend themselves nicely to a telemarketing program:

- Seeking leads to new accounts and identifying potentially good customers that sales reps can follow up with in-person calls.
- Processing orders for standardized products
- Dealing with small-order customers, especially where the seller would lose money if field sales calls were used.
- Improving relations with middlemen
- Improving communications with middlemen in foreign countries and competing better against manufacturers in those countries. In Europe, for example, the auto, chemical, steel, and shipbuilding industries have developed electronic communication systems involving manufacturers, suppliers, and even customs and shipping agents.

3.8 Summary

Personal Selling is an ancient art, which has become a full fledged profession that involves mastering and using a whole set of principles and techniques. In the absence of personal selling, organisations will find it difficult to dispose off their products and services. Personal selling is oral presentation in a conversation with one or more prospective purchasers for the purpose of making sales. It requires salesmanship or the art of successful persuasion. Besides salesmanship, it includes negotiation and relationship building. The executive has to negotiate with the prospective customer to clinch the deal and also has to make good relations that are very important for repeat purchase. Personal selling process comprises of many phases. First few phases may be executed in the office itself and may be called the homework. Remaining phases are executed in the field and are termed as field work. These phases include suspecting; prospecting; opening; problem identification; presentations and demonstrations; dealing with objections; negotiations; closing; and follow up etc.

3.9 Self Assessment Questions

1. What do you understand by personal selling? How it is different from salesmanship? Discuss with the help of suitable examples.
2. Discuss the stages of personal selling process.
3. "Everyone lives by selling something". Do you agree with the statement? Elaborate your viewpoint giving suitable examples.
4. What is personal selling? Discuss the process and advantages of personal selling.
5. Discuss, how personal selling changed over years.
6. Write short notes on the following:
   (a) Negotiation
   (b) Relationship building

3.10 Reference Books

- Anderson, R.E., J.F. Hair, and A.J. Bush, 'Professional Sales Management' McGraw Hill Publications, 3rd edition, 1999, New Delhi.
- Lancaster G. and D. Jobber, 'Selling & Sales Management' Pearson Education, 8th edition, 2009, New Delhi.
- Churchill, G.A., N.M. Ford, and O.C. Walker, 'Sales Force Management', McGraw Hill Publications, 2009, New Delhi.
- Cundiff, E.W., R.R. Still, and N.A.P. Govoni, 'Sales Management – Decision, Strategies and Cases', Pearson Education, 5th edition, 2009, New Delhi.
- Manning, G.L. and B.L. Reece, 'Selling Today – Building Quality Partnerships', Pearson Education, Inc., 8th edition, 2002, New Delhi.
- Spiro, R.L., W.L. Stanton, and G.A. Rich, 'Management of a Sales Force', Tata McGraw Hill Publishing Co. Ltd., 11th edition, 2003, New Delhi.

Unit – 4 : Sales Planning and Budgeting

Structure of Unit

4.0 Objectives

After completing this unit, you would be able to

- Explain the need, elements, and objectives of the sales planning process;
- Understand the types and barriers to sales planning;
- Explain the concepts and issues in budgeting;
- Describe various budget-setting methods;
- Describe sales budget implementation and feedback;
- Understand various budget control methods

4.1 Introduction

The military saying, "If you fail to plan, you plan to fail," is very true. Without a plan, managers are set up to encounter errors, waste, and delays. A plan, on the other hand, helps a manager organize resources and activities efficiently and effectively to achieve goals. Out of the five management functions — planning, organizing, staffing, leading and controlling — planning is the most fundamental. All other functions stem from planning. It is the foundation of management. However, most of the time, planning doesn't always get the attention that it deserves; this is often noticed when the root cause of most of the management failures is traced to a lack of proper planning. A plan is a blueprint for goal achievement that specifies the necessary resource allocations, schedules, tasks, and other actions.

4.2 Sales Planning – Conceptual Framework

Planning not only provides direction and a unity of purpose for organizations, it also answers six basic questions in regard to any activity (including sales):

- What needs to be accomplished?
- When is the deadline?
- Where will this be done?
- Who will be responsible for it?
- How will it get done?
- How much time, energy, and resources are required to accomplish this goal?

4.2.1 Need for Sales Planning

Sales' planning is needed because:

- Without a plan to provide directions, decision making is aimless and disconnected
- Sales managers must make their decisions within an environment where change is continuous
- Planning helps minimize environmental shocks.
- It is important to improve morale of the employees
- Through planning, there is an improvement in cooperation and coordination
- It helps in developing individual and collective standards
- Increases the sales organization's flexibility towards the dynamic business environment
- Planning improves the quality of decision making
- Focuses attention on organizational objectives and results
- Establishes a basis for teamwork
- Helps anticipate problems and cope with changes
- Provides guidelines for decision making
- Serves as a foundation and a prerequisite to employing all other management functions

4.2.2 Elements of sales planning

The main elements of sales planning include the following:

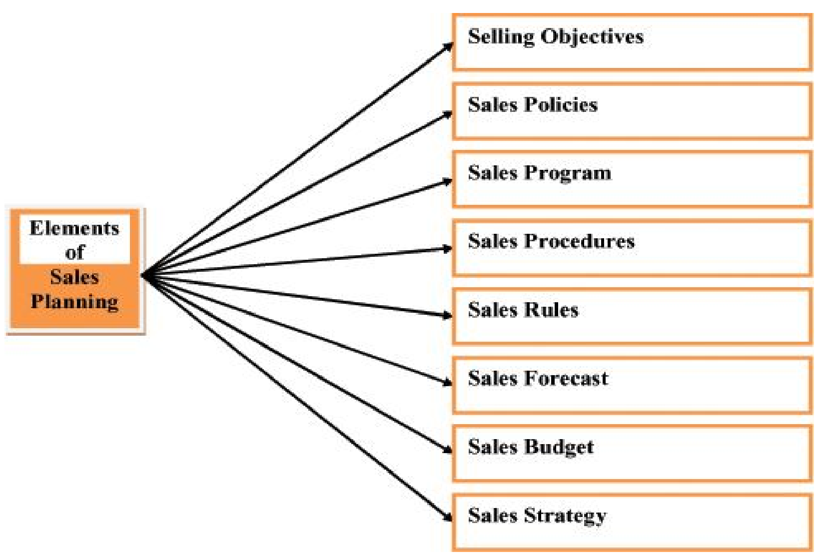


Figure 4.1: Elements of Sales Planning

- **Selling objectives –** This includes the list of objectives that need to be attained after the completion of the sales planning process. The objectives should be realistic and attainable. For example, if the sales representative is selling financial products to the customer, a target of 20 to 30 products per month is mostly an achievable target. If the sales planning document sets the objective as 100 financial products, then it might not be achievable most of the times. Hence the objectives must be achievable and be completed in time. The objectives may be short term (to be achieved in about one year) or long term (to be achieved in 2-3 years time period) in nature.

- **Sales Policies –** They provide the guidelines to the sales staff to help them in performing the sales activities. Policies help the sales representatives in achieving their targets. For example, when a sale gets returned by the customer, the refund policy will guide the sales representatives how to deal with the situation effectively, so that the customer will be handled with care rather than getting into an uncomfortable situation. The sales policies also help in clearly identifying the right pricing for the customer depending upon the relationship the customer shares with the company. For example, if the customer is loyal to the company and is doing sales from several years, the policy would inform the sales representative about the maximum discounts that can be given to such customers.
- **Sales Program -** Sales programs help to develop the necessary skill set in achieving the sales objectives effectively and in given time period. They are essential to ensure the sales representative can handle any sales situation which they are entitled to perform. Sales planning should clearly mention the required skill set needed in handling the sales and the program appropriate to instill those skills in the sales representative. Sales program may be necessary whenever a new product/ service are introduced by the company or when the sales representatives handle sales from new territories. Cross-cultural training would be given most of the times, when the sales include the customers other than the native country.
- **Sales Procedures -** Sales procedure is the sequence of various activities that need to be performed for different sales functions. They vary from sale to sale and from market to market. Sales procedure for a business to consumer sales varies greatly from business to business sales. The sales procedure may include meeting the customer, explaining the product /service through slides, use closing techniques, take the order and following up. The procedure for B2B sales may indicate to take a complete team from various departments who are the stakeholders in the project to carry out the explanation of the product/ service. The procedure for the B2C sales may indicate that a single representative is enough to handle the task.
- **Sales Rules -** Sales rules indicate the set of actions that need to be performed or otherwise depending upon the situation. For example, in credit card payments, if the customer is asking for the refund of the late payment fee, then the rule says clearly not to refund if the amount is received after the due date. Hence, the sales staff is not permitted to refund the amount no matter how loyal the customer is with the company. In some cases, refund could be done. For example, when there is some genuine reason for the late payment, such as the due date is on a non-working day for the bank due to festival, curfews or any other natural disasters etc. In such cases the sales staff would refund the amount if the rule mentions to refund the amount. Even in personal sales, the sales

representative would be given rules regarding the maximum discount or the maximum amount of credit that the sales staff can offer the customer.

- **Sales Forecast -** Sales forecast lays the foundation of sales planning and objective setting. Based on the sales forecast the sales manager would know the sales that could be attainable for the coming period (next quarter or year). Various time series analysis tools such as trend estimation, moving average, weighted moving average, exponential smoothing etc. may be used to forecast. Forecast can be also done based on the predictions done by the industry experts. Methods can be many but the aim of forecasting is to clearly identify the demand and plan the sales activities to generate more leads to the business. Sales forecast also help in identifying the strategies to gain or maintain the market share. For example, if the forecast turns out to be negative i.e. the industry sales are going to dip, then the company may execute their operations effectively to retain the existing customers and attract the new customers.
- **Sales Budget -** Sales budget identifies the necessary expenditure that is occurred in making the sales. The sales budget estimates the revenue based on sales that would be generated and identifies the profit for the organization after subtracting the operational costs of the sales staff. The sales budget sets the standards for the sales team in terms of the expenditure that is permitted to incur upon the sale. For example, when the sales staff goes for selling the product, the maximum expenses that can be incurred would be mentioned and the sales representative has to maintain his travel expenditure and other costs within that limit. Maintaining the operations within the budget becomes a complex task in B2B sales where the sales team had to travel to the customer site many times before the sale happens. Hence the sales manager has to see that the operational costs are under control and provide some mechanisms like video conferencing to reduce the travelling costs. To attain a desired profitable level in sales, it is very important to curtail and control the operational costs.
- **Sales Strategy -** Sales strategy involves how the company is going to act in the market place with the proposed products/ services. The market is dynamic and competitive in nature which makes the companies alert all the times with their strategies regarding all the marketing mix elements. The company, who can handle the sales strategies in the market place, is likely to be the winner.

4.2.3 Types of Sales Planning

The following are the various types of sales plans in an organization:

a) **Sales plan on the basis of market area -** Whenever the sales are done in the entire country, then the entire region would be divided into several areas depending upon certain characteristics. A simple segregation would be dividing the entire country sales into different states and assigning a head for each state. For example, in the telecommunication business, the telecom plans varies from state to state and within the state it remains the same. There are some services which are applicable for the entire country too. Even the promotional offers vary from state to state depending upon the nature of the business in these states. Some products in FMCG sector are very strong in south and have a little presence in North and hence the companies may introduce special promotional campaigns which are available only to the northern states to improve leads. Hence the sales plan would vary from region to region.

b) **Sales plan on the basis of selling functions -** Sales team performs several functions such as promotions; follow up activities, presales and sales activities etc. Hence the company lays out various sales plans for each activity if necessary.

c) **Sales plan based on type of customers –** The 80-20 rule (80 percent of the business comes from 20 percent of the key customers) is followed by most of the companies. Although each and every customer is important to the company, the survival of the company depends on those 20 percent. Hence following the same sales plan for all the customers wouldn't be practical since the key customer have to be handled more effectively. Hence the companies may have different sales plan for the key customers. Also the company may have different sales plan for customer depending upon the markets like B2B or B2C.

d) **Sales plan based on the type of products -** Every product/ service may not have the same selling activities. Hence having different sales plan is essential to handle the sales effectively. For example, if the company produces technical products, services, FMCG goods etc. it needs to have separate sales plan for the FMCG goods and the technical products and services.

e) **Sales plan based on the time period -** There are different sales plan for long term and short term objectives of the company. For example, it would not be feasible to have the same sales plan for increased sales in existing territory and getting sales in new territories. Acquiring the new territory would be a long term objective where as increasing the sales in existing territory would be a short term objective which would be a one year time period. Hence, in both cases, strategies would be different and the operational costs would be different.

4.2.4 Sales planning process

The sales planning process is very important for an organization. It can be carried out only when the company has a strategic marketing plan in place. The first thing that an organization does is make a strategic marketing plan. Once the strategic marketing plan is made, the organization knows the segment that has to be targeted, and also, the consumer buying behavior for that segment. Accordingly a sales planning is done, the stages of which are given below:

1. **Setting objectives –** The sales planning is going to start only when the objectives for the sales team have been defined. For example – The objective of an air conditioning company might be to increase the market share of the company. For this, it may decide to penetrate a new geographic market.

2. **Determine the actions necessary –** Once the objectives of the sales plan are known, the actions and operations needed in effect before implementing the sales plan have to be determined. This is a crucial step in the sales planning process because if the correct operations strategy is not made, then in future the company will face a lot of operational difficulties resulting in failure to meet sales objectives. For example –

The air conditioning company needs to penetrate a new geographic territory to increase market share. Thus it needs Sales as well as service operations backup in this territory. The marketing department should also know the new territory so that they can come up with aggressive marketing tactics to target that territory.

3. **Organize the actions –** Once the necessary operations have been charted out, there is a need to organize the sales planning. For example, the first priority of the air conditioning company in new territory will be to have a sale and service setup and the necessary channel in place. This shall be followed by using aggressive marketing tactics in the new sales territory. Thus an organized action plan needs to be made during the sales planning process.
4. **Implement –** After the actions have been planned and organized, implementing them is the next step. Many problems may have to be faced while implementing a sales plan. For example, the customers of the new territory might not respond to the new air conditioners entering the market. On the other hand, the product might be picked up readily by the customers and the company might not be able to adapt with the unexpected demand.
5. **Measure results –** As in any planning process, the fifth and very important step in the sales planning process is to measure the results. Unlike advertising, sales results are very easy to measure because everything is documented and recorded. For example, the air conditioning company will measure the total sales of the geographic territory in study, along with the competitors' sales as well for record keeping.
6. **Re evaluate –** When there are sales records in hand, it has to be ensured that they are properly analyzed to know whether or not the sales planning process has succeeded. This critical analysis is important to know as to which strategy worked and which strategy failed. This stage helps to set objectives for the next year.

4.2.5 Sales Strategy

Discussed below are different sales strategies useful in B2B and B2C situations:

Table 4.1: Sales Strategies

Components of Sales Strategy	
Classifying market segments and individual customers within a target segment	• Each firm should first decide on target market segments and if possible, to classify customers into high, medium, low sales & profit potentials • Sales strategy is developed accordingly
Relationship strategy	• Whether a selling firm should use transactional, value-added, or collaborative relationship depends on both the seller and the customer • Each selling firm to decide which segments and individual customers respond profitably to collaborative relationship

Selling Methods	• These are: - Stimulus response, - Formula based, - Need-satisfaction, - Team selling, - Consultative selling • Selection of appropriate selling method depends on relationship strategy
Channel Strategy	• There are many sales/ marketing channels. For example: company sales force, distributors, franchisees, agents, the internet, brokers, discount stores • Selection of a suitable channel depends on both the buyer and the seller, products / services, and markets

Sales planning and strategies would be different for B2B (Business to Business) and B2C (Business to Consumer) markets most of the times. The following are the main considerations in B2B markets:

1. It deals with the business to business deals where the time management is a critical factor for the customer satisfaction.
2. Since the sales process takes place for months, maintaining the progress in sales is very important.
3. The sales staff has to stick with the timings given by the customer and ensure that all the team members are present at the right time.
4. The sales team has to deal with customers and plan the activities.
5. There is no standardization of activities which can be applied to several customers. Since the requirements differ from customer to customer, the B2B sale plan has to deal with a flexible plan and plan the resources accordingly.
6. The customer health in financial terms is very important and hence the customer business trend is observed time to time. Most of the times the sales are on credit basis with timely payments in regular intervals.
7. Forecasting plays a very important role in preparing a sales plan for B2B customers. Monitoring the forecast of the customer business will give a clear picture of the company future sales. For example, if the company is selling product 'A' to the customer who in turn sells it to its customers after some value addition, and if the customer business in future sees a down trend for the product 'A' then it clearly indicates that the leads in future will take a downturn. In such case the company has to use appropriate sales strategies to sustain in the market place.

The following are the main considerations in B2C markets:

1. It refers to the business to the customer deals.
2. The product/ service is used for his/her own benefit.
3. Sales plan in B2C market has to deal with several issues related to the warehousing, distribution channels and retail.
   a) *Handling warehouse effectively*:
      - The sales plan has to take care that the stock of goods are ensured at all the times to handle the demand. Thus, the right

forecasting of the demand and coordination with the manufacturing department at regular intervals is very important. Problems may occur when the goods are produced more or less than the required quantities by the market. In case of over production, goods lie in inventories there by adding up the inventory costs. In case of low production, companies may lose the customer to their competitors if the goods are not available.

- Knowledge of the tax structure is very important to avoid double taxation for selling idle stocks in other states. Due to this the profit on the product may go down to such a level where a loss is incurred to the company. Having the knowledge about the no tax zones also helps in decreasing the costs.

b) *Handling distribution channels*:

- The sales plan has to ensure that the products may not end up lying with the distributors due to less demand.
- Sales plan has to take care that the goods are distributed in necessary quantities only and are not pushed excessively into the market when the demand is less. Excessive distribution of good may damage the relationship between the distributors and the company.
- This process is very critical in case of perishable goods like fruits, vegetables etc. If they lie for more time in the distribution channels then the chances of them being sold to the end customer decreases due to getting spoiled. It is the task of the sales plan to ensure that proper checks are done to remove excessive stock of perishable goods from the distribution channel and store them appropriately in inventories and sell them when the demand rises.

c) *Handling retail stores*:

- It has to be ensured that the sales staff visits retail outlet on monthly basis and check for the stock of goods. Products that are lying for more time means that more costs have to be incurred for the shelf space. In organized retail, the shelf space comes at a cost and in case of unorganized retail; excessive stock means the company might enter into credit situation with the retailer as he/she will not be able to pay. More credit in retail may lead to untimely payments and bad relationships.
- Hence the sales plan has to deal with such situations and ensure that the stock is sold properly and any excessive stock has to be removed from the retailer place. Sales plan also has to ensure that the stocks are made available all the times in case of a hiked demand.

d) Handling the price changes:

- The interest rates or tax rates may go up intermittently, and there is also the factor of inflation, due to which the cost of the product shoots up due to a rise in the operating costs. As a result, the profit margins shrink. Hence the sales plan has to handle any such situations where the price needs to be increased and necessary sales activities have to be performed to deal with the price changes in the market place.

4.2.6 Barriers to Planning

Various barriers can inhibit successful planning. In order for plans to be effective and to yield the desired results, managers must identify any potential barriers and work to overcome them. The common barriers that inhibit successful planning are as follows:

i. **Inability to plan or inadequate planning –** Managers who are not successful planners due to lack of experience, education, and/or ability may not know how to conduct planning as a process. It is very critical to have a responsible person or persons as planners.

ii. **Lack of commitment to the planning process -** The development of a plan requires hard work and proper time management. Another possible reason for lack of commitment can be fear of failure. As a result, non-committed managers may do little or nothing to help in the planning process.

iii. **Inferior information -** Facts that are out-of-date, of poor quality, or of insufficient quantity can be major barriers to planning. No matter how well managers plan, if they are basing their planning on inferior information, their plans will probably fail.

iv. **Focusing on the present at the expense of the future -** Failure to consider the long-term effects of a plan because of emphasis on short-term problems may lead to trouble in preparing for the future. Managers should try to keep the big picture i.e. their long-term goals, in mind when developing their plans.

v. **Too much reliance on the organization's planning department -** Many companies have a planning department or a planning and development team. These departments conduct studies, do research, build models, and project probable results, but they do not implement plans. Planning department results are aids in planning and should be used only as such. Formulating the plan is still the manager's responsibility since he or she has a thorough knowledge of the actual working conditions.

vi. **Concentrating on controllable variables -** Managers often concentrate more on the things and events that are controllable and not paying much attention to the various uncontrollable factors like economy, politico-legal or technological factors etc. this may be due to the reason that managers tend to demonstrate a decided preference for the known and an aversion to the unknown.

4.3 Sales Budgeting

A sales budget is a spreadsheet which documents monthly, quarterly and annual budgets as well as financial goals, expressed in currency and units of production. A sales *budget* is a financial tool of control that a manager uses to plan for profits by giving a detailed break-down of estimates of sales revenue and selling expenditure. It is the most important element of sales. It is an instrument of planning that shows how to spend money to achieve the targeted sales. This is the key budget. A sales budget is a necessary component in every company's corporate backbone in order to predict accurate sales forecast and a particular level of profit. It's crucial to the business that the sales budget is maintained and is accurate because if information is missing, this negatively affects the rest of the budgeting process. It states what and how much each salesperson will sell. It also spells out what and how much will be sold to the different classes of customers. Once the budget is accepted in terms of estimated sales, expenses and profit figures, the actual results are measured, and compared against the budgeted figures; managers estimate the sales of each product and often make separate forecasts for each class of customer and each territorial division.

The marketing department would get more budgets for advertising and sales promotions if the sales forecast predicts higher sales in the next year. Similarly the budget allocation for the sales department also depends upon the sales forecast. Sales budgeting have to deal with several issues like identifying the right budget allocation according to region wise, dealing with NPA accounts, developing new territories, identifying and analyzing the variances, creating new revised budgets etc. Hence understanding these issues is an important task and the analysis should be done at regular intervals. Budget funds must be appropriated wisely in order to properly support selling activities that allow sales personnel and the total marketing group to reach their performance goals. If a company has a large number of products, it usually aggregates its expected sales into a smaller number of product categories or geographic regions; otherwise, it becomes too difficult to generate sales estimates for this budget. The sales budget is usually presented in either a monthly or quarterly format.

Budgets are commonly created for yearly, bi-annual, and quarterly periods. Some firms prepare budgets for all three periods; others prefer to operate on an annual basis, thereby reducing the amount of paperwork.

The quarterly budget forces a reappraisal of the firm's position four times a year, thereby decreasing the likelihood of the operations getting out of control. Many companies find a quarterly system advisable because it coordinates roughly with their operations conversion cycle. Garment makers usually have four conversion cycles per year. That is, they put out four different lines of goods, one for each season, and find it convenient to budget for each selling season. The main advantage of a short planning period is that it is more likely to be accurate than a long one. The shorter the forecasting period, the less likely is the estimate getting disturbed by unforeseen developments. In deciding which period to use, a firm must balance the degree of control with the costs of compiling the budgets.

All the budgets are interrelated, and begin with the sales budget. In essence, a sales budget sets the stage and controls the finances every step of the way and allows the company to achieve its financial targets:

- Most of the detail for existing products comes from those personnel who deal with them on a day-to-day basis.
- The marketing manager contributes sales promotion information, which can alter the timing and amount of sales.
- The engineering and marketing managers may also contribute information about the introduction date of new products, as well as the retirement date of old products.
- The chief executive officer may revise these figures for the sales of any subsidiaries or product lines that the company plans to terminate or sell during the budget period. It is generally a good practice, not to include in the sales budget any estimates for sales related to prospective acquisitions

of other companies, since the timing and amounts of these sales are too difficult to estimate. Instead, revision of the sales budget may be resorted to after an acquisition has been finalized.

- The projected unit sales information in the sales budget feeds directly into the production budget, from which the direct materials and direct labor budgets are created. Thus, the production budget is prepared after the sales budget.
- The production budget in turn is used to determine the budgets for manufacturing costs including the direct materials budget, the direct labor budget, and the manufacturing overhead budget.
- The sales budget is also used to give managers a general sense of the scale of operations, from which they create the overhead budget and the sales and administrative expenses budget.
- The total net sales rupees listed in the sales budget are carried forward into the line item in the master budget.
- The selling and administrative expenses budget is both dependent on and a determinant of the sales budget. This reciprocal relationship arises because sales will in part be determined by the funds committed for advertising and sales promotion.
- These budgets are then combined with data from the sales budget and the selling and administrative expenses budget to determine the cash budget.
- Sales Budget influences the other components of master budget either directly or indirectly. This is due to the reason that the total sales figure provided by sales budget is used as a base figure in other component budgets. For example the schedule of receipts from customers, pro forma income statement, etc.

In essence, the sales budget triggers a chain reaction that leads to the development of the other budgets. All other items in the master budget including production, purchase, inventories, and expenses, depend on it in some way. Sales budget is the first and basic component of master budget and it shows the expected number of sales units of a period and the expected price per unit. It also shows total sales which are simply the product of expected sales units and expected price per unit.

4.3.1 Purpose of Budgeting

The primary purpose of having a sales budget is to effectively and accurately determine the number of units that will need to be produced. Units can be used to refer to a physical product, or service. The budget is very important for the successful operation of the sales force. It serves several purposes as briefed below:

1. **Planning -** Corporations and their functional units develop objectives for future periods, and budgets determine how these objectives will be met. For example, alternative marketing plans, the probable profit from each plan and the individual budget for each will be considered before management is able to decide on future marketing programs.

   I*n* order to achieve goals and objectives of the sales department, a sales manager must outline essential tasks to be performed and compute the estimated costs required for their performance. A sale budgeting therefore helps overall costing and profit planning and provides a guide for action towards achieving the organizational objectives. It is through a detailed breakdown of the sales budget among products, territories, and customers that sales representatives learn what management expects of them.

2. **Coordination -** The budget is a major management tool for coordinating the activities of all functional areas and subgroups within the entire organization. For example, sales must be coordinated with production to ensure that enough products are available to meet the demand. The production manager can use sales forecasts and the sales department's marketing plans to determine the firm's revenues and expenses (for example, accounts receivable, inventory, and raw material, labor) and have enough capital to finance all business operations. However, some flexibility must be built into the budget so that plans may be changed in response to market conditions. Many companies allocate an amount lump sum to their sales managers, allowing the managers to invest in the selling activities dictated by the sales and marketing plans. Thus each sales group (for example, division, region, and district) has a budget. The process of developing realistic sales budget draws upon forward and backward linkages of selling with marketing and in turn brings about necessary integration within the various selling and marketing functions. It also establishes coordination between sales, finance, production and purchase functions. Thus, the budget enables sales executives to coordinate expenses with sales and with the budgets of the other departments.

3. **Evaluation or Control -** Allocation of budgeted funds gives management control over their use. Sales managers estimate their budget needs, are given funds to operate their units, and then are held responsible for reaching their stated goals by using their budgets effectively. As the sales program is implemented and income and expenses are actually generated, manager access results against the amount budgeted and determine whether they are meeting objectives.

   The budget also restricts the sales executives from spending more than their share of the funds available for the purchase of revenues. In sum, the budget helps to prevent expenses from getting out of control. *T*he sales department budgets become tools to evaluate the department's performance. By meeting the sales and cost goals set forth in the budget, a sales manager gives a dependable evidence of his or her success as an executive. The sales budget on adoption becomes the mark against which actual results are compared and performance evaluated. For example in the table below:

Table 4.2: Sales Variance and Analysis

	Budget (Rs.)	Actual (Rs.)	Variance Favorable	Variance Unfavorable
Sales	7000	8900	Rs. 1900	
Expenses				
Direct Selling	2500	2375	125	
Sales Promotion	1500	1650		Rs. 150
Advertising	997	1075		78
Administrative	875	775	100	
Total expenses	5872	5875		03
Profit (before tax)	1128	3025	Rs. 1897	

As is evident from the table above, the analysis of the factors causing variance enables the Sales Manager to quickly spot potential problem areas and plan for unexpected outcomes. The budget variance analysis approach thus helps in improving insights of sales manager and enables him or her to refine and develop realistic sales budgets in future with minimal variance.

4.3.2 Uses of Sales Budget

This is a very important document for a number of reasons. The sales budget has multiple advantageous uses and some of them are as below:

- The sales budget is the starting point in preparing the master budget.
- It is the basis of all operating activities in the sales department and in the production and finance areas.
- Having an effective financial plan in place helps management decide on inventory, pricing and allows them to set future goals to promote profitability.
- It is a benchmark for actual results. An effective sales budget is used to compare actual sales volume to revenue for a specific period. The result informs the organization which estimates missed the mark, and helps it to improve its accuracy in writing future sales budgets.
- It forms the basis for unit price increase and business campaigns. The sales budget can also offer insight as to how to manage price increases, and when to conduct marketing campaigns and promotions. An increase in demand for a product can be an opportunity for a price increase, after management's review and analysis of the sales budget.
- It is extremely important to do the best possible job of forecasting, since the information in the sales budget is used by most of the other budgets (such as the production budget and the direct materials budget). Thus, if

the sales budget is inaccurate, then so too will be the other budgets that use it as source material.

- A sales budget helps in attaining the sales forecasts and controls the expenditure of resources.
- It helps to monitor sales performance.
- They also help to maintain and improve the efficiency of sales operations.
- Sales budgets are developed for the smooth functioning of the sales function.

4.3.3 Budget Planning in Sales

The following are the major considerations for it:

- To create a sales budget, some assumptions have to be made about the future. If the business is running for few years, the sales and expense forecasts can be made on the performance in previous years. Projections are less predictable when the business is new. In this case, the company has to rely on the business plan and research into the state of the concerned industry to develop a realistic forecast.
- Various details should be included in the budget. Particulars like pay of all employees (sales staff) and management, advertising and marketing cost, and cost of goods, office overhead and transportation need to be included when assembling the expenses. Besides, the costs of any business loans to be taken in the coming year to finance company growth are also included. In order to develop a realistic income side to the budget, how much can be charged for the products or services and how much volume can be realistically sold in the current marketplace should be properly evaluated.
- Budget planning in sales should be performed for immediate use as well as for long-term planning. A one-year plan that drives the marketing projects and advertising campaigns in the short-term can be devised along with creating a longer-term, five-year budget to plan larger expenditures, such as taking on new lines of products, opening another location, going for consolidation or increasing the profits through staff expansion. A long-term budget plan helps to prepare for future expenditures and growth while continuing to increase revenues. At the same time, both the short- and long-term budgets should remain flexible enough to respond to changes. Part of the planning should include timelines and benchmarks or baselines upon which the progress can be audited in comparison to the budget and leave enough room to make adjustments as needed.
- It’s usually a wise step to underestimate the income when creating a budget as it is not easy to deal with shortages at the end of the year. It is better to include the financial staff in budget preparations rather than relying only on the estimates of sales force. Besides, the final budget may be cross checked by the accountant to ensure that it's realistic enough.
- Companies typically create an operational plan to increase sales. These activities may need more money than accounted for in previous budgets. Sales managers may need to review this plan with accountants during the budget process to ensure the expenditures are sufficient, in comparison with sales forecasts.

- Sales managers should submit a list of potential large-scale expenditures to owners and executive managers. Large organizations often set aside funds for items such as marketing campaigns, promotions or other sales events. Owners and executive managers spend these funds at their discretion, based on submissions from sales managers.

4.3.4 Types of Sales Budget

Sales executives are responsible for formulating three basic budgets namely:

1. **Sales budget** – A sales budget gives a plan showing the expected sales for a specified period in the future. This budget is kept for sales activities and is a detailed plan. It is developed based on expected revenue (sales forecast). It gives sales according to the geographic location or the product/service offering or salespeople or customers. Generally the first part of the master budget, it usually forms the basis for other operational budgets like finance and production.
2. **Selling expense budget** – Selling expense budgets details the schedule of expenses that may be incurred by the sales department to achieve planned sales. These are the salaries, commissions, and expenses for the sales force. This is not a difficult budget to develop. If the salespeople are on a straight commission, the amount of the revenue allotted for compensation expense will be determined by the commission rate. Experience usually indicates how much money must be set aside for expenses. If sales representatives are paid a salary, the process merely requires compiling the amounts, taking into consideration any raises or promotions to be made during the coming period. Any plans for sales force expansion also should be anticipated in this budget.

   The selling-expense budget must be closely coordinated with the sales budget. Suppose the sales budget calls for the introduction of a new product line that requires considerable retraining of the sales force and the addition of a new service department. The expense budgets must reflect those needs. What will it cost to accomplish each line in the sales budget? That is essentially the question the sales manager must answer in preparing the selling-expense budgets that will accompany the sales budget.
3. **Sales department administrative budget** – This budget is designed for expenses related to administrative purposes. In addition to having direct control over management of the sales force, the typical sales executive is also an office manager. Ordinarily, the staff includes sales department secretaries and office workers; the total staff can be large. There may be several assistant sales managers, sales supervisors, and sales trainers under the sales manager. Managers must make budgetary provisions for their salaries and their staff. They also must budget for such operating expenses as supplies, rent, heat, power and light, office equipment, and general overhead. These costs constitute the administrative budget.

4.3.5 Limitations of Budget

Discussed below are a few limitations of budgets:

- Due to the fact that many components of master budget rely on sales budget, the estimated sales volume and price must be forecasted with sufficient care and only reliable forecast techniques should be employed.

Otherwise the master budget will be rendered ineffective for planning and control.

- While having a sales budget is necessary, it also has its own set of limitations.
- It is unable to effectively forecast the future trends of events and thus cannot take this into consideration when making the budget.
- Additionally, preparing a sales budget is very time consuming, something not all managers will agree with.

4.4 Preparing Sales Budget

A sales budget is used as a guide in the overall business planning process to discern how much in sales is expected and what kinds of profits will be garnered from those sales. The sales budget is typically the first stage in preparing a master budget for a company. A sales budget should focus on the goals of the company while presenting a realistic picture of the financial impact of the sales. Creating a sales budget requires thinking about the current situation and where the company would like to be in the years to come. Some questions to take into consideration include:

- How much can the company realistically sell next year?
- How much will be charged for the goods or services?
- How much will it cost to produce the product?
- How much are the operating expenses?
- Is it required to hire employees? If so, how many, and how much will be paid to them?
- How much will be paid to self?
- How much tax will be paid?
- How much money is needed to be borrowed, and how much will the monthly loan payments be?

The key to answering these questions will be to reflect on the past performance so realistic figures can be used. It may even be wise to be conservative in the numbers so that a financial padding is available in the event something unexpected happens that may affect the business. The answers to these questions will guide the direction of the business and allow the formation of a realistic budget, forecast and expected expenses.

District sales managers prepare their district budget and submit it to the regional or divisional office where they are added to and included in the divisional or regional budget. In turn, these budgets are submitted to sales managers for the particular product or market groups. At the end of the chain of subordinate budgets, the top executives in the sales department scan and prepare a final sales budget for the company.

Resources have to be allocated to products, customers and territories. The budget should be realistic in order to maximize its favorable impact on the firm. An analysis of SLEPT (an acronym for social, legal, economic, political and technological factors) is undertaken before setting the budget. These factors are present in the environment and help in scanning the environment. Every budget proposal submitted to top management must remain in competition with proposals submitted by heads of other divisions. Actual budget control features go into operation as soon as the approved budget has been distributed to all units of the firm. Each item in the budget serves as a quota or standard against which performance is measured.

Example of the Sales Budget - 'XYZ' Company plans to produce an array of plastic rolls during the upcoming budget year, all of which fall into a single product category. Its sales forecast is outlined as follows:

Table 4.3 XYZ Company's Sales Budget For the Year Ended December 31, 2012

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Forecasted unit sales	5,500	6,000	7,000	8,000
x Price per unit(Rs.)	10	10	11	11
Total gross sales (Rs.)	55,000	60,000	77,000	88,000
- Sales discounts & allowances(Rs.)	1,100	1,200	1,540	1,760
= Total net sales (Rs.)	53,900	58,800	75,460	86,240

XYZ's sales manager expects that increased demand in the second half of the year will allow it to increase its unit price from Rs.10 to Rs.11. Also, the sales manager expects that the company's historical sales discounts and allowances percentage of 2% of gross sales will continue through the budget period.

This example of the sales budget is simplistic, since it assumes that the company only sells in one product category.

Table 4.4: Format of a Sales Budget (Quarterly)

Budgeted	*Actual*	*January*	*February*
March			
Expenses			
Salaries			
Commissions			
Bonus			
Medical			
Retirement			
Travel			
Lodging			
Food (Boarding)			
Entertaining			
Office expenses			
Mail			
Telephone			
Miscellaneous			
Promotions			
Samples			
Catalogues			
Pricelists			
Visuals			
Advertising			

Source: Professional Sales Management by Anderson, Hair and Bush

4.4.1 Strategies for Creating a Sales Budget

Sales teams employ a variety of strategies when creating their budget. They are:

Table 4.5: Strategies for Sales Budget

1.	Historical Base Strategy	• Some budget teams create a new budget by starting with the previous budget. • They may approach this budget by determining an anticipated percentage increase in sales during the budget period. • They apply this percentage to all of the sales from the previous budget by multiplying each sales amount by the percentage. • This determines the increase in sales. • Adding this increase amount to the original budgeted amount determines the total sales for the budget period. • This strategy is easy; however, the numbers created mean little in regard to the unforeseen events that may occur in the future.
2.	Sales Target Strategy	• Using a sales target strategy means that senior management determines what the total sales budget must be. • Under this approach, senior management states that the sales team must earn a targeted level of sales in the budget period. • The sales team divides this amount among the different product lines and then spreads it over the months in the budget period. • This strategy ensures that the sales represented in the budget meet the targeted sales level required by senior management. • However, it does not consider any economic or industry factors that may impact sales in the budget period.
3.	Product Push Strategy	• When company management plans to launch a new product line, they anticipate a specific level of sales for that product line. • Managers direct the sales team working on the budget to include this anticipated level of sales in the budget and direct resources toward reaching this level of sales, often at the expense of other products sold by the company. • When the sales team spends its resources on the product line being pushed by management, little time exists to focus on other areas. • Without adequate time invested in budgeting the sales for the other product lines, these product lines will lack realistic numbers. • This reduces the credibility of the entire budget.
4.	Industry Comparison Strategy	• Some companies approach sales budgeting by evaluating the events occurring in the industry. • The company acquires sales numbers from industry trade groups and government publications and uses this information to evaluate the potential sales of its own product lines. • This approach incorporates a perspective beyond the activities and goals of the company and also considers external factors. • Some information may not be readily available or detailed enough to use in this approach.

4.4.2 Methods of Sales Budgeting

A variety of methods ranging from the Sales Manager's gut feeling to the application of management science models are used for determining the sales budgets. These methods can be described as:

A. **Affordable Method -** Many companies set the promotion budget at what they think the companies can afford. This method is adopted by the firms dealing in capital industrial goods. Also, companies giving less emphasis to sales and marketing function or having small size operations make use of this judgmental method. So, the management develops sales budget depending on the ability to spend on sales function; such an estimate usually fall short of sales department's requirements.

B. **Rule of Thumb (percentage of sales) Method -** Most companies set their sales budget as a specified percentage of sales (either current or anticipated). Mass-selling goods and companies dominated by finance are major users of this method. In this method, the sales revenue is multiplied by a given %;

   Sales revenue = Past revenue / forecasted figure/ weighted average of both

C. **Competitor's Parity Method -** This method is adopted by large-sized companies whose products face tough competition and need effective marketing to maintain profits make use of this method. The knowledge of competitor's activities and resource allocation is important if an organization wants to pursue this method. It is based on budgeted figure of competitors or industry average and the competitor who is comparable in size and revenue is chosen

D. **Objective and Task Method –** The above methods do not take cognizance of the following organization's objectives in developing budget:

   - Identify objective with employees
   - Identify tasks for achieving objective
   - Expenditure required
   - Form budget

   Being a systematic method it helps in the determination of the sales budget by identifying the objective of sales function, and then ascertaining the selling and related tasks required to achieve each objective. Later, the cost of each task or activity is calculated to arrive at the total budget. The finalization of the budget may require adjustment both in the objectives as well as in the way the task may be performed.

E. **Zero based budgeting** – It is a relatively new approach to budgeting. It involves a process in which the sales budget for each year is initiated from Zero base thus justifying all expenditure and discarding the continuation of conventions and rules of thumb. This method suffers from practical limitations which relate to a very elaborate and time consuming process required by it.

In practice, companies make use of a combination of the above methods and depending upon the experience gained, sales budgeting approach stands refined. The status of the sales and marketing function within the organization determines the extent of sophistication used in the approach to sales budgeting. Whichever method is chosen, the actual amount budgeted will be based on the organization's sales forecast, marketing plans, projected profits, top management's perception of the sales force's importance in reaching corporate objectives, and the sales manager's skill in negotiating with superiors. Budgets are often modified several times before the final figures are determined.

4.4.3 Budgeting Process

An effective sales management budget process is critical for achieving sales goals. If the process isn't designed properly, sales budgeting will only be a futile exercise as opposed to a process that enables the sales team and related department to achieve their goals.

1. **Business Plan** - The sales management budget process should not begin until a draft of the business plan and supporting financials has been developed. Without understanding the overall plan for the business and available financial resources to support the plan, a good sales budget will be difficult to develop.
2. **Staffing** - A company or sales department should assemble a team to develop the sales management budget. The team should be led by the senior sales management executive from a top-down-direction leading perspective but should also include the lowest level in a sales organization such as a new salesperson. Those people should be involved who are in the front lines out in the field, calling on prospects, provides a real-life perspective of the budget creation process.
3. **Segmentation** - The team should prepare a sales management budget from multiple perspectives with all the numbers adding up for the same total. For example, the budget should be prepared by product, territory and salesperson. Each perspective should be validated. For example, in examining sales by salesperson, the team should examine a review of the past year's performance by salesperson to decide how realistic goals are for each individual. When examining budgeted sales by product, product availability should be examined.
4. **Contribution** - A sales management budget must also translate the forecasted sales into contribution to company overhead and profits. This helps assure that the right mix of products with the right profit margin is sold.
5. **Expenses** - The sales management budget process also includes budgeting expenses. One common approach for budgeting expenses is to review last year's expenses and adjust those expenses based on the coming year's forecasted sales and any additional expenses not incurred in the previous year. Another approach is zero based budgeting, which does not examine previous year's expenses but develops expenses with no assumptions. Such an approach often results in unnecessary expenses being eliminated and expenses being incurred where they can have the biggest impact.

4.5 Sales Budget Implementation and Feedback

Actual budgetary control features go into operation as soon as the approved budgets have been distributed to all units of the firm. Each item in the budget serves as quotas or standards against which management measures the unit's performance. In case of the actual performance showing the variance from the budgeted performance, two courses of actions are available to the organization.

To ascertain whether the variance is a result of poor performance by the sales group. In this case necessary steps should be taken to ensure that salespersons organize their selling efforts more carefully, so that budgeted performance can be brought back into line. To revise the sales budget by incorporating the changed allocation of the item. For example, if it is discovered that travel expenses have increased because of the necessity of calling on new customers not previously covered action should be taken to revise the budget to reflect changed conditions.

Salespersons are generally trained to be budget conscious. It is the responsibility of the sales manager to ensure that the sales revenue and cost ratios remain within reasonable budget limit.

Experience brings out the following main items on which variance between budgeted and actual costs often arise:

- Salaries and fringe benefits
- Direct selling expenses
- Maintenance of company vehicles
- Sales and other product/business promotional costs, and
- Promotional allowances including discounts, rebates, etc.

The sales manager must give attention in varying degree to each of the above and other items. It is wise to tighten control over expenses especially under circumstances when sales forecasts are not being met or sales budgets are being exceeded. A general attitude of caution before incurring an expense is considered prudent. For example, a leading FMCG company may have a norm that not more than forty percent of sales expenses budget will be spent unless more than fifty percent of the forecasted sales have been realized.

All shortfalls in budgeted sales that affect gross profit contribution must at least make a case for a thorough review of the sales and marketing programs of the firm. Researches reveal the causes of shortfalls as:

- Distribution problems
- Shift in market mood
- Competitive activity
- Wrong pricing
- Under-manning of sales staff or inexperienced sales staff
- Delays in new product launch, etc.

4.6 Strengths and Weaknesses of a Sales Budget

A sales budget is only as good as its assumptions, as it is difficult to forecast future trends and event. A sales budget takes the components of the selling process of a business to forecast sales, which ultimately determines the company's bottom line or operating profit. By its very nature, a sales budget requires management to make assumptions regarding various expenditures to achieve its targeted sales objectives. Developing a realistic sales budget is critical for management to properly allocate the company's resources, such as capital, staff and indirect labor. Before implementing the sales budget, the strengths and weaknesses should be analyzed and modify the budget as a result of the analysis.

- **Sound Logic -** There must be sound strategic reasons for expenditures, based on a clear understanding of how to reach target customers. It's not sufficient, for example, to say that advertising spending will be increased five percent over last year because that's the percentage increase always used. The cause and effect analysis has to be done. Post analysis it should be clear which marketing methods were most effective in generating new business.
- **Completeness -** A weakness in a company's sales budget could be that it underestimates the actual funds required to implement the chosen strategies and action plans. Adopting an underfunded budget may result in a profit shortfall because more money than forecast will have to be spent to implement the required action plans. The result could also be there won't be sufficient funds to implement all the action plans, which could have a negative impact on future sales. If a new strategy is being implemented for which there is no prior cost history, extra funds may be included to meet the possibility of underestimation of the cost of implementation.
- **Efficient Resource Allocation -** One of the most difficult parts of sales budgeting is determining which categories are the most important and should receive the most funding. This needs to be discussed in an open forum with inputs coming from all concerned people. This discussion allows everyone to contribute views and perspectives. The result should be a better-informed allocation of human and financial resources.
- **Sufficient Expenditures -** Another important test of the sales budget's strength is whether it is adequate to accomplish the strategic objectives. Advertising, for example, is more effective if done on a consistent basis. The consumer needs to see the ad several times in order to remember the message. For many firms, an increase in the sales budget can mean lower profits in the short term as marketing initiatives take time to gain a hold in the marketplace. But marketing expenditures fuel the growth of the business and help build a competitive advantage. Data from industry trade organizations about what the competitors in the industry spend on marketing can be studied to make sure that the expenditures are comparable.

4.7 Issues in Sales budgeting

There are several issues in budgeting and allocation which needs to be analyzed. Sales budgeting are mainly done at the macro level but the actions take place at the micro level. The top management allocates the budgets and may take the feedback from the local sales managers which again depend upon whether the organization follows a centralized or decentralized decision making process. There can be many other issues which the sales budgeting process has to look at. Some of them are:

- **Establishing the need for budget -** The budget would be established for different regions depending upon the need. Hence the sales manager should be able to establish the need for budgets. The sales managers at a branch level would best know the real activities of the sales process happens at the micro level i.e. at the branch level and the expenses in incurring the sales. The exact need of budget should be established by taking into account for all the expenses such as travel expenses, office rents and bills for electricity, phone lines etc. The budgets should be allocated at the local level by taking the feedback from the sales managers.

- **Having multiple views of the sales budget -** The sales budget created should clearly identify the sales from various dimensions such as:-
    - Sales by the region/ territory
    - Sales by the product or service
    - Sales by the sales representative

  Having multiple views will help in guiding if the expectations are not as per the sales forecast.

- **Identifying NPA's and planning the events -** Having created the sales budgeting from many angles like stated above enables the sales manager to identify the NPAs in his region/ territory. In sales non-performing assets are termed as NPT which stands for Non-performing territories. For example, the overall sales figure for the city is increasing but due to multiple views the sales manager can easily see that one of the territories in his region is showing a down trend in sales figures. Hence necessary action can be taken to improve the sales figure. It is understood in business world that a market leader will work to develop new territories and may leave the territories which are under performing whereas a market follower would safe guard existing underperforming territories and strive for development. The NPA can be the sales representative too if they are not able to attain their sales quotas. Hence, the sales manager can identify such representatives and take necessary action to improve their productive levels.

- **Monitoring the forecasted figures to the actual sales -** Most of the companies divide the yearly forecast figures into monthly sales which could be attained by the sales representatives if they achieve their assigned quotas. But there would be chances that the forecast may go wrong and the quotas set were not realistic. In such cases it is always important to monitor the actual sales figures with the forecasted sales figures at regular intervals. Sales manager may use the variance analysis technique like ANOVA to check the variance.

- **Time interval for monitoring sales budgets -** The time interval to check for variance and sales budgeting depends upon the sales manager and may be done daily or weekly or monthly or quarterly or half yearly or yearly. However one must understand that too frequent monitoring may result in wastage of time and money on trivial or uncontrollable factors. On the other hand, too loose monitoring process may result in lower performance levels.

4.8 Summary

The sales planning process helps in achieving the sales in a profitable manner. It consists of several elements. The selling objective deals with setting realistic and attainable objectives which the sales team would work for. Sales policies, procedure and rules help the sales representatives to handle day to day situations in sales. Sales program provides the necessary training needs to develop the required skill set to make the sales. Sales planning process varies for B2B and B2C markets and hence there are different processes which need to be performed to manage the sales in these markets. Handling distribution channels, warehouse, retail stores and price changes are very important to ensure sales in a profitable manner. The sum of money required over a specified period to run a sales department is the sales budget and how much money should be spent on the sales function is the foundation of a sales budget. The sales budget is a statement of revenues and costs. It is one of the control devices available with the management which also helps in sales planning, and acts as a standard of performance. While sales budget acts as a tool of sales force evaluation and control, it is important to have continuous monitoring and control of the total sales function. Sales control is a function of sales management for ensuring that operations are carried out as per plan to achieve the sales objectives. Thus budget and control complement each other in the implementation of the sales program.

4.9 Self-Assessment Questions

1. What is a sales budget?
2. Identify various issues in sales budgeting
3. Illustrate the importance of sales policies, program and rules in the sales planning process.
4. What is the need of having a flexible sales budget?
5. What is the role of budget-setting in achieving the actual sales target?
6. What are the components of sales strategy?
7. How is sales planning different in B2B and B2C markets? Discuss in detail.
8. Write short notes on the following:
    - Methods of sales budgeting
    - Types of sales budgets
    - Determination of strengths and weaknesses of a sales budget
    - Implementation and feedback mechanism
    - Uses of budget
9. Write a short note on the following:
    - Barriers to planning
    - Limitations of budgeting

4.10 Reference Books

- Anderson, R.E., J.F. Hair, and A.J. Bush, 'Professional Sales Management' McGraw Hill Publications, 3rd edition, 1999, New Delhi.
- Lancaster G. and D. Jobber, 'Selling & Sales Management' Pearson Education, 8th edition, 2009, New Delhi.
- Churchill, G.A., N.M. Ford, and O.C. Walker, 'Sales Force Management', McGraw Hill Publications, 2009, New Delhi.
- Cundiff, E.W., R.R. Still, and N.A.P. Govoni, 'Sales Management – Decision, Strategies and Cases', Pearson Education, 5th edition, 2009, New Delhi.
- Manning, G.L., and B.L. Reece, 'Selling Today – Building Quality Partnerships', Pearson Education, Inc., 8th edition, 2002, New Delhi.
- Spiro, R.L., W.L. Stanton, and G.A. Rich, 'Management of a Sales Force', Tata McGraw Hill Publishing Co. Ltd., 11th edition, 2003, New Delhi.
- Tyagi C.L., and A. Kumar, 'Sales Management', Atlantic Publishers and Distributors, 2004, New Delhi.
- Saxena, R., 'Marketing Management' Tata McGraw-Hill Publications, 3rd edition, 2006, New Delhi.
- Vashisht, K., 'A practical approach to sales management', Atlantic Publishers and Distributors, 2006, India.
- Honeycutt, E.D., Ford, J.B., and A. C. Simintiras, 'Sales management: a global perspective', Rutledge, 2003, New York.
- Johnston, M.W., and G. W. Marshall, 'Sales Force Management', Tata McGraw Hill, 9th edition, 2009, New Delhi.

Unit – 5 : Sales Forecasting

Structure of Unit

5.0 Objectives

After reading this unit, you shall be able to:

- Understand the meaning, importance, and usage of sales forecasting;
- Know the process of sales forecasting;
- Understand various qualitative and quantitative techniques of sales forecasting and their application;
- Learn the errors that can occur while conducting sales forecasting and the limitations of forecasting;
- Understand the principles governing sales forecasting.

5.1 Introduction

The world and the markets are undergoing a change at an unprecedented speed. We have reached today in the world of supermarkets, internet sales, with highly competitive products coming out in the markets on a continuous basis. In such a scenario, establishing a strong market presence is not an easy task. Companies are continuously involved in taking decisions regarding product planning, resource planning, financial and operational planning. Sales forecasting provides an important input for such decision making. It is an integral part of business management. Without predicting the sales for the future, one can’t manage, sustain and plan for the future growth. Intelligent business decisions can be made only through accurate sales forecasting. Although, sales forecasting has become very complex and difficult because of various dynamic factors which affect the market, yet on the other hand, the availability of a number of techniques and software has facilitated forecasting and its widespread use. Companies, big or small, domestic or multinationals, single product or multi-products are all trying to use this tool to their maximum advantage and, thereby, create a strong market space for themselves.

5.2 Meaning and Definition

Before we take up sales forecasting for discussion, it is important that we understand the meaning of two important terms namely market potential, and Sales potential

Market potential is an estimate of the:

- **Maximum** possible sales opportunities present in a particulars market segment.
- Open to **all** sellers of good/service.
- During a **stated future period.**

For example, sales of low priced cameras that might be sold in India during the calendar year 2014 by all sellers irrespective of a particular brand would represent market potential.

Sales Potential is an estimate of the:

- Maximum possible sales opportunities present in particular market segment.
- Open to a **specified company** selling a good or service.
- During a **future stated period**.

For example, sales of low priced cameras that might be sold in India during the calendar year 2014 by Eastman Kodak Co. would represent sales potential of the above company.

Now we define **Sales Forecast**. Sales forecast is an estimate of sales:

- in physical units
- in a future period
- under a particular marketing program
- and an assumed set of economic and other factors outside the unit for which the forecast is male.

Hence, we see that sales forecast are often viewed within the context of total market potential. Whereas, market potential relates to the total capacity of the market to absorb the entire output of a specific industry, sales potential, on the other hand, is the ability of the market to absorb or purchase the output from a single firm.

In very simple words – Sales forecasting is the process of estimating what will be the business's sales in the future.

In the words of **Henry Fayol** – "To foresee means both to assess the future and make provision for it. According to **Robert Albanese** – The sales forecast is one of the major planning premises in business organizations. It is the result of numerous assumptions made about the external and internal environments of the firm. In the words of **Philip Kotler** – Sales forecast is the expected level of company sales based on chosen marketing plan and assumed marketing environment.

Sales forecasting of an established business is easier than that for a new business. For an established business, the past sales combined with present economic and market scenario work well for predicting a business sale in future. Whereas, a new business has no past sales baseline. Hence, it requires researching the target markets, trading area and the state of competition to guesstimate future sales.

5.3 Need for Forecasting

There is often a debate about the accuracy of forecasts. And on that premise some might feel that there is no need of forecasting as it is time consuming, doesn't add value to the product directly and of course, the most important reason being that they are wrong. It is absolutely OK for companies **to not take to** forecasting if

- They have enough time to buy material, make the product and ship it after the procurement of customer orders.
- They can add or reduce capacity very economically.
- The owners of the business do not require forward financial planning.

The above three conditions are not found in practical world and hence, companies cannot do away with forecasting. Hence, every kind of company needs to forecast. And the above reasons are strong enough to prove the need of forecasting in all kinds of companies.

Table 5.1: Need for Sales Forecasting

1) Meeting customer demand such that there is neither excessive inventory, nor stock out situations.	• Producing for stock – Forecasts about purchase of raw material made formally or informally based on past history. • Producing for order – Predict future sales and undertake production, planning and scheduling.
2) Change capacity which requires that equipments and workforce are efficient and effective enough for smooth and cost effective functioning of the organization.	• When labour is key factor – Forecasting is essential to hire and train people in the lead time. • When equipment is key factor – Forecasts are essential for equipment upgrading replacement etc.
3) Financial Planning is essential to attract investors, acquire loans.	• Projections regarding income, expenses, benefits investments, cash flow, asset levels and so on, are important.

5.4 Importance of Sales Forecasting

Sales forecasting is important due to the following implications:

1) It helps in evaluation of past and current sales levels and annual growth.
2) Comparison of one's own company to industry benchmarks is possible.
3) It helps in establishing policies to monitor prices and operating costs.
4) It also enables a company to detect minor problems before they become major problems.
5) Companies that implement accurate sales forecasting processes realize important benefits such as:
   - Optimized cash flow
   - Knowing when and how much to buy.
   - In – depth knowledge of customers and the products they order.
   - The ability to plan for production and capacity.
   - The ability to identify the pattern or trend of sales.

- Determine the value of a business above the value of its current assets.
- Ability to determine the expected return on investment.

Planning

- Production levels
- Inventories
- Operational planning
- Budgeting
- Sales force planning
- Product planning

Determine

- Sales Quotas
- Training needs
- Purchase quantity policies
- The profit and market share in future

Sales Forecasting

Formulate

- Sales plans
- Promotional

Assist

- Research & Development

Figure 5.1: Importance of Sales Forecasting

5.5 Factors Affecting Sales Forecasting

Sales forecasting is the basis for a number of decisions ranging from tactical ones to strategic decisions. A host of factors & affect sales forecasting – both internal, as well as External. For forecasting to be more precise and accurate, a company needs to consider all of the following factors:

(a) Internal factors - The factors internal to the organization which can have a bearing on the volume of expected sales in future can be discussed as follows:

- **Labour problems** – It can have an adverse impact on the production levels and thereby affect future sales.
- **Credit policy changes** – If the credit policy is made liberal sales can be affected positively and vice- versa.
- **Sales motivation plans** – Sales force of any company has a direct relationship with its sales. Hence, a motivated sales force can add up to sales and market share.

Figure 5.2: Internal factors affecting Sales Forecasting

- **Inventory changes** – The position of inventory also has an impact on sales of a company. Over stocking and under stocking, both affect the sales adversely.
- **Working Capital shortages** – Can again lead to irregular and fluctuating production, which in turn affect sales.
- **Price changes** – in raw material and other inputs lead to cost escalations which can again have an impact on sales.
- **Changes in distribution method** – Every channel of distribution has its own advantages and disadvantages changes in distribution system can affect sales and the state of competition.
- **Changes in production capacity** – When production capacity increases/ decreases, sales will be affected because of production volumes and costs. Hence forecasting becomes difficult.
- **New Product lines** – When new product lines are added, sales might not be easily predicted.

Internal factors are controllable factors and hence organizations can have a bearing on them and can use them to not only predict sales but also impact sales.

Figure 5.3: External Factors Affecting Sales Forecasting

(b) External factors - Just as internal factors affect sales forecasting, external factors also have an impact on sales forecasting. They are as follows:

- **Seasonality of business** – When business is of a seasonal basis, sales are also irregular and hence forecasting is more difficult.
- **State of the economy** – Sales have a direct co-relation with the state of economy. When the economy is in depression, sales do not pick up so easily.
- **Direct and Indirect Competition** – When the competition is direct, sales can be forecasted easily in comparison to when it is indirect.
- **Political events** – In case of political uncertainly sales forecast is a difficult task.

- **Styles / Fashion** – If the product is a stylish or a fashionable product, its life cycle is much shorter and hence sales forecasting is more complex and difficult.
- **Consumer earnings** – When the income of consumers increases, sales also increase.
- **Population changes** – The changes in demographic pattern of the population has a direct relation with sales. When the population has a geographical shift (from rural to urban) or younger population is higher in percentage, sales rise proportionately.
- **Weather** – Sales forecasting is also affected by trends due to change in weather conditions.
- **Productivity changes** – Increase/ Decrease in productively of the organization also impact sales forecasting.

5.6 Process of Sales Forecasting

Sales forecasting is a process – but not a physical one, such as building a product or packaging and shipping it. It is an informational and decision making process.

Processes have inputs, a conversion phase and outputs. When talking about forecasting the three elements in the forecasting process can be studied as follows:

INPUTS → CONVERSION → FORECASTS

1. People
2. Forecasting Software
3. Structured Steps

Figure 5.4: Process of Sales Forecasting

Let us look at these three elements in the forecasting process:

I. **People** - The people involved in forecasting process have to take some important decisions by which the magnitude and direction of the forecasting is clearly defined. These decisions are –

   - **Forecast frequency** – Depending on the purpose of forecast, frequency of forecast varies. For formal review and update, the most commonly used frequency is once per month. When demand changes more frequently, then even mind forecasts have to be done. Some companies, on the other hand, who excel at Continuous Replenishment (CR) update their 'forecasts' a number of times per week.
   - **Forecast interval** – The gap between two consecutive forecasts is its interval. Companies can use weekly forecasts to monthly ones to project future sales.
   - **Forecast horizon** – Although companies are involved in 12 monthly projections, they should prefer 15 months time horizon for making the budgeting process a lot easier and more routine.

Although for some companies like aerospace or chemicals go out for three years because they require longer lead times for facilities, equipment, materials and highly trained people. Some might need even more longer projections than this.

II. **Forecasting software -** The second component of the forecasting process is software. The ABC approach applies to the forecasting process –

The C item is the computer software and hardware

Essential, but not critically important item. Used for statistical projections & handling data.

The B item is the data

The validity and utility of the input data is of more significance than the computer.

The A item is the people

The success of a forecasting improvement initiative will depend almost totally on the people: their dedication, their willingness, their knowledge.

III. **Structured steps** – The third element, structured steps in the forecasting process is important, because, these steps are the vehicle for the people – An item – to do their jobs. The sales forecasting process contains the following steps -

(1) **Determination of Goals -** The sales manager should decide the goals for sales forecasts. These objects may include –

- Determination of sales publicity programme,
- Marketing methods,
- Sales quota determination,
- Estimation of working capital requirements, and
- Estimation of income and expenditure, etc.

Clarity in goals set the right direction for sales forecasting process.

(2) **Determining the factors affecting sales -** Identifying and analyzing the controllable and uncontrollable factors scientifically will help in assessing their impact on future sales. The controllable factors are basically internal to the organization, whereas, the uncontrollable ones are mostly external.

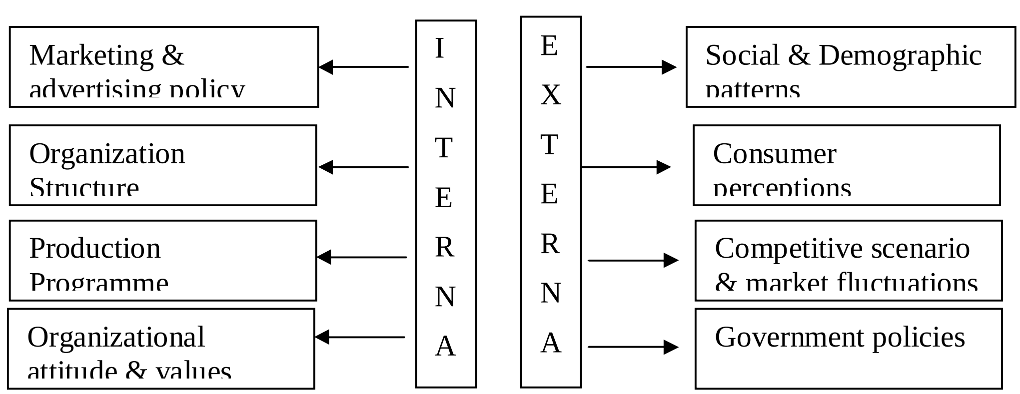


Figure 5.5: Determination of factors affecting Sales

(3) **Selection of Techniques -** Suitable methods for forecasting sales must be selected keeping in view the sales objectives, time intervals, resources of the firm and the nature of the product. The manager should ensure that the informations gathered are sufficient and collected from reliable sources.

(4) **Collection of Data -** Field research and motivation research are conducted to obtain relevant information for estimating future demand. A study of consumer behaviour as to know about the consumer profile – that is who the present consumers are, who can be in the future, what they buy, why they buy, when and from where they buy, is of utmost importance. On this basis, market potential can be determined. This is the next step in the process.

(5) **Analysis of Market Potential** - Analysis of market potential requires a two-step process.

(i) Select the market factors associated with product's demand.

(ii) Eliminate those target segments that do not contain prospective buyers of the product. The sales manager should ensure that the information gathered is sufficient, before doing analysis.

(6) **Forecasting of Future Sales** - Sales projections should be made on the basic of analysis done. A company may make a forecast for an entire product line or for individual items within the line. Sales may be forecasted for a company's total market or for individual market segments. After determining the market or sales potential for a product or service, management can make a sales forecast.

(7) **Converting Industry Forecast to Company Sales Forecast -** Many companies forecast both their own sales and sales of the industry. The general practice is to forecast industry sales early in the procedure and from it derive a company sales forecast for use as a check against forecasts arrived at through other methods. Deriving a company sales forecast from an industry sales forecast requires an appraisal of company strengths and weaknesses against those of competitors. The result is an estimate of expected market share that results in a forecast of company sales.

(8) **Making Operational Programme and the Budget -** After the sales forecasts have been made, budgets are made. The requirements of various operational activities such as production, purchasing, marketing, capital assets, work forces etc. are met with if the budget estimations are correct. If the sales forecasts have large deviations from actual sales, then the budgets might need revisions.

(9) **Deriving Sales Volume Objective -** A sales forecast (1) contains an estimate of sales tied to a proposed marketing plan or programme and (2) assumes a particular set of economic and other forces outside the unit for which the forecast is made. The sales forecast estimate does not necessarily become the company's sales volume objective, but it provides an orientation point for management's thinking. Further adjustments in the sales forecast estimate are necessary whenever management decides to alter its marketing plan or programme or changes occur in competitor's marketing strategies.

(10) **Evaluation and Revision of Forecasts -** Every forecast contains elements of uncertainty. All are based on assumptions. So a first step is evaluating a sales forecast is to examine the assumptions on which it is based. The company should review the forecasting process periodically. The first step in the review is to determine the accuracy of past forecasts to learn if changes are needed in the way forecasts are made. If the company finds that sales forecasts are significantly different from actual sales in the period, it should undertake a review of the sales forecasting process before making any more forecasts.

The evaluation process then should review the data used in sales forecasting Poor data collection methods can decrease the quality of the data used for forecasting, or the data may be inappropriate for forecasting sales of the product. Forecasts should be checked against actual results, differences explained, and indicated adjustments made for the remainder of the period. When the period's sales results are all recorded, all variations should be explained and stored for future use in improving forecasting accuracy.

5.7 Approaches to Sales Forecasting

William J. Stanton, Etzel and Walker have described two types of approaches to sales forecasting. These are a follows:

1. **Top-down Approach**: A company can forecast sales by using top-down approach. Using this approach, management needs to :
   (a) Develop a forecast of general economic conditions.
   (b) Determine the market potential for a product.
   (c) Measure the share of this market the firm is currently getting or plans to capture.
   (d) Forecast the firm's sales of its brand of the product.
2. **Bottom-up Approach**: In bottom-up forecasting, management follows a two-step procedure :
   (a) Generate estimates of future demand by acquiring information from segments of the market or from organizational units (salespeople or branches) in the company.
   (b) Add the individual estimates to get one total forecast.

5.8 Techniques of Sales Forecasting

Sales forecasting method is a procedure for estimating how much of a given product can be sold if a given marketing programme is implemented. No sales forecasting method is full-proof. Well-managed companies do not rely upon a single sales forecasting method but use several. The methods can be placed in three general categories and the ones that are more widely used are discussed as under:
These are discussed below:

I. Survey Methods - Survey methods rely on the opinions of expert, such as salespeople, sales executives, and the customers who will be making purchase decisions.

1. **Executive Opinion** – It consists of obtaining the views of top executives regarding future sales – views that may or may not be supported by facts.

Some executives may have used forecasting methods to arrive at their opinions. Others may have formed their estimates largely by observation, experience, and institution. The forecasts made by the executives are averaged to yield one forecast for all executives, or the differences are reconciled through discussions among executives. If these are informed opinions, based on valid measures such as market-factor analysis, then executive judgment can produce accurate forecasts.

2. **Delphi Method** – This is specialized form of 'executive opinion'. According to William Stanton the Delphi method begins with a group of knowledgeable individuals anonymously estimating future sales. Each person makes a prediction without knowing how others in the group have responded. These estimates are summarized, and the resulting average and range of forecasts are fed back to the participants. Now, knowing how the group responded, they are asked to make another prediction on the same issue. Participants may change or stick with their original estimates. This process of estimates and feedback is continued for several rounds. In some cases – and usually in sales forecasting – the final round involves face-to-face discussions among the participants to produce a sales forecast consensus.

3. **Sales – Force Composite** – This method is based on collecting an estimate from each salesperson of the products they expect to sell in the forecast period. The estimate may be made in consultation with sales executives and customers and based on the salesperson's intuition and experience. The individual forecasts are then aggregated to yield an overall forecast for the firm. This method is sometimes termed as 'grass-root' approach.

4. **Surveys of Buyer Intentions** – This method consists of contacting potential customers and questioning them about whether or not they would purchase the product at the price asked. Sometimes this is referred to as the market research method. For industrial products, where there are fewer customers, such research is often carried out by the sales-force on face-to-face basis.

   Some firms maintain panels of consumers for use in such surveys. Sales people may be asked to survey customers regarding their future buying intentions.

   This method is probably most accurate in forecasting demand when (1) there are relatively few buyers in the target market, (2) these buyers are willing to express their buying intentions, and (3) their past record shows a consistent relationship between their actual buying behaviour and their stated intentions.

5. **Product Testing and Test Marketing** – This technique is of value for new or modified products for which no previous sales figures exist and where it is difficult to estimate likely demand. It is therefore prudent to estimate likely demand for the product by testing it on a sample of the market beforehand. It involves the limited launch of a product in a closely

defined geographical test area. Test market results can be grossed up to predict the national launch outcome.

II. **Mathematical Methods -** Mathematical methods apply mathematical and statistical techniques to historical data to forecast sales. These include the following:

1. **Moving Average Technique** – The simplest way to forecast sales is to predict that sales in the coming period will be equal to sales in the last period and it assumes that the conditions in the last period will be the same as the conditions in the coming period. It is likely, however, that the factors affecting sales change from period to period. Hence, it makes sense to take an average of sales from several periods to construct the sales forecast for the coming period. In the moving average technique the sales of the designated periods are summed and then divided by the number of periods to yield the average.
2. **Exponential Smoothing Models**: This is a statistical technique for short-range sales forecasting. It is a type of moving average that represents a weighted sum of all past numbers in a time series, with the heaviest weight placed on the most recent data.
3. **Regression Analysis**: This technique is often used to project sales trends into the future. In this method, sales totals are plotted for each past time period. This technique is a statistical process. It determines and measures the association between company sales and other variables. There are three major steps in forecasting sales through regression analysis :
   (1) Identify variables casually related to company sales.
   (2) Determine or estimate the values of these variables related to sales.
   (3) Derive the sales forecast from these estimates.

   Where sales are influenced by two or more independent variables acting together, multiple regression analysis techniques are applied. Computers make it easy to use regression analysis for sales forecasting.

4. **Projection of Past Sales** : The projection of past sales method of sales forecasting takes a variety of forms :
   (a) One is to set the sales forecast for the coming year at the same figure as the current year's actual, sales or
   (b) The forecast may be made by adding a set percentage to last year's sales, or
   (c) It may be a moving average of the sales figures for several past years.

   Time series Analysis, Market Factor Analysis, Correlation Analysis, and Z charts are other few techniques which can be used to forecast sale depending upon the purpose of the forecasts.

III. **Operational Methods -** Operational methods take information about the company's capacity and financial requirements to derive sales forecast. A few operational techniques which are used are – 'Must do' calculation, capacity based forecasts, Econometric model building, simulation, diffusions models etc. The choice of the technique will depend on the **purpose**, **cost**, **time** and **urgency** of the forecast.

5.9 Principles of Sales Forecasting

Sales forecasting is undoubtedly a difficult and challenging task. A few guiding principles that can enhance the accuracy of sales forecast are as follows:

i) **Choose the right method and basis -** Forecasts can be either based on products or geographical location. Depending on the nature of product and competition, right forecast method and basis should be chose.

ii) **Use more than one method** – using more than one method can improve the accuracy of a sales forecast.

iii) **Minimize the number of market factors** – Including greater number of market factors result in confused sales forecast, because it becomes difficult to determine exactly what affects the demand for a product.

iv) **Recognize the limitations of forecasting** – For some products – say innovative and highly competitive products, forecasts are difficult; similarly, for products which have variable demand, forecasting becomes more complex.

v) **Use the minimum / maximum techniques -** Sound research strategy dictates the use of both minimum and maximum estimates in all computations in order to obtain a range of variations.

vi) **Understand Mathematics and Statistics** – Sales forecasting makes wide use of mathematics and statistics hence understanding of statistical and mathematical techniques is important to avoid any errors.

5.10 Limitations of Sales Forecasting

Despite the use of statistical and mathematical techniques used in sales forecasting which makes it quite accurate, sales forecasting has its own limitations:

i) **Lack of Sales History** – For new products there is lack of past sales data; hence it limits the accuracy of the forecast.

ii) **Change in Business Environment** – Changes in business environmental factors like income, price, demand, supply etc. brings about changes in sales forecasts and if these changes are fluctuating, forecasting becomes difficult.

iii) **Change in Consumer Behaviour** – Similarly, change in consumer preferences, habits, consumption patterns, attitudes and needs, also impact sales forecasting and its degree of accuracy.

iv) **Lack of Facts and Data** – Inaccurate data and incomplete facts hinder the process of sales forecasting and can have incorrect forecasts.

v) **Based on Assumption** – Sales forecasting is based on certain assumptions, and if these assumptions are over or under optimistic, it can lead to inaccurate sales forecasting.

vi) **Availability of Substitute Products –** When the substitute products are available in plenty, sales forecasting becomes complex and difficult.

vii) **Uncertain growth rate –** Since the business environment has become very dynamic and complex, resulting in fluctuating demand, investments, and income levels. Hence, correct sales forecasting has become difficult.

viii) **Higher Cost –** For smaller firms it is not viable to use sales forecasting techniques due to high cost of statistical and mathematical techniques.

ix) **Changing demand and changes in consumer** preferences, consuming habits leads to lot of changes in demand, hence making sales forecasting difficult.

x) **Influence of Psychological factors –** Psychological factors such as attitudes, perceptions, personality, life styles, self concept etc. are difficult to assess and measure. And since these form an important input to sales forecasting, reliable and accurate forecasting becomes difficult.

xi) **Complex Techniques** – The techniques used in sales forecasting are complex and difficult making the process of sales forecasting a tedious and complex one.

xii) **Lack of trained forecasters** – Lack of efficient, trained and experienced forecasters can have adverse impact on sales forecasting.

If these limitations are taken care of, the chances of occurrence of errors in forecasting can be minimized.

5.11 Summary

Forecast is a prediction or estimation of a future situation, which tries to indicate the level of activity which might be realized under given conditions. Sales forecasting consists of judgment applied to information to produce an expectation. Judgment can be applied at various levels of the company's management and in various ways. Market potential for a product is the expected sales volume for all sellers of that product to an identified customer group during a specified period of time in a given market. Sales potential is the maximum sales possible for a firm's product as the firm's marketing effort increases relative to competitors. Thus it is the ratio of a firm's sales to the total industry sales. Short-term forecast is a prediction for a period of a year or less. It is concerned with daily operations within the limits of resources currently available. Long-term forecast covers a forecast for more than one year. It is concerned with extending or reducing the limits of resources. Direct methods of forecasting attempt directly to assess the consumer intention. Indirect methods are based on statistical techniques, where relationship between variables is ascertained which indicate the potential position of sales. Survey approach is a forecasting technique in which the customers are asked to indicate the products and amounts they expect to purchase in a future period. Executive opinion is a method of forecasting whereby views of top executives concerning the products to be forecast are collected are collected and combined. Sales-force composite is a method of sales forecasting where forecasts are made on the basis of the opinion of the sales force. Delphi method is a sophisticated method of measuring and manipulating judgments about the future sales.

Controlled market experiments is a method of forecasting where a firm may conduct the experiments in the actual market by varying the determinants of demand like price, advertising, etc. in order to assess their impact on sales. Trend analysis based on past experience attempts to make a projection into the future by using several years rather than one year's experience. Moving average is simple method of forecasting where forecasts are made by projecting moving average. Exponential smoothing method like weighted moving averages emphasizes recent data and discounts old information. Regression analysis attempts to find out the unknown value of an item from the known value of another item.

5.12 Self Assessment Questions

1. Define Sales forecasting. What are its major characteristics and significance?
2. What do you understand by short-term forecast? How does it differ from long-term forecast?
3. Identify and examine the factors that generally influence sales forecasting in contemporary business.
4. What is the process used for sales forecasting. Write a step by step procedure.
5. Write a short note on –
   (a) Approaches to Sales forecasting.
   (b) Limitations of Sales forecasting
6. What are the major sales forecasting techniques? Write a descriptive note commenting on their merits and limitations.
7. Explain Delphi method of sales forecasting. How does it differ from executive opinion?
8. What are the guiding principles that should be kept in mind while forecasting?

5.13 Reference Books

- Anderson, R.E., J.F. Hair, and A.J. Bush, 'Professional Sales Management' McGraw Hill Publications, 3rd edition, 1999, New Delhi.
- Lancaster G. and D. Jobber, 'Selling & Sales Management' Pearson Education, 8th edition, 2009, New Delhi.
- Churchill, G.A., N.M. Ford, and O.C. Walker, 'Sales Force Management', McGraw Hill Publications, 2009, New Delhi.
- Cundiff, E.W., R.R. Still, and N.A.P. Govoni, 'Sales Management – Decision, Strategies and Cases', Pearson Education, 5th edition, 2009, New Delhi.
- Manning, G.L. and B.L. Reece, 'Selling Today – Building Quality Partnerships', Pearson Education, Inc., 8th edition, 2002, New Delhi.
- Spiro, R.L., W.L. Stanton, and G.A. Rich, 'Management of a Sales Force', Tata McGraw Hill Publishing Co. Ltd., 11th edition, 2003, New Delhi.

Unit – 6: Quotas and Territory

Structure of Unit

6.0 Objectives

After completing this unit, you would be able to:

- Understand the concept and purpose of Sales Quota;
- Know about Types of Quotas;
- Learn the methods of setting Sales Volume Quotas;
- Develop insights into requisites of a successful sales quota;
- Know the purpose and reasons for establishing sales territories;
- Develop insights into essential requirements of a good sales territory.

6.1 Introduction

Sales quotas assist in planning, evaluating and monitoring sales force activities. While establishing sales quotas, the sales head considers the objectives and strategies devised in the marketing plan. The quotas can be stated in rupees, product units, net profits or activities related to sales. The time period for the quota varies from a month, a quarter, six months to a year and sometimes maybe for a week in certain cases. A quota is set for individual products, types of customers and geographical area. Sales quotas assist in effective implementation of strategic plans, guiding sales representative activities and evaluating sales force performance. Monthly or quarterly quotas are used for rewarding salespeople while performance evaluation is possible through annual quotas. **John P. Steinbrink** states, "The quota is the lifeblood of a business and serves both as a goal and as a means of measuring the performance of a company in relation to that goal."

6.2 Sales Quotas

Sales quota is the estimated value or volume of sales expected to be achieved by the sales personnel over a given period of time. Sales quotas are set for salesmen, marketing unit or territory. According to **Paul H. Nystrom**, "A sales quota is a part of a company's total estimates sales assigned to a salesmen, a territory, a branch, a distributor or dealer or to some other selling unit, as a goal to be attained in a designated future period of time." According to **Still, Cundiff and Govoni**, "Sales quotas are quantitative objectives assigned to sales personnel and other units of the selling organization." According to **Philips Kotler**, "A sales quota is the sales goal set for a product, company, division or sales representative." According to **Stanton, Spiro**, "A sales quota is a performance goal assigned to a marketing unit for a specific period of time." It is evident from these definitions that quotas are quantitative goals assigned to sales force in a particular territory during a specific period of time.

6.2.1 Purposes of Sales Quotas

Well-established sales quotas help in effective implementation of the strategic plans. According to **Stanton and Spiro** they are significant and serve many valuable purposes as shown in Figure 6.1

Figure 6.1: Purposes of Sales Quotas

- **To indicate strong or weak spots in the selling structure:** The extent of territorial development can be gauged by whether the quota has been achieved or not. Sales performance varies product by product, sales personnel by sales personnel, territory by territory and quotas help identify the strong and weak points but further analysis of performance data is required for uncovering reasons for performance differentials. If sales significantly exceed the pre-determined targets, companies analyze the reasons for variance and similarly, if sales fail to meet the quota, firms analyze what went wrong. Reasons for failure and success can be evaluated. The failure to meet the quotas, must have happened because of competition, over-estimation of market potential or under-performance by sales force.

- **To furnish goals and incentives for the sales force:** Sales relative to quotas is the most prevalent performance criterion for judging salesperson performance. With a measurement standard, sales representatives are better guided to perform their activities and achieve goals. **Dalrymple and Cron** state, "Achievement-oriented people want specific and challenging goals, with regular feedback on their performance. Sales quotas perform this function."

- **To control salespeople's activities:** Quotas help firms manage sales force performance more effectively as with the assistance of appropriate type of quota, sales managers can motivate sales force to undertake certain activities such as calling on new accounts, building displays, selling high ticket items, etc The sales representative sometimes maybe unclear about which activity to focus on unless stressed by management.
- **To evaluate productivity of salespeople:** Quotas act as a tool to measure the performance of the salesperson as it provides targets to the salesperson. Quotas provide a yardstick, against which the actual performance is compared to comprehend whether the sales representative is performing well or not. Quotas also provide a means for deciding which retail outlet or units/branches of the sales organization are contributing above-average or below-average.
- **To improve effectiveness of compensation plans**: Quotas play an important role in sales compensation system. Quotas bring in incentives for salespeople who are remunerated through straight salary. Sales representatives are well aware that a worthwhile performance in quota achievement reflects favorably on appraisal and salary reviews.
- **To control selling expenses:** Profitability and expenses are more tightly controlled through quotas. Organizations many times encourage expense control by establishing expense quotas alone, without clubbing them to the remuneration plan. Sometimes companies set rupee expense quota and appraise salesman partially by their accomplishment in staying within assigned expense limits.
- **To evaluate sales contest results:** Organizations usually use performance against quota as the core basis for rewarding in sales contests. With all the participants feeling they have an almost equal chance of winning, these contests serve as a powerful incentive tool. Common denominator feature is built into contests by basing rewards on percentage of quota fulfillment. However, attempts are also made for adjusting differences among territories and differences among sales force.

6.2.2 Factors Affecting the Determination of Sales Quotas

There are various factors which affect the determination of sales quotas. Some of the important factors are as follows:

1. **Sales quotas of last year**: Sales quota for the next year can be set on the basis of past year sales after undertaking necessary modifications in lieu of changed circumstances.
2. **Sales forecasts for future**: If the management and channel intermediaries predict bright sales prospects in future for a particular territory then they will fix higher sales quota for that territory.
3. **Market potentialities**: Potentialities of the market is a significant factor in deciding sales quota. Macro and micro-environmental factors like, consumer's taste, liking, purchasing power, extent of competition, political, legal factors etc. are dimensions which affect sales possibilities to a great extent and analysis of these factors help calculate marketing possibilities of the entire industry succeeded by fixing total sales target of

the firm. Finally, this sales target is distributed among different sales territories established by the enterprise.

4. **Product modification and improvement**: If a firm carries out product improvement at a large scale it can increase its quota to that extent.
5. **Advertising and Sales Promotion**: If a firm adopts aggressive promotion policy in a particular territory then it can fix a higher sales quota for that territory.
6. **Production Capacity**: Production capacity of the firm is kept in mind while setting sales quota. If the company intends to enhance its production capacity then sales quota is raised accordingly.
7. **Ability of salesmen**: If the enterprise has experienced and professional sales team it can establish higher quotas.
8. **Level of Competition**: Fixation of quota largely depends on the intensity of competition. If the company is facing intense competition along with the entry of fresh, new competitors, sales are expected to be adversely affected and hence a lower sales quota may be fixed. On the other side, if the company is a market leader then a higher sales quota may be fixed.
9. **Changes in the marketing policy and strategy of the enterprise**: The firm's strategies largely govern the setting of quotas. Suppose the firm plans to follow penetration pricing strategy then it will set higher quotas.
10. **Changes in the marketing policies and strategies of competitors**: All business enterprises are directly affected by competitors. In situations where competition is aggressive and competitors change their marketing strategies and bring in price cuts or launch cost-effective new models, the firm will have to set lower quotas.
11. **Changes in the purchasing power of customers**: Higher buying capacity of target market results in setting of higher quotas.

6.2.3 Types of Sales Quotas

Sales quotas are goals established by managers to measure and compare the performance of their individual employees and to help determine their compensation. The different types of sales quotas include volume-based quotas, budget quotas, activity quotas and combination quotas.

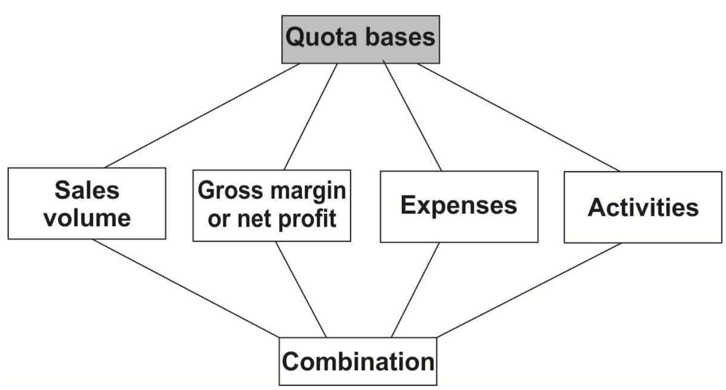


Figure 6.2: Types of Sales Quotas

(1) Sales Volume Quotas: This is easy to compute, oldest and most common type of sales quota and under it, quotas may be expressed either in rupees or in number of units. Under this method of deciding sales quota, the quantity of product to be sold is determined for a particular salesman or specific sales territory. The quota indicates "How much and for what period?" If a sales personnel has to sell 10,000 units of a product from January to March, it is his quota for three months. Sales volume quotas can be broken down into quotas for individual products, brands or lines, which can help sales head ensure that all offerings get appropriate attention. For appraising the performance of individual salesman, retail outlet, and any other units of the sales organization sales volume quota serves as a significant standard of evaluation.

The three ways in which sales volume quota is set includes:

- **Rupees sales volume**: The cases in which sales personnel are required to sell multiple products it is beneficial to set quotas in rupees. This type of quota because of the rupee terminology permits an analysis of selling expenses to sales, through ratio or percentages. Further, in case of products with no fixed prices and sales personnel empowered to cut prices, rupee volume quota ensures that salesman do not cut prices too strongly to meet unit volume quota. Rupee-based quotas may at times encourage salespeople to focus on items that are expensive but do not yield the highest profits.
- **Unit sales volume**: This quota is set under three situations. First case is when salespeople are engaged in selling few products. The second case is when product prices are highly fluctuating and in such a situation sales force is able to easily achieve rupee sales volume quota on account of increase in prices. If a product is currently priced at Rs. 80 a unit, 500 units sold transforms into 40,000 rupees in sales, but in case the price is hiked by 25 percent to Rs.100 a unit, only selling 400 units will bring in the same rupee volume. In third situation when the price of product is very high unit sales quota is more manageable. For psychological reasons sales man considers a Rs. 100000 quota as a bigger challenge than selling forty unit quota for bikes priced at Rs. 25,000 each.
- **Point sales volume**: This quota is more appropriate in the situation in which the company desires to improve its profitability, by motivating salespeople to sell more of those products that contribute to the profits comparatively more. For example, an organization had two products X and Y. Product X's contribution to profits was two times higher than product Y. In order to improve profitability, the company considered Rs. 1000 sales as worth one point and valued unit sales of product X at 3 points and of product Y at 1 point. In this situation in appraising performance, management will regard a 160 percent total point volume attainment with 3 bonus points as less deserving than a 120 percent point volume accomplishment with 6 bonus points. Thus, it can be inferred that point sales volume quota leads to a more profitable sales assortment.

(2) Budget Quotas: Budget quotas are established to control expenses, net profit or, gross margin. The objective of these quotas is to orient sales personnel towards cost consciousness and higher profitability than merely attaining sales volume. Budget quotas are of two types (i) Gross margin or net profit quotas and

(ii) Expense quotas. Main objective of using budget quotas is to raise the profits of the enterprise by controlling selling overheads. Expense quotas and gross margin or net profit quotas are linked to each other because having expenses in alignment with sales volume automatically indirectly controls gross margin and net profit contributions.

(i) Gross Margin or Net Profit Quotas: Organizations not opting for sales volume quotas set gross margin or net profit quotas, shifting the focus on gross margin (net sales minus cost of goods sold) or profit contributions (gross margin minus direct selling expenses). The logic is salesman operate more efficiently if they realize that sales increase, expense decrease, or both, are significant only if raised margins and profits result. Table 6.1 compares profit contribution of two salespersons. Profit contribution of 35% by second salesperson is better than the first salesperson. Profit based quotas are more beneficial when salespersons decisions significantly affect the profits of the company.

Table 6.1: Net Profit Comparison of Salespersons

	Ravi	Rahul
Sales	Rs. 4,50,00,000	Rs. 5,50,00,000
Cost of Sales	Rs. 3,00,00,000	Rs. 3,50,00,000
Gross Margin (75%)	**Rs. 1,50,00,000**	**Rs. 2,00,00,000**
Salary	Rs. 1,50,000	Rs. 2,00,000
Other Selling Expenses	Rs. 3,00,000	Rs. 3,50,000
Total Selling Expenses	**Rs. 4,50,000**	**Rs. 5,50,000**
Profit Contribution	Rs. 1,45,50,000	Rs. 1,94,50,000
Profit/Sales Percentage	**32%**	**35%**

(ii) Expense Quotas**:** Many organizations tend to encourage profit consciousness among its sales force by setting quotas based on executive’s travel and other expenses. According to **Still and Cundiff** “Control over expenses and profitability is tightened through quotas.” Expense quotas are mostly used as a supplement to other types of quota. Many a time companies provide sales persons with financial incentives to keep their expenses in check. This is done by tying performance against expense quotas directly to the remuneration plan or by offering special expense bonuses for expenses lower than the allotted quota.

(4) Activity Quotas: This method of determining sales quotas is different from other methods as under this method, the quotas are set for the activity of salesmen for a particular period. Organizations interested in using activity quotas begin by defining the important activities sales person perform and afterwards setting target performance frequencies. The examples of activities for which sales quotas are fixed include (1) product demonstrations made, (2) total number of sales calls, (3) orders from new accounts, (4) maintaining the quantity of sales of previous year; (5) maintaining the amount of sales of previous year, (6) establishing contacts with new customers or distributors, (7) displays built, (8) participation in events etc. Activity quotas are apt when sales people are engaged in important non-selling activities. For example, activity quota is relevant in case of Pharmaceutical marketing, where medical representative call on doctors and hospitals to explain new product formulations and applications. Table 6.2 shows how a sales company determines activity quotas for its salespersons.

Table 6.2: Activity Quotas for a Sales Company

Activities of a salesperson	**Time required (minutes/hours)**	**Priority**	**Quotas (frequency)**
Calling on existing customers, classified into A,B,C	For A=60 mins B=30 mins C= 15/20 mins	1 4 7	4 calls per month 2 calls per month 1 call per month
Calling on Prospects	30-45 mins	3	2 calls per month
Visiting and servicing retailers	30 mins	2	Average 2 calls per month
Payment collection from payment overdue customers	15 mins	5	Average 1 call per month
Participation in events	20 hrs	6	Once in three months

A well set activity quota contributes effectively in a completely balanced sales job. The rationale is logical because for effective sales outcomes the sale force has to be engaged in doing many related jobs like, making calls on the potential customers, opening new accounts, building displays, recommending new or improved products, giving demonstrations. Thus, if the objective is to strengthen sales volume, the management has to co-operate with the salesmen, encourage them to undertake the strategic initiatives that result in sales and assist in achieving sales quotas.

Combination Quotas: If the marketing objective is to raise market share, then sales volume quota is appropriate and if the objective is to enhance a company's net profit as a percentage of sales or return on investment, then quota based on gross margin, or expense quota, is more beneficial. Sometimes for better results firms combine two or more quotas. For instance, as shown in Table 6.3 a company established a gross margin quota along with a quota based on three activities and following are the outcomes for one sales executive for the April-June quarter with his average performance score being 106%.

Table 6.3: Evaluation of Salesperson with Combination Quota

	Quota	Actual	Percent of Quota obtained
Gross margin, all products	Rs. 30,000	Rs. 25,000	83
New customers called on	15	20	133
Product demonstrations done	120	130	108
Window displays built	20	20	100
			Average = 106%

6.2.4 Procedures for Setting Sales Volume Quotas

Various methods are used by companies in setting sales quotas. The quotas are established based on territory sale potential, complete market estimates, executive judgment, sales force's estimates and compensation plans. The sales volume quota depicts quota-setting procedures well as it is the most commonly used type however, at the same time the same method can be extended for the other types as well. Popular procedures used to set volume quotas include:

- **Quotas based on Territorial Sales Potential:** The most prevalent practice in quota setting is to relate quotas directly to the sales potential of the territory. This approach is apt when territorial potentials are decided in relation with territorial design, or bottom-up planning procedures are utilized in calculating estimated sales in the sales forecast. For example, if the sales potential in territory X is Rs.3,00,000, or 5 percent of the total firm potential, then management may decide to allot this amount as a salesperson's quota for his assigned territory. The sum total of all territorial quotas then would be equal to the firm's sales potential.
- **Quotas derived from Total Market Estimates:** Sometimes organizations neither have statistics nor sales force estimates of territorial sales potentials to base their quota upon. In such cases, companies use top-down planning and forecasting to arrive at the sales estimate for the whole company. To determine quota, the sales head may either breakdown the total company sales estimate, calculated by various indexes of relative sales opportunities in each territory, and then make adjustments or translate the company sales estimate into an organization sales quota (by considering projected changes in marketing-mix variables like, product, price, promotion and other policies) and then break down the company volume quota, by involving an index of relative sales opportunities in each territory.
- **Sales quotas determined by Executive Judgment:** Management judgment is vital ingredient in sound quotas establishment, but relying

solely on it is not recommended. Executives may set quotas purely on judgment in case limited information exists like, no sales forecast is available, or the product is new and thus its market acceptance unknown or there exists no practical procedure to decide territorial sales potential. The executive may be very experienced still too much risk is involved in relying on this factor alone without using quantitative market measures.

- **Sales Volume Quotas related to Compensation plan:** Management sometimes set sales volume quotas purely upon the projected remuneration that companies wish to offer to the sales personnel rather than basing it on potential. In the situation where a firm prefers to pay its sales representatives by straight commission but realizes that the sales personnel prefer salary-plus-commission plan, the firm adopts a combination plan. Under it, with a salary of Rs,5,000 per month and a commission of 10 percent on total sales over Rs.50,000 a month, by using the quota, management attains its preference for a straight commission as no commission is paid until the salary is recouped (10 percent of Rs.50,000 equals Rs.5000).
- **Quotas based on past Sales Experience:** Few firms work on the principle of exceeding last year sales figure as a consequence sales volume quotas are established purely on the last year's sales or in some cases on an average of sales over a period of three or five years. The advantage of this method is estimation simplicity and low-cost administration but the method has many limitations. This method does not take into account probable changes in the territorial sales potential, does not uncovers poor performance in a given territory and also tends to discourage sales representative morale by sending the message that the more they sell, the more they are supposed to sell.
- **Allowing sales personnel to set their own sales volume quotas:** This is an uncommon method and is primarily used by firms expanding into new geographic territories. In situations where it is difficult to project sales, companies engage their sales force to set quotas for initial one or two years. This way, sales men become responsible for determining their own performance standards. The company officials are of the opinion that sales personnel being closest to their territories will set more realistic quotas, will complain less and work harder towards attaining them. Limitations arise when sales force is uninterested in setting their own quotas or they overestimate or underestimate their capabilities and set unrealistic high or low quotas. Quotas established unrealistically high or low by sales force causes dissatisfaction and affects sales force morale.

6.2.5 Requisites of Successful Quota System

Given below are a few requisites of successful quota systems:

- **Accurate, Fair and Attainable Quotas:** Sales quotas set in synergy with the territory market potential are considered as realistic and salespeople in such situations feel motivated to work and accomplish their quotas. **According to Still and Cundiff,** "Accurate quotas result from skillful blending of planning and operating information with sound judgment" while **John P. Steinbrink** states, " Setting unrealistic quotas that cannot be met only results in a morale problem and serves no useful purpose. Too often, management is guilty of fooling itself in putting down figures that are no more than wishful thinking." In practice, whether quotas are realistic and attainable depends not only upon the quality of management's judgment but also on the capabilities and efforts of sales force.

- **Securing and Maintaining Sales Force Acceptance:** Organizations should ensure that sales force understand quotas and quota setting procedure. It is crucial that sales representatives understand the significance of quotas as communicators of "how much to be sold in what period", as well as also consider their quotas fair and achievable. Thus the quota-setting procedures should be simple enough for sales person to understand and at the same time be sophisticated to permit acceptable accuracy.
- **Participating in Quota Setting:** Sales people participation in quota setting ensures the ease in understanding and attaining quotas. When sales people set their own quotas they are more convinced about its fairness. However, it is not advisable to handover the complete quota-setting job to the sales staff, but certain amount of involvement by sales force can provide more realistic and accurate quotas.
- **Keeping the Sales-force updated on quota attainment:** For efficient sales management it is important to keep sales personnel informed about their progress related to quotas. Usually, sales people receive frequent reports detailing their performance till date which helps them in analyzing their strengths and weaknesses and taking corrective action. Frequent personal contacts with supervisor as well as detailed regular reports on sales person performance provide advice, encouragement and occasional warnings to sales people to take measures to improve their performance.
- **Continuous Managerial Control:** There is requirement of continuous monitoring of performance in administering quota system. Proper record needs to be in place for collecting and analyzing performance statistics without delay. Individual sales person performance is properly documented against quota on a monthly basis, or sometimes weekly basis to facilitate analysis. An efficient management continuously reviews and appraises the operation of the system and makes the needed changes. Flexibility in quota administration is required, if a quota is proving unrealistic, it should be adjusted.

6.3 Sales Territory

A sales territory is the economic unit which is set with an objective of planning and controlling sales efforts. Setting up of sales territories facilitates matching sales opportunities with firm's selling efforts**.** Establishing or modifying sales territories and managing their efficient and effective coverage are an important part of sales management's strategic planning component**.** Identifying and organizing sales territories helps management to bring other dimensions of planning such as sales budgeting and forecasting down to limited geographical areas**. According to Still, Cundiff and Govoni**, "Operationally a sales territory is a particular grouping of customers and prospects assigned to an individual sales person." **According to Maynard and Davis,** "Sales territory is a basic unit of sales planning and sales control." **According to B.R. Confield** "A sales territory is a geographical area containing present and potential customers who can be effectively and economically served by a single salesman, branch dealer or distributor." Target market of a business enterprise is quite large and is generally divided into a number of segments so that the activities of distributors, dealers, retailers and salesmen etc., may be clearly checked and controlled. Division of a market into various segments is referred to as determination of sales territories.

6.3.1 Objectives of Establishing or Revising Sales Territories

Some of the important objectives of establishing sales territories include providing efficient services to the customers, preparing sound plans for different territories according to the needs and requirements of individual territory, planning and implementing separate marketing programs for different territories, enhancing the market share of the enterprise, monitoring repetition of marketing efforts in a particular territory, managing sales expenditure prudently and enhancing salespeople's morale and effectiveness. More specifically, there are following six factors contributing towards establishment of sales territories:

1. **Provide proper market coverage**: Well-designed sales territory permits salespeople to spend sufficient time with present and prospective customers, which improves the coverage of the market economically and adequately. Proper market coverage is ensured if company intelligently sets up the territories and carefully assigns its salespeople.
2. **Control selling expenses**: Lower selling expenses and higher sales volumes are ensured through well-designed territorial plans clubbed with prudent salesperson assignment. The careful establishment or revising of sales territories is one decision management takes to ensure that selling expense rupees are spent to the best advantage. Good territorial design ensures sales personnel spending fewer nights away from home, eliminates lodging and food expenses, reduces transportation expenses and results in increased productive selling time.
3. **Assist in better evaluation of sales personnel performance:** The intensity of competition and sales problems varies geographically. By analyzing markets territory wise and assigning sales and cost responsibility to individual sales person, management seeks the information required to set quotas and to evaluate individual sales personnel's performance against it.
4. **Contribute to sales force effectiveness:** Properly designed sales territories result in reasonable workload allocation to salespersons with reduction in conflicts as specific customers are assigned to them. Good territorial design combined with well- planned territorial assignments results in sales force spending minimum time on road which in turn enhances sales force morale.
5. **Improve co-ordination of personal-selling and advertising efforts:** By combining advertising and personal selling, management takes benefit of a synergistic effect and gets a positive outcome greater than the sum of its parts. Sales person plays a significant role in capitalizing upon synergistic advantages. For instance, before a new product launch sales force calls upon retailers to outline the launch plan's objectives, provide them with tie-in display material, and make sure that sufficient supplies of the

product are available in the retail outlets. Under territorial arrangements every retailer is assigned under some salesperson and proper routing and scheduling ensures that sales person is in touch with retailers at opportune times thus, the outcomes are more satisfactory when the work is allotted on a territory-by-territory basis.

6. **Improve customer relations:** Relationship between customers and salespeople is strengthened when salespeople spend adequate time with customers understanding and satisfying their needs effectively.

6.3.2 Factors Determining Sales Territories

The following factors affect the establishment of sales territories:

- **Size of Business:** A major factor in establishing sales territories is the size of business. Larger business size results in bigger sales force and higher number of sales territories.
- **Methods of Distribution:** Distribution method also affects the setting of sales territories. The firm may sell their products directly, or by establishing its own shops or through the chain of distributors and retailers.
- **Ability of the Salesmen:** If a firm has team of efficient salesperson, then the size of planned territory can be comparatively larger compared to a situation where a firm has inexperienced sales team.
- **Level of Competition:** Territory with more competitors will require more time and efforts of salesperson and in such cases the size of the territory will be comparatively smaller allowing the salesperson to concentrate his efforts efficiently and fight competition. On the contrary, territory in which less or no competition exist the salesperson is in a position to cover bigger area and thus the size of sales territory will be larger.
- **Means of Advertisement and Sales Promotion:** When the firms use diverse means of promotion on a wider scale, the size of the sales territory will be large.
- **Density of Population:** Population density affects the setting up of sales territories. Thickly populated areas with greater buying potential of customers require smaller sales territory to cover them more effectively while, for thinly populated areas with low buying potential firms opt for larger sales territory.
- **Market Potentialities:** If the market has huge sales potentialities then it will have small sales territory compared to a situation in which the market possesses less sales possibilities then it will have larger sales territory.
- **Product Demand:** In case of higher demand of product, the size of sales territory is smaller contrary to the situation in which demand for the product is low the territory size is larger. **Company Policies:** Policy of the organization deeply affects sales territories. If the firm has a policy of mass production, low prices and maximizing sales then smaller size sales territories are preferred. The size of sales territory is large when the firm has an objective of low production, high prices with profit maximization.

6.3.3 Methods of Establishing Sales Territories

Many different methods of establishing sales territories exist and a firm may choose any of these methods as per its requirements. While selecting a particular method of setting sales territories, several dimensions must be considered, such as number and type of customers, location of customers, nature of products, competitors policies and firm's own strategies to manage and control different territories. According to **Stanton, Spiro** plan for establishing, modifying or redesigning territories involves the following six steps, as exhibited in Figure 6.3

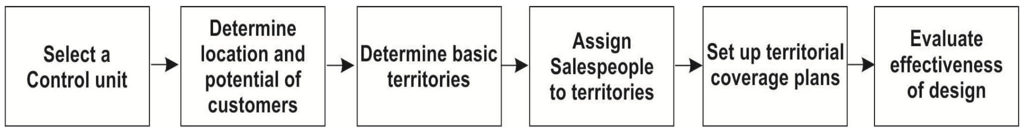


Figure 6.3: Procedure for designing sales territories

(i) Decide Control Unit for Territorial Boundaries - The designing of territories begins with the selection of a control unit as a territorial base. Some methods of establishing basic control unit for sales territorial boundaries commonly adopted by enterprises are explained here in Figure 6.4:

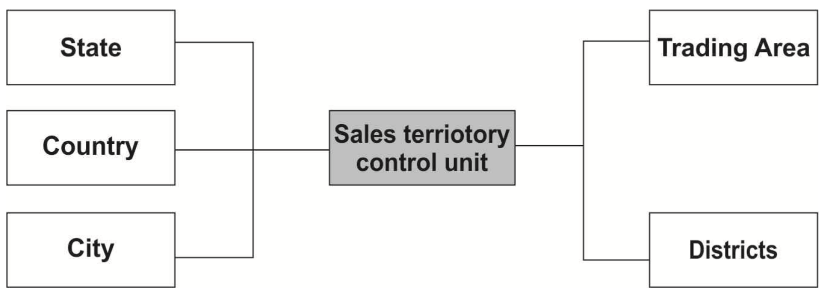


Figure 6.4: Territorial Control Units

(1) Country Unit- Business enterprises operating in international markets, adopt this method. Under this method, individual country in which the products/services of the organization are marketed, is considered as a separate sales territory and sales teams are appointed for every such territory which are responsible for sales related activities in their territory.

(2) State Unit- Organizations with business operations at national level, adopt this method under which every state in which the products of the company are sold, is treated as a separate sales territory. Building territorial boundaries around states is a convenient and simple method deployed by firms which have small sales force covering national markets and adopting selective distribution policy.

(3) District Unit- Some enterprises establish their sales territories at district level. Under this method, every district in which the products of the firm are sold, is treated as a separate sales territory. Individual sales representative is appointed for every territory and is held responsible for all the selling activities in his territory.

(4) Trading Area Unit- Some firms select some specific areas in which their products are sold at a higher rate and every such area is established as a different sales territory.

(5) Other Methods- There may be some other methods of establishing sales territories also. For example, some firms establish their sales territories on the basis of direction, such as North, South, East and West or Zip code.

(ii) **Determine location and potential of customers -** Management needs to identify the location and potential of both existing and prospective customers within the selected control units. Sales record assist in finding the location of existing customers in each control unit while, prospective customers can be determined with the help of company's sales representatives and external sources such as, trade directories, trade journals subscription lists, classified telephone directories, credit rating firms, etc.

After customer identification, management needs to assess the expected business from each account followed by classification of these accounts into various categories based on their potential profitability to the marketer.

(iii**) Determine Basic Territories -** The third step in finalizing sales districts include establishing a basic territory based on statistical methods which involves the buildup or the breakdown method. In the buildup method territories are designed by adding small geographical regions decided on the basis of number of calls a salesperson is expected to make. Under this method the workload of salespeople is equalized. This method is mostly employed by organizations desirous of intensive distribution and dealing in consumer products.Under the breakdown method of territorial design the whole market is divided into approximately equal segments based on sales potential. In this method the sales potential is equalized and it is more popular among companies which want selective distribution and are engaged in manufacturing of industrial products.

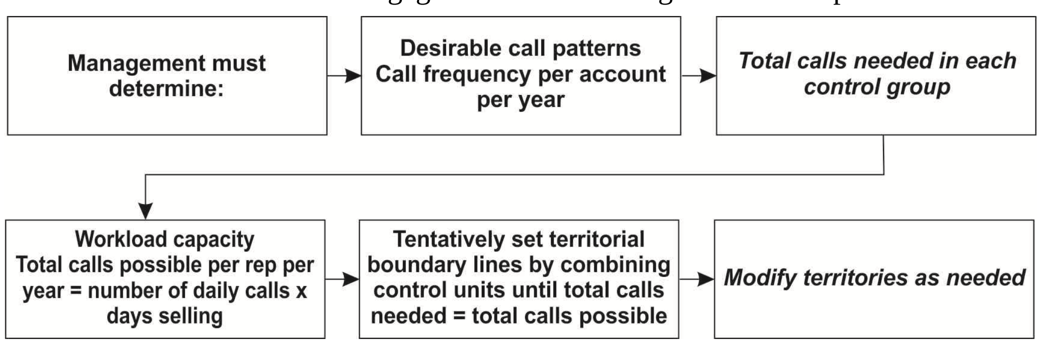


Figure 6.5: Buildup method of territorial design

1. Decide optimal call frequencies: Organizations have to determine optimal call frequencies for its customer which implies that it must establish the number of times an account should be called upon in a year. The frequency of call is influenced by the sales potential, type of product, consumer buying behavior, number of competitors, and the expenditure involved in calling on customers. Thus frequency of call is decided by the account's profitability. Table 6.4 exemplifies the manner in which the management classifies its customers into three classes based on profitability. Platinum accounts are the most profitable and are called on

twice a month. Gold customers are visited monthly and lead customers are called upon bimonthly.

2. Decide the total number of calls required in each control unit: The total number of calls required in each control unit can be calculated by multiplying the number of each type of account in the control unit by the number of calls that type of account needs. Assuming that districts are the control unit, and using the call frequencies exhibited in Table 6.4**,** it can be determined that control unit X requires 660 calls per year and Y requires 630.

Table 6.4: Call Frequency for different customer classes

		District X		**District Y**	
Customer Class	**Call Frequency**	**No. of accounts**	**No. of Calls per Year**	**No. of accounts**	**No. of Calls per Year**
Platinum	2 per month	15	360	10	240
Gold	1 per month	20	240	25	300
Lead	1 every two months	10	60	15	90
		45	660	50	630

3. Estimate workload capacity of an individual salesperson: A salesperson's workload capacity is estimated by multiplying the average number of calls a salesperson can make in a working day by the number of working days in a year. The number of calls a sales person can effectively make in a day relies on the average time length required for a call, the number of people to be called upon and the amount of travel time required between customers. For instance, if a salesperson works for 8 hours per day with one hour being the average length of a call and the average travel time being 30 minutes per call, then the person can make five calls per day. If the number of working days in a year is 250 (excluding Sundays and national holidays), then the estimated workload capacity for the sales person per year works out to 1250 calls (Number of working days i.e. 250 x 5 i.e. number of calls possible per day)

4. Make tentative territories: In this step, the company groups adjoining control units until the number of calls required in a year in those control units equals the total number of calls a salesperson can make which is the workload capacity of the salesperson. Continuing with the example depicted in Table 6.4**,** districts X and Y together require (660 + 630) 1290 calls per year, which is almost equivalent to 1250 calls of normal workload capacity of a salesperson.

5. Develop final territories: In situations where workload capacity of salesperson is not equalized, modification of tentative territories is done by adding or subtracting control units. The prime focus being to equalize the workload for each salesperson. Before finalization of the sales

territory, sales manager discusses with salespeople and also make necessary adjustments giving due considerations to particular territory.

- Breakdown Method - Companies selling industrial products usually opt for breakdown method of territorial design. The steps involved under this method are depicted in Figure 6.7.

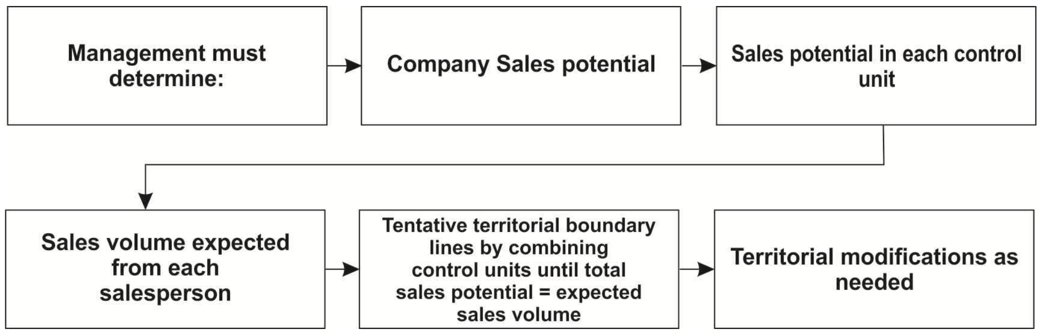


Figure 6.7: Breakdown method of territorial design

The breakdown method comprises:

1. Establish sales potential: The management in the beginning has to decide the sales potential it expects in the whole market.
2. Decide sales potential in each control unit. In order to obtain the sales potential in each control unit, total sale potential is multiplied by a market index to assign it among the several control units.
3. Settle on the sales volume expected from each salesperson: In this step sales manager evaluates the amount of sales to be done by each sales man in order to ensure profitable operation. Often a study of cost analysis and past sales experience is done to determine this information. For example, if the cost of goods sold and cost of distribution is estimated to equal 70 percent of sales, direct selling costs are Rs.30000 and management desires to earn a profit of around 10 percent of sales then, it is estimated that each salesperson must sell a minimum of Rs.150000. At times management decides that each salesperson should sell twice of this amount then, the expected sales volume is set at Rs.300000.
4. Establish tentative territorial boundaries: In this the sales manager draws tentative territories by clubbing adjoining control units (sharing a border) until the potential of each territory is equal to or higher than the expected sales volume from each salesperson. In continuation with the above example, the sales potential of each territory should be equal to or greater than Rs300000.
5. Modify and develop final territories: As in the buildup method, the tentative territories need to be adjusted on account of unequal sales potential of some territories or geographical locations of customers in which the modifications are done by moving selected customers or control units from one territory to another with the prime objective to achieve equal sales potential of territories.

(iv) Assign salespeople to territories - In assigning salespeople to territory, the sales manager considers the relative ability of sales people, and salesperson's effectiveness in a territory.

Relative Ability of Sales People: Sales manager need to assess the relative abilities of sales persons based on strategic factors, such as product and market knowledge, past sales performance, communication and negotiation skills. By assigning weightages, the sales manager evaluates each salesman on relative ability and determines an ability index with a maximum score of 1, as depicted in Table 6.5.Sales people relative abilities are then related to the business potentials of various territories. In the current table, the ability index of the salesperson is 0.920. Similarly, ability index of other sales persons may be calculated. However, evaluation factors and weightages assigned to evaluation parameters may differ from company to company based on product and customer characteristics.

Table 6.5: Evaluation of Relative Ability of a Salesperson

Evaluation Parameters	**Weightage (A)**	**Evaluation (B)**	**Salesperson score (A) x (B)**
Product Knowledge	0.15	0.8	0.120
Market knowledge	0.10	0.9	0.09
Past Sales Performance	0.50	1.0	0.50
Presentation & Communication skills	0.10	0.9	0.09
Negotiation and Selling skills	0.15	0.8	0.120
	1.00		0.920

Sales People effectiveness in a territory: While assigning salesperson to territory the sales manager has to judge the effectiveness of the salesperson by comparing the concerned person's social, cultural and personal characteristics with those of the territory. For example, a salesperson who belongs to a metro like, Delhi, Mumbai will find it very difficult to adjust in rural territories and interact with rural consumers. The objective of the sales manager in matching salespeople to territories is to ensure maximization of sales and profit potential of territories. This objective is accomplished by making both the salesperson and the customers comfortable with each other in the territory. Thus the decision on assigning salesperson to territories is based on salesperson's considerations which include relationship between salesperson and customers and between sales manager and the salesperson. The existing relationship between the salesperson and customers is not disturbed by the sales manager while assigning salespeople to territories.

Using Computers in Territory Design: For designing and revising sales territories, sophisticated computer-based mathematical models have been developed. The advantage of utilizing information technology is to allocate sales effort across customers in such a way as to maximize sales or profits for the firm. Geographic Information Systems is a technology that facilitates a framework to analyze and circulate geographical knowledge. Number of software such as Arc GIS, Arc Editor, and Arc GIS Data Models are available which are capable of running simulations and aid in optimizing territorial design.

(v) Establish territorial coverage plans for the sales force - Once sales territories are designed and sales representatives are assigned to them, the next step involves the management of territorial coverage by determining how the assigned salesperson covers his territory. This consists of three main tasks (1) efficient route planning for salespeople, (2) scheduling the salesperson's time, and (3) deploying time management tools.

Routing the Sales Force: Planning of efficient routes for salespeople is a managerial task that sets a formal travel plan or pattern for sales person to follow as they go through their territories. The main benefits of routing are: (1) reduction in travel time and cost by avoiding back-tracking by salespeople in their territory, (2) effective and orderly territory coverage, as salespeople reduce their travel time and increase selling time with customers.There are some objections to routing as some sales executives are of the opinion that it reduces salesperson's initiative specifically when market conditions vary and customers' needs change. This objection can be addressed by using computers for formulating the route plans.

The procedure used for establishing a route plan includes identification of the present and prospective customers on a territory map and classifying them into high, medium and low potential customers. After this the desired call rates and call frequency for each class of customers is decided. This information has already been determined during the territory design process. With all the information available the route plan is built around locations of high potential customers. Some of the commonly used routing patterns include circular, straight line, clover leaf and hopscotch. The circular pattern is appropriate when accounts are evenly distributed throughout the area and in this case, the salesperson starts from his base, and travels in a circle, making sales calls and coming back at the base. The cloverleaf pattern is followed when accounts are located randomly throughout a territory and in this, the salesperson first trip covers a part of the territory while the next route covers the adjoining circle and this continues until the entire territory is covered. In straight line pattern, the salesperson begins from home or office base and makes sales calls in single direction, combining this with hopscotch pattern we have a salesperson starting from the farthest point from home or office base and making sales calls on customers on the way back to home/office. This process is repetitive in different directions. Nowadays computerized mathematical models have been developed to maximize selling time and minimize the travel cost.

Scheduling: It involves planning a salesperson's specific time of visits per sales call to the customers. Research has proven that best salesperson's are those who manage their time effectively. Sales manager first determine and then allocate major duties of the salesperson along with the amount of time to be allocated to each activity. Although the activities vary from organization to organization but Table 6.6 highlight the major activities of salesperson along with the time spent.

Table 6.6: Evaluation of Relative Ability of a Salesperson

Salespeople's Tasks	Time Spent (in percentage)
Administrative Activities	15
Service calls	13
Face-to-Face/Personal Selling	32
Waiting/Traveling time	21
Selling on telephone	19
Total	100

The tool that is used mostly to assist the salesperson to understand the time spent on various tasks is referred to as "time and activity analysis." The salesperson records the time spent on various activities, discusses with the sales manager and decide how to increase the time spent on major activities.

Time management Tools: Many supports are available to assist salesperson in managing their time more productively. These include use of computers, mobile communication and other high-tech equipments like, laptops, automatic dialers, fax machines, videophones, air phones etc. To reduce time demands on their outside sales force many firms are increasingly employing inside salesperson such as sales assistants who provide clerical support to the outside salespersons, technical support persons to give technical information and telemarketers to find new prospects, qualify them and refer them to outside salespersons. Outside salesperson that travel outside the firm then get more time to spend on selling to existing customers, getting orders from prospects and strengthening relationships with customers.

(vi) Evaluate effectiveness of Territorial Design - The final step involves analyzing effectiveness of territorial designs by conducting territorial sales and cost studies on a continuing basis which helps in identifying strong and weak territories in relation to potential. Revision of sales territories is also a continuous process on the basis of which the sales manager re-plans the existing sales territory and makes necessary adjustments as and when required. Territory performance is calculated in terms of total sales during the evaluation period. After evaluation necessary revisions are done.

6.4 Essential Requirements of a Good Sales Territory

In assigning territories following points need to be taken care of:

1. An inexperienced salesperson should not be assigned an independent territory in the beginning. Initially he is expected to assist the senior sales person in the specific territory to comprehend the working procedure.
2. To an extent transfers of sales persons from one territory to other should be avoided as it adversely affects the customer and dealer relations with them. However, sometimes because of lack of performance or other attitude problem this may become inevitable.
3. For exclusive goods or heavy machines territories are created by classifying customers or class of business.
4. Territories should be set in such a way that they can be effectively covered by a salesperson. Too big and too small territory size is undesirable.

5. Territorial design as far as possible should equalize sales potential and work-load of salesperson.
6. Territorial coverage plan should ensure control on expenses with coverage in a cost effective manner.
7. Territorial plans should be flexible.

6.5 Summary

Quotas are quantifiable objectives allotted to salesperson and other units of the sales organization. Their main purpose is both to stimulate performance and to evaluate it, by communicating management's expectations as well as serving as performance measurement yardstick. Sales volume quota (in rupees and in units) is the most commonly used basis for establishing sales quotas. Other types include gross margin or net profit, expenses, sales activities, or a combination of these elements. The approaches used in setting sales volume quotas include, based on territorial sales potential, total market estimates, executive judgment, past sales and compensation design considerations. Characteristics of a sound quota plan include realistic attainability, objective accuracy and fairness, ease of understanding and administering. A sales territory consists of a number of present and prospective customers falling within a geographical area assigned to individual salesperson, marketing unit or middlemen. There are numerous benefits from establishing territories. Well-designed territories help to improve market coverage and customer service, reduce selling expenses, achieve co-ordination of personal-selling and advertising efforts, and improve the evaluation of sales personnel performance. Some factors that affect the setting up of territories include size of business, competition level, product demand, company policies, density of population, ability of salesmen and methods of distribution. The steps in establishing sales territories are (1) Select a control unit for territorial boundaries, (2) Determine location and potential of customers, (3) Determine basic territories, (4) Assign salespeople to territories, (5) Establish territorial coverage plans for the sales force, (6) Evaluate effectiveness of territorial design. In assigning sales person to territories, management tends to establish the best alignment of sales efforts with sales opportunities, and strategic planning for routing and scheduling sales person help in accomplishing this.

6.6 Self Assessment Questions

1. What are sales quotas and why is it significant for sales managers to set quotas for sales personnel?
2. Elaborate on the methods utilized by organizations for setting sales quotas.
3. What is a sales territory and why is it important for organizations to establish sales territories?
4. Discuss the methods for designing sales territories.
5. Highlight the major differences between build-up and break-down methods, of designing sales territories.
6. Mention some of the signals that indicate that a company's territorial structure may need revision.

6.7 Reference Books

- Still, R. R., E.W. Cundiff, and N.A.P. Govoni, 'Sales Management: Decisions, Strategies, and Cases,' Prentice Hall of India Pvt. Ltd., 2006, New Delhi.
- Stanton, W., and R. Spiro, 'Management of a Sales Force', McGraw-Hill Book Co., 1999, Singapore.
- Panda T.K., and S. Sahadev Sunil, 'Sales and Distribution Management', Oxford University Press, 2011, New Delhi.
- Havaldar K. K., and M.V. Cavale, 'Sales and Distribution Management Text and Cases', Tata McGraw Hill Education Pvt. Ltd., 2009, New Delhi.
- Honeycutt, E.D., J. B. Ford, and A. C. Simintiras, 'Sales Management: A Global Perspective,' Routledge Group, 2003.
- Gupta S.L, 'Sales & Distribution Management: An Indian Perspective', Excel Books, 2010.

Unit – 7: Sales and Cost Analysis

Structure of Unit

7.0 Objectives

After completing this chapter, you would be able to:

- Understand Sales Control and Analysis;
- Describe the Techniques of Sales Analysis;
- Know about Methods of improving the productivity of sales force;
- Discuss the various Types of Marketing Cost Analysis;
- Discuss the Steps of Marketing Cost Analysis.

7.1 Introduction

In every business, performance is closely associated with cost. Companies focus on ensuring that performance exceeds the cost incurred. Even, the most profitable companies cannot cut out costs altogether. Infact, 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. Therefore, it is necessary for companies to know what costs they are incurring in obtaining the desired performance from their employees.

Sales force personnel are the part of company employees, who oversee activities like setting sales and profit targets, formulating sales related marketing policies, designing personal selling strategies and integrating the sales organizations with the company's other functions. In short, they build and develop the sales organisation 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 sales 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 maintain a fair balance between costs and profits in order to achieve the overall organizational goals.

The present day dynamic market place 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 the performance of the sales force and identifies the problems and opportunities that the firm is exposed to.

Appropriate designed and skillfully implemented control mechanisms increase the chances that the sales organizations will focus upon achieving selling and profit objectives. Sales budgets and sales quotas, if set properly and administered well can stimulate sales personnel to achieve the sales and profit objectives set. Further, setting up sales territories makes the control of sales operation more effective. While, controlling sales force expenses and transportation costs helps the company to achieve its profit objectives, control mechanisms such as sales audit, sales analysis and cost analysis can contribute to effectiveness of personal selling effort. These control mechanisms helps sales executives to monitor profitability of the operation.

This chapter on Sales and Cost Analysis explores the various aspects related with sales and control functions of sales management. The chapter begins with an introduction. After that, a brief description of a sales manager's responsibility to ensure profits followed by an explanation on the nature of sales control. After this, sales analysis and sales audit is explained. Various aspects associated to cost analysis; marketing cost analysis, marketing audit, and profitability analysis are also described in detail.

7.2 Sales Manager's Responsibility to Ensure Profits

Sales managers are responsible for organizing the sales effort, both within and outside their companies. Within the company, the sales manager builds formal and informal organizational structures that ensure effective communication not only inside the sales department but also in its relations with other organisational units. Outside the company, the sales manager serves as a key contact with customers and other external public and is responsible for building and maintaining an effective distribution network.

Sales managers have still other responsibilities. They are responsible for participating in the preparation of information critical to the making of key marketing decisions, such as those on budgeting, quotas, and territories. They participate- to an extent that varies with the company- in decisions on products, marketing channels and distribution policies, advertising and other promotion and pricing.

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 weakness, if any, in their sales efforts before these weaknesses become liabilities to the firm.

The sales control function involves sales and cost analysis of the company. This function has undergone a lot of changes over the past. Initially, the responsibility of a sales manager was to ensure that the sales team achieved its sales targets given by the company. Later on, companies realized that achieving high sales volume did not by itself, assure the firm of high profitability. Sometimes, high sales volumes brought in undesired results for the organisation, such as unprofitable operations, customer dissatisfaction etc. The techniques, that some of the companies adopted to increase their sales volume also attracted a lot of criticism. Many companies expanded their plan capacities and achieved high sales volume through forceful selling sometimes, which actually increase customer satisfaction.

Therefore, there was a growing need realized that sales managers should take profitability of the business into consideration while setting the sales volume. The emphasis on profitability made the sales managers focus on the sales control and analysis process as well, apart from his useful focus on other marketing activities like managing the distribution structure, market research, and price emphasis, etc.

A typical sales analysis involves deciding on the purpose of evaluation, comparing the sales figures with set 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.

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. Sales managers use profitability analysis to relate the sales revenues to marketing costs. This helps sales manager 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 behaviour of sales data and the actual reasons underlying them. They fore warn sales managers of impending dangers and help them to take measures to counter them in future.

7.3 Meaning and Nature of Sales Control

Control is a function of management to ensure that operations are being carried out as per the plan to achieve the objectives. Sales coordination is essential to ensure proper conduct of sales operations by different functionaries in the field. The Sales manager has to produce tangible results and for this to happen he has to have a clear view of his job specification and responsibility. His position is unique in the sense that he represents the company in the market that treats him as the company. Sales control is a tool for ensuring that the marketing activities of a company are directed towards the marketing objectives. The various types of sales control with their prime responsibility, purpose and approaches are as follows:

Table 7.1: Types of Sales Control

S. No.	**Type of Control**	**Prime Responsibility**	**Purpose of Control**	**Approaches**
1	Annual Plan Control	Top level managers	To examine whether the planned results are being achieved	• Sales analysis • Market share analysis • Marketing expenses to sales ratio

2	Profitability Control	Sales Controller	To examine where the company is making or losing money.	Customer attitude tracking profitability by:- • Product territory • Market Share • Trade Channel • Order Size • Sales Audit

7.3.1 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 a sales control are as following :

(a) **Performance Measurement:** The first step in the effective sales control is measuring the performance of the sales force working in the organisation. The objective of evaluation of various sales efforts is critical in ensuring that company's growth is progressive as planned. It helps the company to identify the difference between actual and standard performance and enables sales managers to take corrective action before irrevocable damage takes place. During these days, managers have started giving more emphasis on performance ratios than the traditional time –to-time increase in sales, to measure sales performance. The ratios used to measure sales team performance include Sales/Quota ratio, Sales/Budget ratio etc.

(b) **Problem Identification:** Sales control helps managers to identify problems in sales, before they become liabilities to the firm. In many businesses, sales problems are difficult to fix because they associate to sales effectiveness and improving sales effectiveness requires ensuring the right mix of skills, supervision, strategy, and systems. Inability of sales personnel to bring in adequate business, in accurate 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 in identify problems at the budding stage itself. Continuous feedback from field sales personnel allow sales managers to identify the problems, both with the system as well those pertaining to the resources involved in selling process.

(c) **Identify Opportunities**: Identify 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 helps a manager to diagnose problems in their initial stages and take necessary actions.

Exhibit 7.1: Sales Planning by Objectives at GE

Many sales plans tend to overlook sales objectives. At GE, however, sales objectives form an important component of the sales plan. The sales persons formulate a sequence of steps that will help them to 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 objective 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 contact 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.

7.3.2 Sales Control Process

The sales control process essentially involve following steps:

(a) Setting goals - Sales managers direct the sales force by setting goals and framing objectives. They design the course of action by which the sales force can achieve these objectives and they measure the sales force's performance against the pre-determined goals. Sales planning guides the sales force in their performance and gives them a direction along with the work. It sets targets in the form of sales quotas. Therefore, 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. It provides the necessary framework for all sales activities. The strengths and weakness of the sales team and individual sales persons have to be taken into consideration when sales planning is done so that training requirements can be suggested to improve the sales team's overall performance. This will, in turn facilitate the fulfillment of the sales objectives. Exhibit 7.1 explains the sales planning at General Electric. Sales budgets set targets for the costs associated with various sales activities. They help to compare actual spending with the budgeted allowance and enable firms to confine their spending to the limited resources available to them.

(b) Comparing actual with targets - This step explains comparing the actual with the set goals. The costs incurred on sales related activities are compared with the budgeting allowances set during the sales budgeting process. An analysis of the deviations between actual and budgeted costs helps the sales management take corrective action, if actual spending exceeds the budgeted cost 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 exceed the targeted sales at a substantially low cost. The need to improve performance and efficiency arises when there is an under achievement of sales accompanied by heavy expenditure.

(c) Taking necessary measures - Once the causes for the gaps between the actual 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 under performance have to be analyzed and remedial measures taken to improve the sales productivity.

Difficulties in Sales Control - There are certain problems that come in the way of effective sales control. External factors (which are uncontrollable), such as the regulatory, legal, political and economic environment play an important role in the process of sales control. This process is further complicated by the inability of sales managers to obtain information about which variable in the marketing mix has contributed to the increase/decrease in sales.

Another problem that sales managers encounter pertains to the type of information that can be obtained. Although, there are several information systems that center to their needs by providing vital information pertaining to sales activities, information's pertaining to buyer's purchase plans and purchase intentions cannot be captured.

7.4 Sales Audit

In sale organisations, the sales audit is a systematic and comprehensive appraisal of the total selling operations. Sales audit appraises integration of the individual inputs to the personal selling effort, identifies, and evaluates assumptions underlying the sales operation. It is a systematic, critical, and unbiased review field appraisal of the basic objectives and policies of the selling function and of the organization, methods, procedures, and personnel employed to implement those policies and achieve those objectives; which are predetermined by the sales organisation. Proponents of the sales audit stress the importance of focusing on overall selling strategy and methods for implementing it rather than examining individual components piecemeal. It uncovers opportunities for improving the effectiveness of the sales organization. An audit identifies strengths and weaknesses: strengths have potential for exploitation; weaknesses have potential for improvements. While audit implies an after the fact evaluation or a backward approach (a carry-over from financial usage), a sales audit provides information useful for planning sales strategy. Infact, sales audit have no standardized formats. Each company designs a sales audit to fit its needs. Generally, six main aspects of selling operations come under the purview of sales audit examination, which are as following:

1. **Objectives**: Each selling input should have clearly defined objectives, related to desired outputs. For example, a firm might have the objective of raising its market share from 10 to 15 percent without reducing per unit profit in the organisation.
2. **Policies**: In case of policies, both explicit and implicit are appraised for their consistency in achieving the selling objectives.
3. **Organization**: In this aspect, it is seen that does the organization possess the capabilities for achieving the objectives? Are the planning and the control systems appropriate for achieving the predetermined targets? If an organization is understaffed, or staffed with incompetent persons, there is a least probability of achieving predetermined objectives or ensuring proper control.

4. **Methods**: In this step; it is felt that the individual strategies for carrying out policies are appropriate or not. Because, it is vain to attempt upgrading quality and price if the company has already established a strong consumer image for low quality and price.
5. **Procedures**: The steps in implementing individual strategies should be logical, well designed, and chosen to fit the situation. The procedures should allocate responsibility for implementation to particular individuals and explain how the goals are to be achieved.
6. **Personnel**: All executives playing key roles in planning sales operations and strategy, as well as those responsible for implementation of sales programmes are evaluated as to their effectiveness relative to stated objectives, policies, and other aspects of sales operations. Too often, an executive is evaluated in terms of ability to increase sales or profit rather than success in reaching pre-determined objectives, such as increased market share.

In total, it can be observed that a company examines both its markets and its products in sales audit.

7.5 Sales Analysis

Always, it is treated that the sales analysis is a detailed study of sales volume performance to detect strengths and weaknesses. If sales management-depends solely on summary of sales data it has no way to evaluate its own activities and those of the sales force. The fact that sales increased by two percent over last year but profit decreased by one percent would be a cause for concern but of no help in determining how to reverse the profit decline. Through sales analyses, management seeks insights on strong and weak territories, high-volume and low-volume products, and the types of customers providing satisfactory and unsatisfactory sales volume. Sales analysis uncovers details that otherwise lie hidden in the sales records. It provides information that management needs to allocate sales efforts effectively. These aspects are discussed below considerably:

7.5.1 Allocation of Sales Efforts

A small percentage of the territories, customers, products, or orders bring in a high percentage of the sales in many businesses and vice-versa. In most of the companies eighty percent of the customers accounted for only fifteen percent of the sales. Comparable situations exist in most companies. This is an example of the 'iceberg principle'; only a small part of the total situation is above the surface and known while the submerged part is less than the surface and unknown. Sales analysis detects such situations, alerting management to opportunities for improving the operations in the organisation. Sales efforts and selling expenses ordinarily are divided on the basis of customers, territories, orders, and so forth, rather than on the basis of sales potentials or actual sales. It usually costs as much to maintain sales personnel in poor territories as in good ones, almost as much to promote a slow-selling product as one that sells. It costs as much to have sales personnel call on customers who give small orders as on those who place large orders. Normally, a large proportion of the total spending for personal-selling efforts brings in a small proportion of the total sales and profits. Sales analysis detects these situations.

7.5.2 Data for Sales Analysis

Data availability for sales analysis varies in all companies. At one extreme, some have no data other than the accounting system records as sales are made, and, of course, copies of sales invoices. On the other hand, some maintain detailed sales records and have data readily available for use in making all types of analyses. The original sources of data for sales analysis are the sales invoices. In a company with a good information system, detailed data from sales invoices are transferred to computer tapes or data-processing cards. The information on each transaction identifies the customer in terms of name, geographical location, and so on; the salesperson in terms of name, territory, etc.; and includes such sales data as order date, products sold and quantities, price per unit, total dollar sales per product, and total order amount. With information stored by the sales organisation, sales analyses are performed quickly and at low cost.

7.5.3 Purposes of Sales Analysis

The sales analyses portray strengths and weaknesses of a sales organization in terms of sales, and each type of sales analysis glimpses different aspect. The sales territories analysis depicts about that the particular product where it can be sold. Analysis of sales by products answers how much of what is being sold. Analysis of sales by customers' answers who is buying how much: All sales analyses relate to how much is being sold, but each answers the question in a different way. Sales analyses identify different aspects of sales strengths and weaknesses, but they cannot explain why strengths and weaknesses exist. In addition to above, sales analysis answered four questions of sales manager: (i) it revealed the sales territories with good and poor performances; (ii) it showed that whom so ever salespersons are above; at par and below the quota given to them; (iii) it indicated that Edwards' performance improved as accounts got smaller, but was unsatisfactory with all sizes of accounts; and (iv) where sales were weak and strong, which salespersons were performing above or below quota, which classes of accounts were buying, and which products were being sold.

7.5.4 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:

1. **Purpose of Evaluation:** A sales manager should decide on the purpose of evaluation before starting the analysis. A simple sales analysis only lists the current sales variables and their values where as a comparative analysis is required when sales performances from many 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 strength and weaknesses in the sales function are not known unless an analysis of the sales activities is carried out. Other 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 source of data and the type of reports that need to be generated.

2. **Comparison Standards:** A simple sales analysis simply states facts where as 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 effectiveness of the sales function can be measured in an absolute or relative sense. An absolute measure is an expected or an ideal measure. 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.
3. **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. 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, sales person'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.
4. **Hierarchical Sales analysis:** It 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 cause for it. This will help identify if there are any fundamental reasons adversely affecting the performance of sale personnel in a particular area, such as poor economic conditions, high unemployment, fierce competition, low sales morale, etc.

7.5.5 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 source 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's, field visits and insights of the manager as well as external sources 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, bill of sale, cash registers, etc. The sales invoice identifies the amount and type of products that customers have bought. This source document should capture that a data in a format that can be easily read and processed.

3. Processing of sales data

Most firm 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.

7.5.6 Bases for Analysing Sales Volume

Following are a few bases of analyzing sales volume:

1. **Total sales volume**

   It is a combined sale of all products in all territories for all customers. The study of total sales volume requires the following data (a) the annual sales figures for the company over the past several years, and (b) the annual industry sales in the geographic market covered by the firm. From these figures, the company's share of the market can be determined.

2. **Sales by territories**

   Analysis of sales volume by territories helps management to identify which territories are strong and which are weak in relation to sales potential.

3. **Sales by products**

   A few products may bring most of the sales volume (80-20 rule). There is no relation between volume and profit. Products having high volume of sales may not contribute a high percentage of net profits. Types of sales volume analysis by products that may be helpful to sales management are:

   (i) A summary of present and past total sales divided into individual products or groups of products, which helps sales managers to study the sales trend for each individual product/group of products.

   (ii) Sales of each product-line in each territory, which can be used to determine the geographical market in which each product is strong or weak.

   As a part of sales volume analysis by products, sales managers must decide what to do about low-volume products and products that did not meet their goals.

4. **Sales by customer classifications**

   80-20 principles is applicable to sale analysis by customers. A small percentage of customers account for a major share of total sales volume. In addition, a firm may sell to many accounts on a marginal or even unprofitable basis.

   Sales volume by customer groups is analysed in the following ways:

   (1) Accounts on an industry basis
   (2) By channel of distribution
   (3) On the basis of accounts (e.g., key accounts)
   (4) Combination basis

   Any of these customer classifications usually should be analysed for each territory and for each line of products. A sales volume analysis alone usually does not furnish enough information to the sales department. The rupee sales volume does not provide any data regarding gross-margin. Hence, a marketing profitability analysis is ideal. Therefore, sales performance measures include marketing –cost analysis and profitability analysis in addition to sales volume analysis. When the sales volume analysis includes the cost of merchandise sold, the sales management can do gross margin analysis by territories, products or customer groups.

7.5.7 Problems in Sales Analysis

The sales analysis is dependent on accounting records for the gross sales and sales returns. Therefore, 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.

7.6 Marketing Cost Analysis

In the Marketing cost analysis; the sales volume and the selling expenses are analyzed to determine the relative profitability of particular aspects of sales operations within a specified period of time. The first step in marketing cost analysis is sales analysis by territories, sales personnel, products, class of account, size of order, marketing channels, and other categories. The outcome indicates relative profitability of the sales territories. Marketing cost analysis searches for ways to improve profit performance through exposing relative strengths and weakness of the sales organization and its sales people.

7.6.1 Purpose of Marketing Cost Analysis

The analysis in terms marketing cost determines the relative profitability of particular aspects of sales operations. By this analysis, various issues can be answered like: (i) which sales territories are profitable and which are unprofitable; (ii) what are the profit contributions of individual sales personnel; (iii) what is the profitability of the different products; (iv) what is the minimum size of a profitable account; (v) how small can an order be and still be profitable; and (vi) which marketing channels provide the most profit for a given sales volume? Further, the marketing cost analyses indicate aspects possibly requiring managerial action, but not the nature of the action. If the expenses of selling different products, for instance, are cross-analyzed with the expenses incurred by individual sales personnel, insights are gained on how sales time should be allocated among products. Nevertheless, the point related to improvement in sales time allocation among products requires consideration of other factors among them, sales potentials for each product in each sales territory. The marketing cost analysis also discusses about the price discrimination among the products. Especially, a marketing cost analysis performed for this purpose would aim to show that the difference in prices was no greater than the difference in selling expenses incurred in servicing the two customers.

7.6.2 Marketing Cost (Profitability) Analysis Procedure

Steps involved are:

1. **Specify the purpose:** The sales managers must decide the purpose to determine the profitability of sales territories, sales representatives, customers, product-lines or organisational units such as district or branch office. Some costs may be direct to one segment but indirect to another. Only by specifying the precise purpose, the analysis is the sales manager able to classify costs as direct or indirect or fixed or variable.
2. **Identifying functional cost-centers:** Functional cost centers for sales organisations can be broadly categorised as (a) order-getting costs, and (b) order -filling costs. Order- getting costs pertain to activities that obtain sales orders, such as direct selling and advertising expenditures. Order-filling costs relate to activities that follow sales (such as order processing, packing, shipping and delivery).
3. **Converting natural expenses into functional accounts:** The accounting statements are used and the accounting expenses must be reassigned based on the purpose of expenditure. For example, profit and loss statement is used in the basis form:
   (a) Sales- Cost of goods sold = Gross margin
   (b) Gross margin-Expenses = Net profit or loss

   Traditional income statements do not reveal the specific purpose of expenditures, i.e., the costs of performing different marketing activities.
4. **Allocating functional costs to segments:** To determine the profitability of separate market segments, the functional costs must be allocated based on the costs incurred in the process of serving the segment. In making the cost allocations, the bases used are: selling time and number of sales calls or actual floor space occupied.
5. **Determining profit contributions of segments:** Professional sales managers want to identify unprofitable customer accounts, products or territories that can be serviced less frequently or dropped for increased overall profitability. The 'concentration principle' implies that often one third of products, customers, orders, sales territories and sales people accountant for two third of profits.
   Profit contributions of segments can be examined in two basic ways: (i) by individual segments, or (ii) by cross-classification of segments, when studied individually, segment categories are examined sequentially. Analysis determines the profitability of one segment category such as product class, and then moves to territory or customer type and so on until all segments are investigated.

7.6.3 Marketing Cost Analysis Techniques

1. **Selling expenses classification**: Marketing cost analysis requires the classification of selling expenses as either separable (direct) or common (indirect). A separable expense is one traceable to individual sales personnel, sales territories, customers, marketing channels, products, or the like. A common expense is one that is not traceable to specific sales personnel, sales territories, customers, marketing channels, products, or the like. Whether a given expense is a separable or common expense may depend on company

policies or aspects of the operation under study. If sales personnel are paid salaries, for example, the outlay for salaries is a common expense as far as selling individual products is concerned. But if sales personnel are paid commissions, sales commissions are a separable expense of selling individual products and of selling particular categories of account or individual customers.

2. **Alteration of accounting expense data and activity expense groups**: Conventional accounting systems record expenses according to their immediate purpose. In marketing cost analysis, accounting expense data are converted into activity expense groups all the expenses related to field sales operations are grouped together i.e. sales salaries, sales commissions, sales travel expense, and branch sales office rent to determine total expense for this activity.
3. **Allocation bases for common expenses**: Selection of bases for allocating common expenses is troublesome. In contrast to the analysis of production costs, where a single allocation basis, such as number of machine hours, is used for allocating all manufacturing expenses, some forms of marketing cost analysis require the allocation of selling and marketing expenses on several bases. Allocation bases are factors that measure variability in the activities for which specific expenses are incurred. Allocation bases permit logical assignment of portions of common expense items to particular aspects of sales operations. Some expenses, such as credit and collection expenses, can be allocated according to a logical basis in any type of marketing cost analysis. However, other expenses, such as sales salaries, can be allocated to sales territories or to customers but not usually to products, unless available data show the allocation of sales time among different products. For most marketing cost analyses, no attempt is made to allocate all common expenses, only those that can be allocated on logical bases. Marketing cost analyses determine relative profitability, not net profitability, of particular aspects of sales operations. Therefore, there is no need to allocate all common costs in the sales organization.
4. **Contribution**: Marketing cost analyses focus upon separable expenses and those common expenses available for allocation on logical bases, relative profitability is measured as a contribution margin. Contribution = Net Sales - Cost of Goods Sold - (separable expenses + common expenses allocatable on logical bases).

7.7 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. It can be either an internal audit or an external audit depending on who is conducting the audit. In an internal audit, a person from with in 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 consultant or a management consulting firm undertakes the audit. An external audit is recommended to ensure objectivity. Exhibit 7.2 describes the procedure followed at 3 M while conducting an internal marketing audit.

Exhibit 7.2: 3M's Internal Marketing Plan Audit

3M uses an internal marketing plan audit procedure to help the divisional marketing managers to 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 as 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 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 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.

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.

7.7.1 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.

1. 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.

2. 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.

3. Report Preparation and Presentation

This 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 cases, leads to discussions and debate among mangers and results in an action plan to overcome the problems or utilize the opportunities identified in the audit.

7.7.2 Components of a Marketing Audit

A marketing audit usually starts with a study of the marketing environment an 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. It comprises six components audits, which may be conducted individually and partially interdependently if the company does not want a comprehensive audit.

(a) Marketing Environment Audit

A marketing environment audit involves a study of macroeconomic factors like the economic, demographic, political, legal, technological, and socio cultural forces over which the firm has no control. The marketing 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.

(b) Marketing strategy audit

The audit looks into 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.

(c) 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.

(d) Marketing systems audit

The marketing function of organizations involves collecting information, planning and controlling the marketing activities like sales forecasting, marketing planning and 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.

(a) 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.

(b) Marketing function audit

It 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.

7.8 Principles of Sales 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.

7.8.1 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 weakness 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 is underneath and thus the term 'iceberg principle'. Therefore, in order to obtain accurate and complete information about the sales figures, the sales data should be broken down into individual sales segments.

7.8.2 80-20 Principle

The 80-20 principle, also called the Pareto principle. The 80-20 rule states that 20% of the elements are responsible for 80% of the results. This rule can be applied to all areas of business and helps management to focus on the real problem or issues. In sales analysis, this principle states that 80% of a firm's sales volume comes from 20% of its customers. Thus, not all business units of firm contribute equally to profitability. Firms facing the 80/20 situation can adopt certain strategies to alter the ratio and increase their profits. This 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.

7.8.3 Cross –classification

It 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, either they can 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. It helps the sales managers to arrive at the same information but with the product-customer detail added. It involves more than two categories complicate the information.

7.9 Summary

The present day dynamic market place has forced sales managers to shift 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 actual with the targets, and taking up corrective action if necessary.

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. 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. 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. 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. A marketing audit evaluates and enhances the effectiveness of a firm's marketing operations by studying its marketing strategies, policies and practices. Sales manager 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. 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 behaviour of sales data and the actual reasons underlying them. They forewarn sales mangers of impending dangers and help them to take measures to counter them.

7.10 Self Assessment Questions

1. Define Sales-analysis? Explain with suitable example.
2. What are the steps in designing a sales control system?
3. How the sales analysis techniques have become so important in success of firm?
4. Discuss the objectives of a sales audit and sales analysis?
5. Discuss the various steps involved in marketing cost analysis.
6. Describe the various types of marketing cost analysis.

7.11 References Books

- Cundiff, E.W., R.R. Still, and N.A.P. Govoni, 'Sales Management – Decision, Strategies and Cases', Pearson Education, 5th edition, 2009, New Delhi.
- Bhat S.K., 'Sales and Distribution Management', Himalaya Publishing House, 2011, Mumbai.
- Gupta, S.L., 'Sales and Distribution Management- Text and Cases- An Indian Perspective', Excel Books, 2005, New Delhi.
- Chunawalla, S.S., 'Advertising, Sales and Promotion Management', Himalaya Publishing House, 2002, Mumbai
- 'Sales & Distribution Management', The ICFAI University Press, 2004, Hyderabad.
- Spiro, R.L., W.L. Stanton, and G.A. Rich, 'Management of a Sales Force', Tata McGraw Hill Publishing Co. Ltd., 11th edition, 2003, New Delhi.
- Anderson, R.E., J.F. Hair, and A.J. Bush, 'Professional Sales Management' McGraw Hill Publications, 3rd edition, 1999, New Delhi.

Unit - 8: Procurement & Training

Structure of Unit:

8.0 Objectives

After completing this unit, you would be able to:

- Understand the concept of procurement;
- Know about Procurement Life Cycle;
- Understand traditional and strategic procurement;
- Know the types, scope and purpose of training;
- Understand how to develop a training programme.

8.1 Introduction

The term ‘procurement’ covers all aspects of the acquisition and delivery of goods or services, spanning the whole contract life cycle from the identification of needs to the end of a service contract, or the end of the useful life and subsequent disposal of an asset. Management training includes courses, workshops and other techniques that prepare managers to face the wide array of challenges involved in supervising people and managing systems and projects. Some companies provide their own training in the form of workshops or seminars; others send management personnel to conferences or outside courses. Some companies contract with professional trainers to offer weekly sessions at the workplace on various management and supervisory topics.

8.2 Procurement Management

Public procurement (PP) management is a cornerstone of good governance. It cuts across all economic sectors and constitutes around 15-30% of the gross domestic product in all countries. Hence its significance for enhancing market competitiveness and sustainable development. Setting up effective national PP systems has often been a challenge, not least because of a deficit in competent human resources and the need to keep up-to-date with the ever-increasing complexity of the legal framework, the globalization of markets, and sophisticated contractual and tendering mechanisms.

The Centre has also actively supported national procurement reform worldwide through assistance with the setting-up or modernization of the four pillars of effective national PP systems, namely:

i) legal framework;

ii) institutional framework;

iii) administrative and managerial processes and systems, including bidding documents and training systems;

iv) Market competitiveness and systems for detection and prevention of fraud and corruption.

How Does Procurement Management Works?

Following are the four main working areas of concerns when it comes to procurement management. The following points should be considered whenever procurement process is involved:

- Not all goods and services that a business requires need to be purchased from outside. It is for this reason that it is very essential to weigh the pros and cons of purchasing or renting these goods and services from outside.
- You would need to have a good idea of what you exactly require and then go on to consider various options and alternatives. Although there may be several suppliers, who provide the same goods and services, careful research would show you whom of these suppliers will give you the best deal for your organization.
- The next step typically would be to call for bids. During this stage, the different suppliers will provide you with quotes.
- After the evaluation process, you would be able to select the best supplier. You would then need to move on to the step of discussing what should go into the contract. Remember to mention all financing terms how you wish to make the payments, and so on, so as to prevent any confusion arising later on, as this contract will be binding.

8.3 Procurement for Project Managers

Projects often require the acquisition of goods or services to be successful. A make-lease-buy decision, as a part of the acquisition strategy, can critically impact a project's benefits and outcome. Formulate the make-lease-buy decision; prepare an effective procurement management plan to guide the team, and use outsourcing and partnering for maximum benefit. Steps involved are:

- Conduct a make-lease-buy analysis
- Prepare a procurement management plan
- Identify strategic advantages of specific contract types
- Use outsourcing effectively
- Establish a partnering program
- Perform a successful evaluation

Steps involved in procurement include:

- **Plan Procurements**
  - Planning procurements and acquisitions
  - Conducting make-lease-buy analyses

- **Conduct Procurements**
  - Sources of prospective sellers
  - Negotiation strategies to enhance position
  - Reaching agreement during procurement negotiations

- **Administer Procurements**
  - Roles and responsibilities: project team, contracting organization, and sellers

- **Close Procurements**
  - The procurement closure process
  - Contract documentation
  - Formal acceptance and closure for sellers

8.4 Programmes for Improving Procurement Management

Following steps may be taken to improve procurement management:

1) Provide Procurement Training
   - Assess the procurement needs
   - Develop course curriculum
   - Select the trainees
   - Identifying the national, international training institutions to provide training
   - Select resources that may be able to deliver training courses including seminar / workshops
2) Develop Public Procurement Database
   - Carry out survey of public procurement entities including staffing and their qualification
   - Develop a procedure for obtaining relevant public procurement data for goods, works and consultants services from concerned entities
   - Establish a database for public procurement entities
3) Project Management Training
   - Provide training separately on Project Management in order to develop management skills.
4) Develop Management Information System (MIS)
   - Review the existing monitoring system
   - Develop an MIS on the basis of present system to monitor project and procurement implementation.
   - Development of website and electronic bid processing system
   - Introduction of MIS for procurement performance tracking
5) Formation of a special pool of procurement specialist.

- Develop criteria for selection of training of trainers, procurement professionals, govt. officials and public and private sector auditors and other relevant persons.

6) Procurement and Compliance Monitoring
   - Project will include a provision of technical assistance to establish and operational a fully computerized and real-time procurement database and management information system (MIS) at the CPTU

8.5 Procurement Life Cycle

Mastering procurement

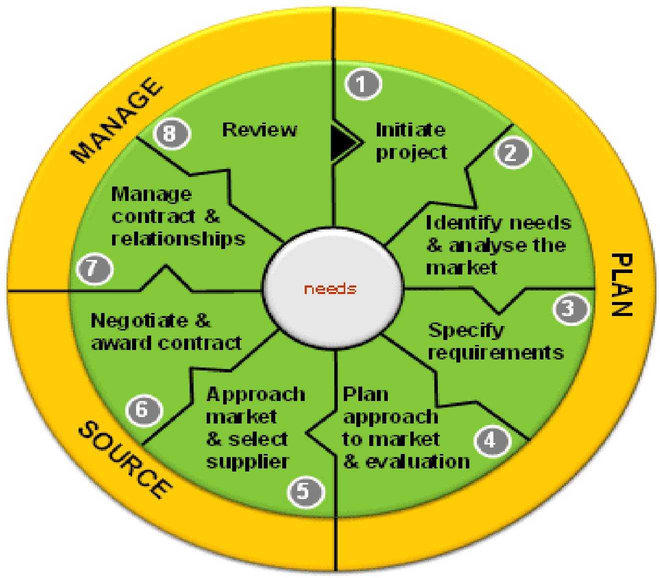


Figure 8.1: Procurement Lifecycle

The procurement lifecycle separates procurement into three phases: planning, sourcing and managing. These phases are further divided into eight distinct, but interrelated stages which are:

1. Initiate project - It is essential to identify key stakeholders at the beginning of the procurement. Consider both internal and external stakeholders. Key stakeholders have interests and influence. Conducting an analysis of stakeholders can help identify issues associated with the procurement and delivery as well as providing an opportunity to learn from their experiences and use this to improve the quality of future outcomes.

A useful tool to help identify different categories of stakeholder is RASCI:

R = responsible: The person who is ultimately responsible for delivering the project and/or task successfully

A = accountable: The person who has ultimate accountability and authority; they are the person to whom 'R' is accountable

S = supportive: The person or team of individuals who are needed to do 'the real work'

C = consulted: Someone whose input adds value and is essential for successful implementation, or from whom you need to gain 'buy-in'

I = informed: The person or group who need to be notified of results or action taken or results achieved but don't need to be involved in the decision making or delivery.

2. Identify needs and analyse the market - The quality of research and analysis, to identify the public policy/business needs, at this stage will seriously impact upon the quality of the solutions and results you achieve. The first step is to consult with key stakeholders and develop a high level statement of needs. Consider the following:

- What is the purpose of the procurement?
- Who will be impacted by the procurement?
- Who are the key stakeholders and what are their expectations?
- Who are the major internal client's and what are their highest needs?
- Who are major external users or recipients of the goods/services and what are their highest needs?
- What similarities and differences become apparent between the needs of the two groups?

The consultation should aim to ensure that:

- stakeholders constructively engage and have 'buy-in'
- stakeholders are able to self-identify their current, predicted and emerging needs
- the consultation elicits information about individual and collective needs
.

Figure 8.2: Market Research Options

3. Specify requirements - At this stage, having defined the needs and researched suppliers and the market, it is now appropriate to clearly, concisely and articulately state the requirements. Requirements can be written in various formats. Often the nature of the format will depend upon the type of procurement and the agency's own practice. Some popular formats include:

- Terms of reference
- Description of services
- Scope of work
- Service specification
- Specification of goods
- Statement of work
- Scope of requirements

Performance standards and measures are essential tools in procurement. There are usually called Key Performance Indicators (KPIs). When applied to the supply of goods/services they allow the buyer to clearly set the parameters for success. In applying the maxim 'what gets measured gets done' it is important not to lose sight of being able to measure what really matters. The 10 Tests of a performance measure It is important to plan what you expect and inspect what you plan.

The 10 Tests can be a helpful to check:

- **Truth test:** are we measuring what we set out to measure?
- **Focus test:** are we measuring only what we set out to measure, and not things that are out of scope?
- **Relevance test:** are we measuring the right thing?
- **Consistency test:** does the measure give a consistent result whenever and by whomever it is applied?
- **Access test:** can the data be easily accessed and understood?
- **Clarity test:** is there any ambiguity in interpreting the measure or the results?
- **'So-what' test:** will the result give us information that we can act upon?
- **Timeliness test:** will the data be available in time to affect action?
- **Cost test:** how much will it cost to measure and is this cost effective?
- **Gaming test:** what behaviours will the measure discourage and encourage? Is there a risk of unintended consequences?

4. Plan approach to market and evaluation - This stage involves deciding an appropriate approach to market, evaluation methodology, process plan and realistic timetable. It brings together your analysis and thinking to date. It results in a procurement plan. There are several process options that need to be clarified. These include:

- Pre-tender supplier engagement?
- Open or closed tender?
- Single stage or multi-stage tender?
- Type of RFx document required (RFQ, ROI/EOI/PQQ, RFP/RFT)?
- Advertising the opportunity (GETS, industry publications/websites)?
- Will alternative proposals be considered?

5. Approach market and select supplier - Suppliers must be treated fairly, impartially and equitably at all stages in the procurement process. This means that ethical standards of behaviour must be demonstrated by all people involved in the procurement at all stages in the procurement. Supplier selection must be based on the process and methodology set out in the procurement plan. You should not deviate from the plan as this can affect the integrity of your process and may result in a legal challenge. If you must change any aspect of the process or methodology you are obliged to notify all potential suppliers and give them sufficient time to respond to the change being made. What is sufficient will depend on the nature of the change.

When implementing the procurement plan here are some key points to remember:

- Each offer must be carefully considered, on an equal basis, against the published evaluation criteria. Your process must follow the approach and methodology set out in the procurement plan and reflected in the RFx.
- Clear, succinct and comprehensive notes are to be taken of all evaluation panel discussions and findings. You should keep a full record of how each offer was assessed against the criteria and demonstrate that each received due and fair consideration. Where an offer is rejected the reasons for the rejection must relate to the criteria, be justifiable, clearly explained and recorded in writing.
- The panel recommendation must be documented with sufficient information to support the scores awarded and the ranking of offers. The rationale for the evaluation panel's recommendation must be based on the findings of the evaluation panel. The recommendation must by supported by clear, transparent and justifiable reasoning.

6. Negotiate and award contract - Negotiation is about reaching agreement on the essential terms of the contract and the deliverables under the contract. It can be a form of trading where both parties are seeking something from the other; there is an exchange of offers, concessions and bargaining. For collaborative relationships the focus will be on gaining a win-win solution. For tactical relationships the approach will be competitive.

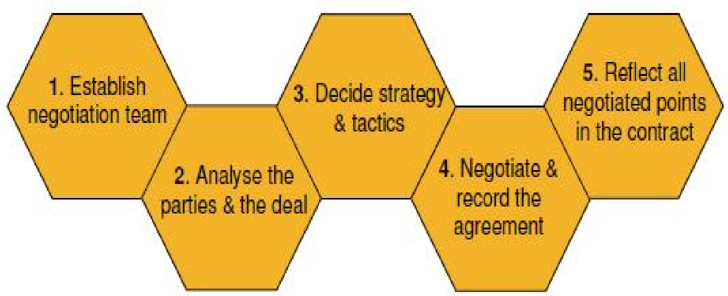


Figure 8.3: Steps to Negotiation

Post negotiation - It is essential to record the exact terms of the negotiated agreement and reflects these in the contract. It is good practice to have an independent officer check and sign the contract. There should be a separation between the person signing the contract and the person who will have day-to-day responsibility for contract management. Most agencies adopt the 'one-up' system, where a manager at the next level up signs the contract.

Supplier debriefs - A good debrief to both successful and unsuccessful suppliers at the end of a tender helps to identify areas where they can improve in future tenders. It gives suppliers the chance to ask questions about the process and to improve their knowledge and understanding of government procurement. It also allows you to show your transparency and accountability in awarding contracts. And it's a two-way street – suppliers can provide feedback to your agency and suggest ideas that could make it easier to do business with government.

Post award notification - The decision to award a contract is typically made when the evaluation panel's recommendation on the preferred supplier has been approved, and any conditions attached to the recommendation (e.g. subject to reference checks) have been resolved. To ensure transparency you need, at the very least, to communicate the two key decisions relating to the award:

7. Manage contract and relationships - Contract management is the process that enables the agency and supplier to meet their obligations in order to deliver the objectives required from the contract, on time, to quality and specification and within budget. This means actively tracking and monitoring delivery and costs, managing risks, and actively managing the relationships between the agency, the supplier and key stakeholders. This process continues throughout the life of a contract and involves managing proactively to anticipate future needs as well as reacting to situations that arise. Ultimately the success of the commercial relationship often comes down to the relationship between the agency and supplier - get it right and the benefits will flow. The benefits of developing and maintaining a good supplier relationship fall on both parties.

The three key factors for successful supplier relationships are:

- openness and excellent communications
- developing mutual trust and understanding
- a joint approach to managing delivery and any related problems.

8. Review - Reviews are an important part of the overall procurement process. A review can improve procurement management and demonstrate public accountability by providing an honest independent appraisal of the procurement, the delivery of the contract and the outcomes achieved.

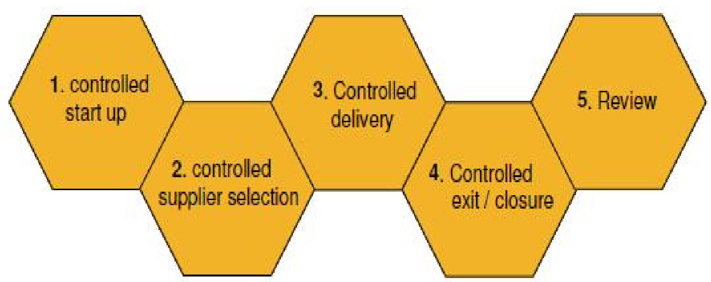


Figure 8.4: Project Implementation Process

A review provides an opportunity to check if the anticipated benefits have been achieved, and if there are opportunities for improvements in what we do and how we do it. Reviews must be conducted in an open manner. Agencies must be prepared to learn in order to get most value from a review. Participants must be prepared to make constructive criticism. It is only in this way that real lessons will be learned or improvements to policy or business objectives made. If the review is to add real value its recommendations need to be implemented by the agency and key stakeholders. This may involve realigning policy settings or changing business systems or processes. Recommendations must be sufficiently robust for the agency to be able to act upon them.

8.6 Traditional versus Strategic procurement

There are several differences in methodology and execution between traditional approaches to individual procurements and strategic approaches.

- A traditional approach to procurement is to view it as an administrative function for buying goods/services.

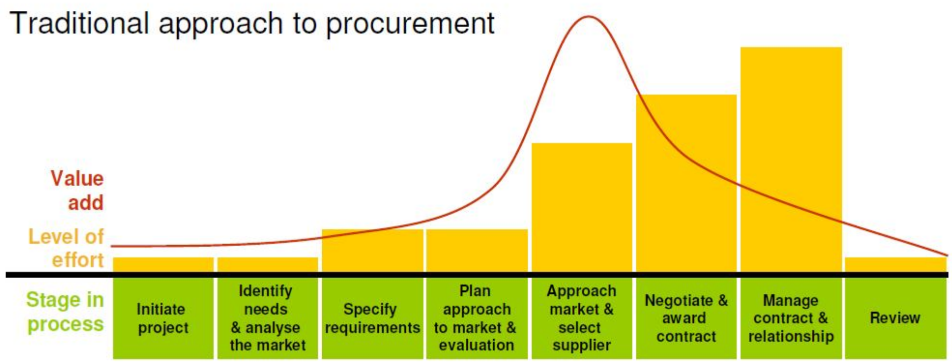


Figure 8.5: Traditional Approach to Procurement

- A strategic approach involves understanding the importance of the procurement to the agency in achieving its outcomes, sourcing suppliers and managing relationships to successfully deliver against public policy objectives and business needs, whilst delivering overall value for money.

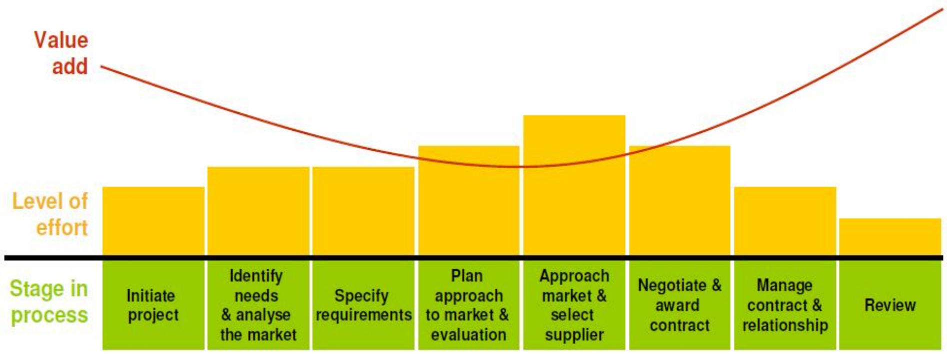


Figure 8.6: Strategic approach to procurement

8.7 Scope and Purpose of Training

The policy of training apply to all government construction projects and activities concerned with demolition, building, landscaping, maintenance, civil engineering, process engineering, mining and heavy engineering. This includes projects that involve private sector participation in the provision of the State's assets, for example, by way of Build/Own/Operate schemes and similar arrangements.

The aim of these Training is to facilitate the achievement of improved training management on government construction projects; and to make training and skills development a part of the culture of enterprises in the construction industry.

Contractors seeking to work on government construction projects will be required to develop and implement training management plans that are appropriate to the nature, size and capacity of their enterprise and projects. In a changing market, construction industry enterprises are responding by focusing on innovation, capacity and the capability to perform efficiently and profitably. The skills and flexibility of the workforce are critical to success.

Industry enterprises are integrating training and skills development into their planning and management through:

- •expanding the pool of skilled workers by offering structured entry-level training such as apprenticeships, traineeships and cadetships to people who wish to enter the industry
- •enhancing the skills of existing workers and those re-entering the construction industry by providing skill opportunities in enterprises and on projects.
- •creating and extending opportunities for women and Aboriginal and Torres Strait Islander people.

8.8 Types of Training in Management

Different types of trainings include:

- **Orientation Training** - This training is geared for the newly hired or reassigned personnel. These programs are designed to give new employees the basic knowledge, understanding, and skill needed for successful job performance. Programs include orientation and various job skills training such as computer usage, communication techniques, phone usage, etc.

  Human Resource Management Services provides general orientation that is designed to give employees a general knowledge of state policies, procedures, and practices relating to the employment relationship. The individual agencies complete orientation by providing information on agency policy and job-specific instruction.
- **Remedial Training** - This training is designed to correct observed deficiencies in employee knowledge, skill, and attitudes. Programs include stress reduction, time management, presentation skill building, assertiveness building, business writing, hands-on experiences in word processing, computer software, etc.
- **Upgrading or Advanced Training** - This training is designed to improve or upgrade individual job skills and knowledge. Programs include advanced computer training, decision making, employment laws, managing conflict, conducting performance evaluations, sensitivity training, supervisory responsibilities, resolving grievances, etc.
- **Right Training at the Right Time** - Supervisors, who perceive a training need, should contact their human resource officer or Human Resource Management Services, who can assist in developing a needs assessment to identify a specific training need. Once the direction is known, agencies may develop short and long-term plans in relation to staffing objectives, career ladders, organization development, etc.

8.9 Benefits of Training Management

Benefits that accrue from the implementation of training management initiatives in individual enterprises include:

- a more motivated, flexible and adaptive workforce
- enhanced workforce capability and skills that are aligned with business goals
- increased innovation
- continuous improvement of processes resulting in better quality products and services
- increased client satisfaction and stronger relationships
- improved competitiveness and opportunities to grow the business
- increased profitability due to improved performance and productivity.

Developing a training management focus will assist contractors and their service providers to comply with the workplace reform, training and skills development requirements outlined in the NSW Government Code of Practice for the Construction Industry and in demonstrating their achievements.

8.10 Developing a Training Management Plan

An Enterprise Training Management Plan and a Project Training Plan must contain the following sections:

A. Apprentice and training targets - An Enterprise Training Management Plan must include:

- total workforce size and trade workforce size
- subcontractors engaged on projects
- apprentice and training targets
- a time frame for implementation.

B. Commitment and management responsibility - An enterprise's training management policy statement:

- has the full support and commitment of the chief executive officer and senior management
- defines training management policies, objectives and targets
- identifies those responsible for training management matters, and the initiation of corrective action
- outlines communication processes with workers, unions, other contractors and subcontractors on training management issues
- outlines measures for assessing subcontractors' ability to fulfill training management commitments and obligations.

C. Planning - This is an ongoing process that determines present and future needs and requires consideration of:

- the skills clients and other service providers need from the enterprise and how the enterprise can become more useful to clients and other service providers
- confirmation of the business goals of the enterprise
- what the enterprise and workforce need to do to make the business more successful

- a consideration of the skills the enterprise needs from the service providers who work for it (i.e., contractors, subcontractors and consultants or suppliers).

D. Prioritized needs - When identifying skills needed and who to train, the enterprise will need to consider each individual's:

- existing skills and experience
- interest in learning
- commitment to the enterprise
- career aspirations.

E. Workforce Participation - Training can happen on the job, off the job, through mentoring, or in a program that combines all three. The method chosen will depend on:

- the type of skill being learnt – some skills are best learnt a particular way
- the person being trained – bearing in mind their capabilities and preferences
- the needs of the enterprise – how quickly the enterprise needs the skill, and how much it can afford
- The availability of training – for example, some skills can only be developed on the job.

F. Resources - The resources essential for the implementation of the Enterprise and Project Training Management Plan and the achievement of the workforce participation measures and targets should be defined and available. These include human, physical (e.g. facilities and equipment) and financial resources. In allocating resources, the enterprise can develop procedures to track the benefits as well as the costs of its workforce training management activities at both the enterprise and project level.

G. Accountability/Responsibility - Personnel at all levels should be accountable, within the scope of their responsibilities for training management performance in support of the Enterprise Training Management Plan and the Project Training Management Plan. A management representative should be nominated as responsible for implementing the Enterprise Training Management Plan and the Project Training Management Plan. There should be no doubt as to who is responsible for taking decisions, monitoring the plan, tracking outcomes and for acting on issues.

H. Subcontractors - Contractors must be able to demonstrate:

- the measures they will take to select subcontractors who can implement training and skill development initiatives and fulfill training management obligations
- how dealings with subcontractors and other contractors is to be managed, and
- how ongoing subcontractor compliance with training management requirements is to be monitored and assessed.

I. Evaluation and Review - Training management activities need to be monitored to make sure that:

- everyone understands and works towards the objectives of the Enterprise and Project Training Management Plan

- the schedule stays up-to-date, so learning activities match production or business requirements
- the trainees and the resources they need are available when needed.

J. Records - Records provide evidence of implementation of the Enterprise Training Management Plan and the Project Training Management Plan:

- employee, subcontractor and service provider induction and training outcomes
- subcontractor information on implementation of their Training Management or workforce participation measures
- workforce participation targets achieved
- monitoring, management review reports and results including follow-up action.

8.11 How to Develop a Public Procurement Training Program

While the idea of developing or redesigning a training program can be daunting, you probably already have many of the skills needed to tackle this project. The questions you have to answer and the process you have to follow should seem familiar to anyone with procurement experience.

Step 1: Figuring out the basics - Let's say a decision has been made to design a new municipal building, and you're put in charge of guiding the construction. You'll need to know some basic facts before you begin the procurement process itself, such as:

1. The budget
2. The purpose of the new building
3. Other staff members, if any, who can assist with the procurement process
4. Deadlines

Step 2: Research the details - Once you've determined the basic parameters of your building project, you'll need to do some research—probably with the assistance of a designer—to get a clear idea of what should be included in your specifications and scope of work. Similarly, you need to spend time and effort on determining what content should be included in your procurement training program.

Step 3: Find and develop courses - There are several reputable organizations that already offer courses related to procurement generally and public procurement specifically, such as NIGP, ISM, and NAEP. You will need to determine which of your learning objectives can be best taught through these outside sources, and which of your learning objectives may be better taught through training developed by your own staff members. (Some issues to consider: (1) cost to purchase from outside sources, (2) cost to develop and administer "in house," (3) location and travel costs, and (4) quality of instruction. When evaluating outside course offerings, use your procurement experience: be clear about what you're looking for, and evaluate fairly.

Step 4 Implement and manage - After the municipal building construction contract has been awarded and executed, we'll need to determine how to manage it: what are the deadlines? What are your responsibilities under the contract? What are the contractor's responsibilities? And once when the project is underway, we have to manage it: make sure the deadlines are met and that problems are dealt with in a timely manner.

Step 5 Evaluate - As our construction project is underway, the people supervising the construction will constantly evaluate our contractor's performance. You should have a system in place to record and track those evaluations so you know how the project is progressing, so you can deal with any problems before they get out of hand, and so you know whether you'd like to work with the contractor in the future. The same holds true for our public procurement

8.12 Summary

Efficient procurement and contract management are at the heart of a productive economy. When administrators work together to buy goods and services, government and organisations can achieve better value for shareholders and taxpayers. Consequently, it is important that a strong community of skilled procurement and contract management professionals with consistent standards and training manage these vital activities. In this environment of a critical skills shortage, people with high-level project management skills, experience and qualifications are highly sought after. The Key to Good Procurement Actions include; Common Sense, Sound business approach, Integrity and ethical standards, Planning, Internal management controls, Clear and detailed conditions, terms and specifications, Open and free competition, and Careful award.

8.13 Self Assessment Questions

1. What do you mean by procurement? Explain the Procurement life cycle in any organization.
2. Describes the programs for improving procurement & training in details.
3. Differentiate between Traditional v/s Strategic Procurement?
4. Write a detail notes on scope & purpose of Training.
5. What do you mean by Training in management? Also State the benefits of Training management
6. Discuss the Developing Training Management Plan in detail.
7. Discuss the Types of Training in management in details.

8.14 Reference Books

- Callender, G., and D. Matthews, The Economic Context of Government Procurement: New Challenges and New Opportunities. 'Journal of Public Procurement', 2002, 2 (1): 55-71.
- Ukalkar S., 'Strategic Procurement Management for Competitive Advantage', Oxford University Press, 2000
- ITCILO/SIGMA-Westring G. and G. Jadoun, 'Public Procurement Manual', 1996
- NIGP-Thai K.V, 'Introduction to Public Procurement', LEAP Textbooks, 2004
- Thai, K. V., Public Procurement Re-examined, 'Journal of Public Procurement', 2001, 1 (1): 9-50.

Unit – 9: Compensation

Structure of Unit

9.0 Objectives

After completing this unit, you would be able to:

- Know about the elements, forms and basis of compensation;
- Understand importance, theories and types of compensation;
- Know how compensation plans are designed;
- Know the benefits and challenges of compensation;
- Learn how to make compensation plans effective.

9.1 Introduction

Compensation is money or other benefits provided by the library organization to employees in return for their work. The term compensation means any form of payment made to an individual for services rendered as an employee for an employer; services performed as an employee representative; and any separation or subsistence allowance paid under any benefit schedule provided in conformance with title VII of the Regional Rail Reorganization Act of 1973 and any termination allowance paid under section 702 of that Act. Compensation may be paid as money, a commodity, a service or a privilege. However, if an employee is to be paid in any form other than money, the employer and employee must agree before the service is performed.

9.2 Theories of Compensation

Discussed below are a few theories of compensation:

(a) Equity Theory - According to this theory, fairness about pay differentials among individuals who hold the same job can be established by using:

- Seniority-based pay systems that reward longevity.
- Merit-based pay systems that reward employee performance.
- Incentive plans that allow employees to receive part of their compensation based on their job performance.

- Skills-based pay systems.
- Team-based pay plans that encourage cooperation and flexibility in employees.
- Comparing inputs and outputs of a similar co-worker
- Perceived inequity affects employee effort

Two types of equity can be ensured:

- **Internal equity** – This can be achieved by the following:
  - Comparison of my input / reward ratio with that of similar others.
  - Employees may seek to address imbalance by changing their inputs.
  - Fairness of pay differentials between different jobs in the organization can be established by job ranking, job classification, point systems and factor comparisons.
- **External equity** – This can be achieved by:
  - Providing fairness of organizational compensation levels relative to similar jobs in other organizations.

(b) Expectancy Theory - According to this theory:

- People are motivated by intrinsic and extrinsic outcomes they desire.
- People will only be motivated if outcome is possible.
- People will only be motivated if outcome is contingent.

(c) Exchange Theory - According to this theory:

- Pay is an exchange for efforts
- Implicit Social Contract: It means beliefs about mutual obligations
- Implicit Psychological Contract
- Temporal Quality: It means amount of time in job & career

9.3 Types of Compensation

Three basic types of compensation are **(a) Direct:** Pay, usually in the form of hourly wages or salary and it also includes bonuses. **(b) Indirect:** (sometimes called “fringe benefits” or simply “benefits”). Legally required benefits (like Social Security and unemployment insurance) and other benefits that provide health care and otherwise contribute to the welfare of the employee. Most often, these are health insurance, retirement, and paid time off (annual leave, holidays, and personal days). Selected indirect benefits may be continued upon the employee’s retirement. **(c) Total:** Taking everything into account. Pay, benefits, and what it is like to work at your library. This includes a friendly workplace, professional development opportunities, flexible scheduling, status and recognition, constructive feedback, a reasonable workload, and the degree of autonomy within the job.

9.3.1 Financial and Non- Financial Compensation

Discussed below are financial and non-financial compensation:
(a) Financial Compensation (Extrinsic Rewards) – This is of two types:

(i) **Direct Financial Compensation** - It consists of the pay an employee receives in the form of:

- wages
- salaries
- bonuses
- commissions

(ii) **Indirect Financial Compensation -** It consists of all financial rewards not included in direct financial compensation i.e., benefits:

- pensions
- insurance
- paid time off
- employee services

(b) Non-Financial or Non-Monetary Compensation (Intrinsic Rewards) – These include:

- Joy from actually doing the job
- Socializing with others at work
- Pride derived from producing or something/providing service
- Security from "belonging"
- Motivation Theories like Maslow, Herzberg, McGregor, etc.

9.3.2 Other basis of Compensation

This includes job based compensation:

(i) Job-based Compensation – It advocates:

- Pay the job (not the person)
- Market-based (external equity focus)
- Point factor-based (internal equity focus)

Table 9.1: Job Based Compensation

Attraction	Depends on market pricing
Motivation	No performance impact
Skill Development	Learn job-related and upward mobility skills
Culture	Bureaucratic, hierarchical
Structure differentiation	Hierarchical, individual jobs and
Cost	Good control of individual pay

A job-based pay work best in situations where:

- Job duties are stable.
- Skills are generic.
- Employees move up through the ranks over time.
- Jobs are fairly standardized within the industry.

Drawbacks of a job-based pay system include:

- Discounts individual ability.
- Discourages lateral movement.
- Tends to be bureaucratic, mechanistic, and inflexible.
- Employees' perceptions of equity are more important than market or point data.

(ii) Skills / knowledge-based Compensation

- Pay the person (not the job)

Table 9.2: Skills / knowledge-based Compensation

Attraction skills individuals	Attracts learning-oriented individuals, high
Motivation	Little performance impact
Skill Development	Motivates needed skill development
Culture	Learning, self-managing
Structure	Flat or team-based
Cost	Higher individual pay

A Skill/Knowledge based Compensation shall be used in following cases:

- The firm has a relatively educated workforce.
- Employees often do different jobs
- Technology changes frequently.
- Employee participation and teamwork are encouraged.
- Opportunities for upward mobility are limited.
- Opportunities to learn new skills are present.
- The costs of employee turnover and absenteeism in terms of lost production are high.

9.4 Designing Compensation System

While designing a compensation system, following steps have to be taken:

Step 1: Establish General Wage Level for Organization: Factors to consider under this step are:

- Other firm's rates
- Union demands
- Cost-of-living changes
- Firm's ability to pay

Step 2: Establish Wage Structure (The Pay for Each Job)

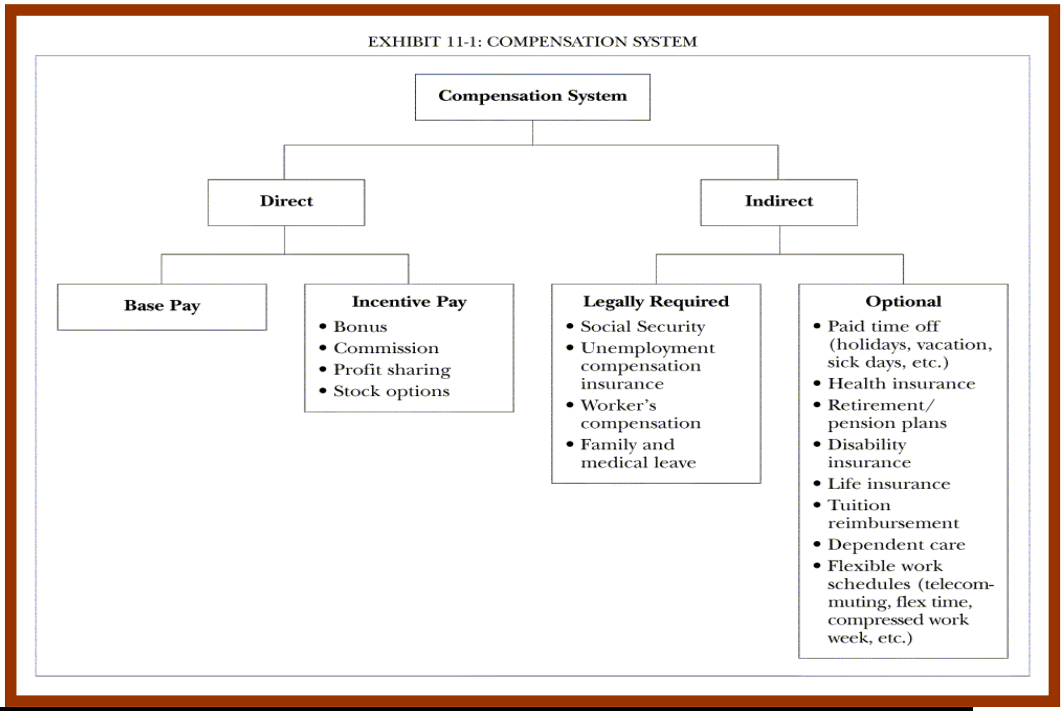
- *Employ a job evaluation system*
  - Ranking
  - Job Classification
  - Point System
  - Factor Comparison
- *Results:*
  - pay grades
  - rate ranges

Step 3: Establish Pay for Each Individual on Each Job

- *Inputs:*
- Performance appraisal information

- Seniority system

Figure 9.2: Compensation System



9.5 Compensation Plans

Compensation Plans should meet the goals of the organization and employees. Its Objective should include goals related to controlling costs, minimizing discontent, easy administration, incentives, minimum income and payments, and benefits.

Following measures/methods are used to determine the above stated factors:

- **General Compensation Structure Ranking:** It is widely being used in businesses. It sorts job description in the order of worth. It measures only overall appraisals of the relative worth of different jobs.
- **Grading:** A system of grades & grade description, against which individuals jobs are compared. The grades are described in terms of job responsibility, skills required, supervision given & received, and exposure to unfavorable & hazardous working conditions.
- **Point system:** It involves establishing & defining the factors common to most jobs that represent the chief elements of value inherent in all jobs. The specific factors chosen are, minimum education required, mental & physical skills, responsibility, and personality requirements. Each factor is assigned a minimum & maximum no of points, different ranges being associated in line with relative importance of the factors.
- **Factors comparison method:** It employs selected factors & evaluation scales. It compares sales person on a set of selected factors & rank them according with the performance performed by them under such criteria factors.

- **Competitors offer:** The compensation structure should me made while seeking the competitors offering to their sales staff .Determine Compensation Level Management must determine the amount of compensation a salesperson should receive on the average. Management should ascertain whether the caliber of the present sales force measures up to what the company would like to have Management weighs the worth of individual persons through estimating the sales & profit dollars that would be lost if particular salespeople resigned Another consideration is the compensation amount the company can afford to pay. The company should make a cost estimate on a break even chart to propose the compensation plan for every individual sales people.

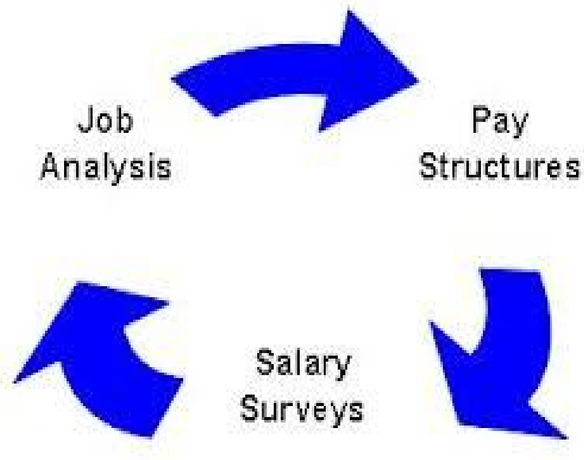


Figure 9.3: Factors determining Compensation Plan

9.5.1 Types of compensation plans

Different types of compensation plans are as follows:

- **Straight salary plan:** It is simplest compensation plan. Salesperson receive fixed sums as regular intervals (usually each week or month sometimes every 2 weeks), representing total payments for their services. Such plans are more common among industrial- goods companies than among consumer- goods companies. Such plans are engaged in trade selling. These jobs, in which selling amounts to mere order taking, abound in the wholesale & manufacturing fields, where consumer necessities are distributed directly to retailers. It is also used for paying driver- salesperson selling liquor & beverages, milk & bread, similarly distributed products.
- **Straight commission Plan**: The theory supports the individual sales personnel should be paid according to productivity. As sales volume rises to different levels, the commission rates differ for different products, categories of customers, or during selling seasons. This method is common in the clothing, textiles & shoe industries & in drug hardware wholesaling. Firms selling intangibles, such as insurance & investment securities, manufacturers of furniture, office

equipment & business machines also are frequent users of straight-commission plans.

- **Salary plus commission:** Most sales compensation plans are combinations of salary & commission plans. By a judicious blending of the two basic plans, management seeks both control & motivation. Actual results depend upon management's skills in designing & administering the plan.

9.6 Factors affecting Compensation

Compensation paid to the employees in any organisation is mainly affected by the two main types of factors:

- **Internal Factors:** Internal Factors which affect compensation mainly include factors like compensation strategy of the organisation, worth of the job, employee's relative worth and above all employer's ability to pay.

- **External Factors:** The external factors which produce impact on the determination of compensation in any organisation include factors like conditions of the labour market, wage rates in the area of organisation, cost of living, collective bargaining and legal requirements in this relation.

An effective compensation system is a blend of all the above stated factors. Less emphasis on any of them will produce bad effect on overall planning of the compensation scheme. The HR manager shall be very conscious in considering all these factors so that the compensation plan shall not only satisfy the employees but shall also make them motivated to work in the best interest of the organisation and prove to be the asset of the organisation in long run.

The Figure given below shows the various factors to be considered in framing compensation strategy of the organisation:

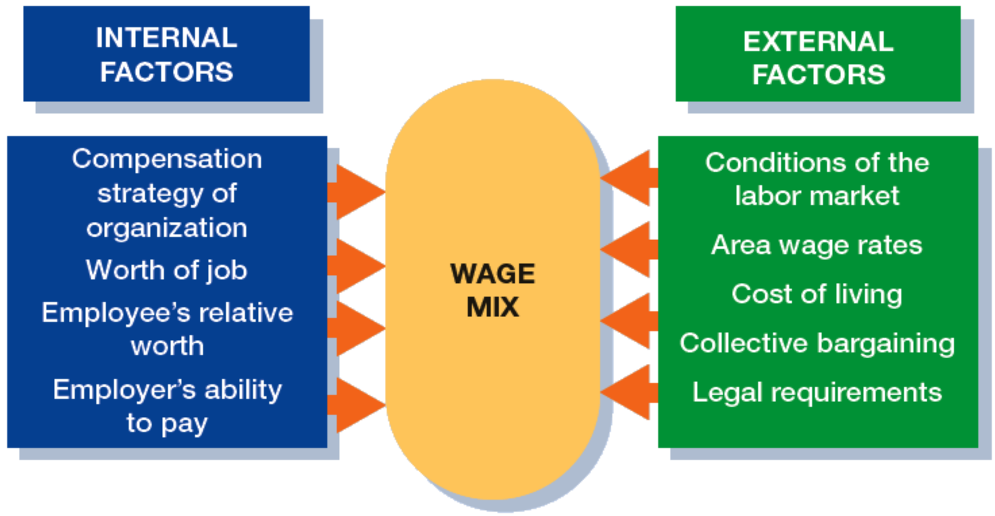


Figure 9.4: Factors affecting Compensation

9.7 Compensation Tools and Techniques

Given below are compensation tools and techniques:

- **Pay Structure:** The first and foremost way to compensate any employee is by defining his pay structure. It is basically of two types (a) graded pay structure and (b) non-graded pay structure
- **Salary Structure:** Salary structure is another way to compensate the employees. While determining the salary structure, minimum wage rate shall be considered.
- **Performance Related Pay:** Performance shall be considered while setting compensation for an employee
- **Merit Payment Scheme:** Merit of an employee shall be a very important criteria for determining compensation for an employee
- **Incentive Scheme:** Various plans shall be considered while determining incentive scheme for the employees
- **Benefit Policies:** The compensation plan shall be such which provide both financial as well as non-financial benefits to an employee to provide him full satisfaction.
- **Salary Review Guidelines:** There must be proper guidelines to keep on reviewing salaries on the basis of internal and external environment of the organisation
- **Compa-ratio:** It must be considered in order to retain efficient employees as if they find the compensation schemes of competitors more effective they may move for their job. Compa-ratio analysis can reveal a situation where earnings drift has taken place.
- **Salary Problems:** There must be proper redressal procedure in the organisation to solve the problems of the employees regarding their salaries and other incentives in order to keep them satisfied and motivated towards their performance.

9.8 Incremental Systems

Incremental systems vary from rigid procedures with fixed and predetermined movements through a scale related to age, service in the company or service in the job, to flexible systems where management exercises complete discretion over the award and size of increments without any guidelines. Between the two extremes there is a middle ground of semi-flexible systems. Different types of Incremental Systems are as follows:

- **Fixed scales with automatic progression:** Where individuals move through jobs or grades by predetermined steps related to age or service, these could be rate for age scales. Fixed scales are criticized because they do not give enough incentive to effort and the improvement of performance-promotion might only be an award in the longer term, if at all. They are defended because they can be operated with complete impartiality- many people, especially civil servants, question the possibility of determining a fair relationship between merit and reward where the only method of measurement is the subjective opinion of someone's boss.

- **Fixed scales with limited flexibility:** Where it is possible to give double or even triple increments to high flyers and withhold increments for poor performers.
- **Semi- fixed scales:** Which allow automatic progression to a 'merit bar' at which progression for some people may stop while other can advance at different rates according to performance.
- **Fixed parallel scales:** Which allow for the exercise of more managerial discretion by providing different patterns of incremental progression for different levels of performance.
- **Variable progression with guidelines**: Where there are no fixed incremental points, but managers are given more or less mandatory instructions on how they should exercise their discretion. The minimum guidelines in this system nay consist of the annual increments that can be awarded for different levels of performance. These may be extended in more rigid systems to give the proportion of staff who should receive a given increment.
- **Variable progression in range without guidelines:** Where management discretion in the award of increments and the determination of their size tends to be restricted only by the maximum of the salary range and the budget they are allowed for salary increases

9.9 Benefits through Compensation

Discussed below are a few benefits that are sought to be achieved through compensation:

Mandated Benefits

- **Unemployment Insurance** is a mandated protection plan that provides a basic substance payment to employees who are between jobs.
- **Social Security** provides limited income to retired individuals.
- **Workers' Compensation** is insurance that covers individuals who suffer a job-related illness or accident

Non-Mandated Benefits

- **Private Pension:** Plans are administered by the organization and provide income to the employees at their retirement.
- **Defined benefit plans:** A private pension plan where the benefit is precisely known based on a simple formula such as years of service.
- **Defined contribution plans:** A private pension plan in which the size of the benefit depends on how much money is contributed to the plan.

Additional Benefits

- **Wellness programs** concentrate on keeping employees from becoming sick rather than simply paying expenses when they do become ill.
- **Child care programs** assist parents with child care expenses.
- **Cafeteria-style benefits** allow employees to choose the benefits they really want.

9.10 Challenges in determining Compensation

Discussed below are a few challenges that are faced while determining compensation:

- **Forms of Pay -** Employee pay begins with a cash base and bonus pay, but may also contain non-cash forms of compensation. The valuation of non-cash compensation is often most difficult for employees to appreciate, but it offers the most opportunity for creativity on the part of the organization.
- **Pay Philosophy -** "All organizations pay according to some underlying philosophy about jobs and the people who do them", says KP Kanchana, a professor at CFAI National College in Bhopal, India. Compensation programs must consider and value the work of those who provide internal support to the organization as well as those who directly impact financial results. An organization's compensation strategy will dictate the rate and timing of pay increases, which jobs are eligible for bonuses, and the level of competitiveness with similar organizations.
- **Employee Incentive -** Pay-for-performance has become increasingly popular. Companies use compensation to reward and boost the morale of high-performing employees, but also to motivate underachievers.
- **Presentation of Compensation -** How a manager speaks regarding pay can inadvertently create ill will when the intention was to deliver good news. It is important to use specifics when speaking with employees rather than categorize any pay increase as "good", "significant" or some other qualifier. Employee perceptions of compensation are based on individual values, needs and expectations.
- **Pay Competitiveness -** Businesses wishing to compete for the best of the available talent pool must offer a competitive compensation program compared to other companies within their industry and at large.
- **Automation and Outsourcing -** Automating compensation, including outsourcing some compensation functions, enables businesses to standardize its system throughout the organization, eliminate paperwork and help departments to communicate more effectively. It minimizes payroll errors and makes it easier to compensate performance based on quantifiable measures. Organizations may also use technology to benchmark jobs and survey employees.
- **Generational Differences -** People are living longer, and thus, working longer. In a look at physician compensation, Max Reibolt of The Coker Group noted a difference in work ethic and expected compensation that fell along generational lines. Older workers were more likely to work longer hours in exchange for their pay while younger workers expected high levels of pay even when their productivity was aided by technology.
- **Multinational Operations -** Multinational corporations must balance the needs and expectations of employees from various countries. Compensation must balance conformity with local laws and customs against global corporate policies.

- **Controlling Labor Costs -** Labour costs often constitute the largest line in a corporation's budget. In a tight economy, companies are faced with a flat, if not shrinking, pool of funds. The cost of labor is broader than the amount paid to employees, taking into account, recruitment, training, turnover, infrastructure and overhead, and the impact of these things on productivity.

9.11 Making Compensation Plan Effective

In order to make Compensation Plan effective, organisation must take care of following points in mind:

- More Money Groups
- Specific Benefits
- Working Schedules
- Opportunity
- Training & Education

In today's world of tackling employee compensation plan, there are some things to be specially taken care off. They are as follows:

- **Favoritism** – One can't offer money, benefits or opportunities to only those you "like." Be fair across the board or you'll lose valuable employees.
- **Saying No** – One also shouldn't immediately say no to any compensation request. Implement surveys and follow through on those surveys. Find out what's important and to whom before to say no. Employees that realize you'll be offering nothing will walk.
- **Be Realistic** – While all of these compensation tips sound great, you have to be realistic with what you can afford—even if you have a varied group of wants and needs. If you have to decide between the expense of raises or promotions, consider the promotion but perhaps offer a small one-time incentive and explain the expense limitations to your employees. Never leave your employees in the dark just wondering—the imagination is a powerful thing.
- **Performance Reviews** –Employees want guidance and they also want to know how they're doing or at least how you think they're doing. Whether you use a standard employee review form or a 360 degree performance review, do use reviews and make sure they come at regular intervals—perhaps based annually after hire date.
- **Follow Through** – Whatever path you decide to take when facing employee compensation challenges, make sure what you promise you follow through with. Nothing will make your employees lose trust in you more than if you don't deliver on promises.

Considering the needs and wants of all the employees is essential for a happy work environment. Survey, analyze, and reward where you can, and don't do what you can't afford. If you can't afford to offer something, let your employees know why—whether it's budget or other constraints; chances are they'll understand and you'll retain a happier group of workers.

9.12 Summary

There is no doubt that compensation is very much important for the employees and the multinational companies. It is important for the employees because employees are selling their time, life, labour, skill, knowledge, and expertise to the organization to earn money in order to maintain their standard of living. Side-by-side it is also important for the companies because compensation is directly related with the cost and profit of the companies. So, the managers of multinational companies should prepare the compensation policy in such a way that will serve the interest of employees and multinational companies. Compensation is a tool used by management for a variety of purposes to further the existence of the company. Compensation may be adjusted according the business needs, goals, and available resources. Recruitment and retention of qualified employees is a common goal shared by many employers. To some extent, the availability and cost of qualified applicants for open positions is determined by market factors beyond the control of the employer. While an employer may set compensation levels for new hires and advertize those salary ranges, it does so in the context of other employers seeking to hire from the same applicant pool. Morale and job satisfaction are affected by compensation. Often there is a balance (equity) that must be reached between the monetary value the employer is willing to pay and the sentiments of worth felt be the employee. In an attempt to save money, employers may opt to freeze salaries or salary levels at the expense of satisfaction and morale. Conversely, an employer wishing to reduce employee turnover may seek to increase salaries and salary levels. Compensation may also be used as a reward for exceptional job performance. Examples of such plans include: bonuses, commissions, stock, profit sharing, gain sharing. Compensation will be perceived by employees as fair if based on systematic components.

9.13 Self Assessment Questions

1. What do you mean by compensation? State the factors affecting compensation.
2. "Compensation if effective is the cause of retaining efficient employee in the rganisation." In the light of this statement, explain Compensation Plan.
3. What are the challenges faced in determining compensation plan?
4. Write brief notes on:
   (a) Compensation tools and techniques
   (b) Types of compensation
5. Explain in detail the various types of compensations provided to the employees in organizations

9.14 Reference Books

- Lencsis, P. M., 'Workers' Compensation: A Reference and Guid', Greenwood Publishing Group, 1998.
- Schuler, R.S., and N. Rogovsky, Understanding Compensation Practice Variations Across Firms: The Impact of National Culture, 'Journal of International Business Studies', Vol. 29, No. 1, 1998, pp. 159-177.
- Anderson, R.E., J.F. Hair, and A.J. Bush, 'Professional Sales Management' McGraw Hill Publications, 3rd edition, 1999, New Delhi.
- Lancaster G. and D. Jobber, 'Selling & Sales Management' Pearson Education, 8th edition, 2009, New Delhi.
- Churchill, G.A., N.M. Ford, and O.C. Walker, 'Sales Force Management', McGraw Hill Publications, 2009, New Delhi.
- Cundiff, E.W., R.R. Still, and N.A.P. Govoni, 'Sales Management – Decision, Strategies and Cases', Pearson Education, 5th edition, 2009, New Delhi.
- Manning, G.L. and B.L. Reece, 'Selling Today – Building Quality Partnerships', Pearson Education, Inc., 8th edition, 2002, New Delhi.

Unit – 10 : Sales Force Motivation

Structure of Unit

10.0 Objectives

After completing this unit, you would be able to:

- Understand the concept of motivation;
- Understand the need for sales force motivation;
- Learn various motivation theories;
- Know various ways of motivating sales force;
- Know relationship between motivation and communication;
- Learn strategies to motivate sales force;
- Know practical tips for motivating sales persons.

10.1 Introduction

The sales executive's job is to get results through company personnel by making decisions and seeing to it that others carry them out. High productivity in sales force comes about neither naturally nor accidentally. Some sales personnel are self starters but most sales personnel require motivation to reach and maintain satisfactory performance levels. Some of them may not work hard for the organization. Manager must understand their behaviour and also factors affecting their behaviour. After that, manager should devise proper strategies to stimulate their efforts. Best way to improve commitment and enhance productivity is to stimulate employees and take them to the next level of performance. This task is possible by the process of motivation. This chapter throws light on this important aspect of directing.

10.2 The Concept of Motivation

Many people incorrectly view motivation as a personal trait—that is, some people have it, and others don't. But *motivation* is defined as the force that causes an individual to behave in a specific way. Simply put, a highly motivated person works hard at a job; an unmotivated person does not.

Managers often have difficulty motivating employees. But motivation is really an internal process. It's the result of the interaction of a person's needs, his or her ability to make choices about how to meet those needs, and the environment created by management that allows these needs to be met and the choices to be made. Motivation is not something that a manager can "do" to a person.

Simply, we can say that motivation is a behaviour through which we can persuade anyone to do what he can't do in ordinary circumstances. The complex of needs and desires, stemming from within individuals, leads them to act as to satisfy these needs and desires. Specifically applied to sales personnel, motivation is the amount of effort the sales man desires to exert on the activities associated with the sales job. This may include calling on potential new accounts, developing sales presentations, and managing technology. Expanding effort on each activity making up the sales job leads to some level of achievement on one or more dimensions of job performance.

Motivation is the inner force that guides behaviour and is concerned with the causation of specific actions. Motivation is a two-dimensional construct consisting of the following:

10.2.1 Intrinsic and Extrinsic Motivation

Intrinsic motivation refers to motivation that is driven by an interest or enjoyment in the task itself, and exists within the individual rather than relying on any external pressure. Intrinsic motivation is based on taking pleasure in an activity rather than working towards an external reward. Intrinsic motivation has been studied since the early 1970s. Students who are intrinsically motivated are more likely to engage in the task willingly as well as work to improve their skills, which will increase their capabilities. Students are likely to be intrinsically motivated if they:

- attribute their educational results to factors under their own control, also known as autonomy;
- believe that they have the skill that will allow them to be effective agents in reaching desired goals (i.e. the results are not determined by luck);
- are interested in mastering a topic, rather than just rote-learning to achieve good grades.

Extrinsic motivation refers to the performance of an activity in order to attain an outcome, which then contradicts intrinsic motivation. It is widely believed that motivation performs two functions. The first is often referred as to the energetic activation component of the motivation construct. The second is directed at a specific behavior and makes reference to the orientation directional component. Extrinsic motivation comes from outside the individual. Common extrinsic motivations are rewards like money and grades, and threat of punishment. Competition is in general extrinsic because it encourages the performer to win and beat others, not simply to enjoy the intrinsic rewards of the activity. A crowd cheering on the individual and trophies are also extrinsic incentives. The concept of motivation can be instilled in children at a very young age, by promoting and evoking interest in a certain book or novel. The idea is to have a discussion pertaining to the book with young individuals, as well as to reward them.

10.3 Need for Sales Force Motivation

For the following reasons a sales force needs motivation:

- Inherent nature of the sales job**:** Although sales jobs vary from one company to the other, sales jobs are alike in certain respects. Every sales job is a succession of ups and downs, a series of experiences resulting in alternating feelings of exhilaration and depression. In the course of a day's work, salespersons interact with many pleasant and courteous people, but some unpleasant and rude are difficult to deal with. The failures in getting order, dealing with rude people, and also too much traveling may depress a sales person. The inherent nature of the sales job, therefore, is the first reason that additional motivation is required.

- Salesperson's boundary position and role conflicts: The salesperson occupies a 'boundary position' in the company and must try to satisfy the expectations of people both within the company (in the sales department or elsewhere) and in customer organizations. There is linkage with four groups: (a) sales management (b) the company organization that handles order fulfillment, (c) the customers, and (d) other company sales personnel. Each group imposes certain behavioral expectations on the salesperson, and in playing these different roles, the salesperson faces role conflicts and require frequent motivators.
- Tendency towards apathy**:** Some sales personnel naturally become apathetic, get into a rut. Those who, year after year, cover the same territory and virtually the same customers, lose interest and enthusiasm. Gradually their sales degenerate into routine order taking, because they know the customers so well, they believe that good salesmanship is no longer necessary. These types of sales people require frequent motivators.
- Travelling: Sales people require a lot of travelling to cover their territories. They spend days and weeks away from their families. This generates lot of frustrations in them and they require lot of motivation to overcome these.

10.4 Theories of Motivation

Following are the theories of motivation that may help motivating sales persons:

(a) **Hierarchy of Needs:** Abraham H. Maslow, a psychologist, developed a theory of motivation based on the notion that an individual seeks to fulfill personal needs according to some hierarchy of importance. Maslow suggests that after an individual gratifies basic physiological needs, he or she proceeds to strive to fulfill safety and security needs, then belongingness and social relations needs, and so on. The individual's level of aspiration rises as needs on lower levels get satisfied. Not every individual and certainly not every salesperson, of course, establishes the order of priority of need fulfillment suggested by Maslow. Some sales personnel, for instance, appear to assign earlier priority to filling the esteem need (for self-respect) than they do to filling the need for social relations within a group.

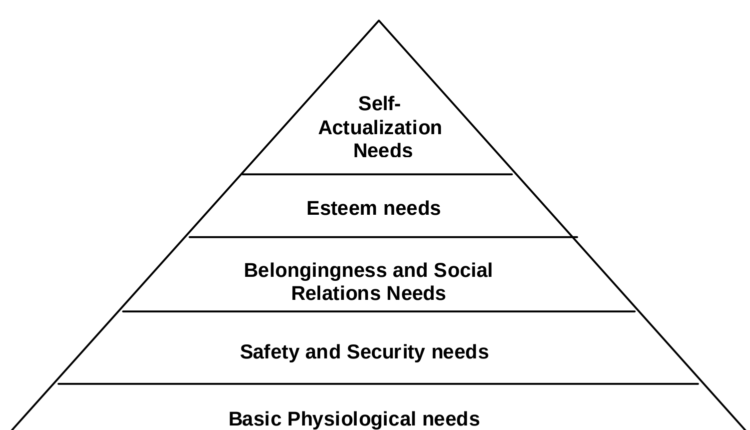


Figure 10.1: Maslow's Hierarchy of Needs

In order to satisfy and hence motivate employees, a manager may offer various things as summarized in the following table:

Table 10.1: Maslow's Hierarchy of Needs and their Satisfiers

Higher Level Needs	**To Satisfy, Offer:**
Self-actualization needs	Creative and challenging work
	Participation in decision making
	Job flexibility and autonomy
Esteem needs	Responsibility of an important job
	Promotion to higher status job
	Praise and recognition from boss
Lower Level Needs	**To Satisfy, Offer:**
Social needs	Friendly coworkers
	Interaction with customers
	Pleasant supervisor
Safety needs	Safe working conditions
	Job security
	Base compensation and benefits
Physiological needs	Rest and refreshment breaks
	Physical comfort on the job
	Reasonable work hours

(b) **Motivation-Hygiene factor theory:** Frederick Herzberg and his co-researchers developed the motivation-hygiene factor theory. According to this theory the factors that lead to motivation and job satisfaction are not the same as those leading to apathy and job dissatisfaction. In other words, the contention is that job dissatisfaction is not the opposite of job satisfaction – two separate groups of needs are involved, one related to job satisfaction and the other to job dissatisfaction. According to this theory, all the factors affecting a particular job are divided into two categories, namely motivation and hygiene factors.

- **Hygiene factors** include salary, job security, working conditions, organizational policies, and technical quality of supervision. Although these factors do not motivate employees, they can cause dissatisfaction if they are missing. Something as simple as adding music to the office place or implementing a no-smoking policy can make people less dissatisfied with these aspects of their work. However, these improvements in hygiene factors do not necessarily increase satisfaction.

- **Satisfiers** or **motivators** include such things as responsibility, achievement, growth opportunities, and feelings of recognition, and are the key to job satisfaction and motivation. For example, managers can find out what people really do in their jobs and make improvements, thus increasing job satisfaction and performance.

Following Herzberg's two-factor theory, managers need to ensure that hygiene factors are adequate and then build satisfiers into jobs.

(c) **McGregor's Theory 'X' and "Y':** Douglas Murray McGregor came out with two theories namely theory 'X' and theory 'Y'. According to **Theory 'X'** average human being has an inherent dislike of work and will avoid it if he can. Because of this most people must be coerced, controlled, directed, threatened with punishment to get them to put forth adequate effort towards the achievement of organizational objectives.

As per **Theory 'Y'**, for employees, experience of physical and mental effort in work is as natural as play or rest. External control or threats of punishment, therefore, are not the only means of bringing about effort towards organizational objectives. People want challenging work and this will motivate them.

(d) **Alderfer's ERG theory:** Clayton Alderfer's ERG (Existence, Relatedness, and Growth) theory is built upon Maslow's hierarchy of needs theory. To begin his theory, Alderfer collapses Maslow's five levels of needs into three categories:

- **Existence needs** are desires for physiological and material well-being. (In terms of Maslow's model, existence needs include physiological and safety needs)
- **Relatedness needs** are desires for satisfying interpersonal relationships. (In terms of Maslow's model, relatedness correspondence to social needs)
- **Growth needs** are desires for continued psychological growth and development. (In terms of Maslow's model, growth needs include esteem and self-realization needs)

This approach proposes that unsatisfied needs motivate behavior, and that as lower level needs are satisfied, they become less important. Higher level needs, though, become more important as they are satisfied, and if these needs are not met, a person may move down the hierarchy, which Alderfer calls the *frustration-regression principle.* What he means by this term is that, an already satisfied lower level need can become reactivated and influence behavior when a higher level need cannot be satisfied. As a result, managers should provide opportunities for workers to capitalize on the importance of higher level needs.

(e) **McClelland's acquired needs theory:** David McClelland's acquired needs theory recognizes that everyone prioritizes needs differently. He also believes that individuals are not born with these needs, but that they are actually learned through life experiences. McClelland identifies three specific needs:

- **Need for achievement** is the drive to excel.
- **Need for power** is the desire to cause others to behave in a way that they would not have behaved otherwise.

- **Need for affiliation** is the desire for friendly, close interpersonal relationships and conflict avoidance.

McClelland associates each need with a distinct set of work preferences, and managers can help tailor the environment to meet these needs.

High achievers differentiate themselves from others by their desires to do things better. These individuals are strongly motivated by job situations with personal responsibility, feedback, and an intermediate degree of risk. In addition, high achievers often exhibit the following behaviors:

- Seek personal responsibility for finding solutions to problems.
- Want rapid feedback on their performances so that they can tell easily whether they are improving or not.
- Set moderately challenging goals and perform best when they perceive their probability of success as 50-50

An individual with a high need of power is likely to follow a path of continued promotion over time. Individuals with a high need of power often demonstrate the following behaviors:

- Enjoy being in charge
- Want to influence others
- Prefer to be placed into competitive and status-oriented situations
- Tend to be more concerned with prestige and gaining influence over others than with effective performance

People with the need for affiliation seek companionship, social approval, and satisfying interpersonal relationships. People needing affiliation display the following behaviors:

- Take a special interest in work that provides companionship and social approval
- Strive for friendship
- Prefer cooperative situations rather than competitive ones
- Desire relationships involving a high degree of mutual understanding
- May not make the best managers because their desire for social approval and friendship may complicate managerial decision making

Interestingly enough, a high need to achieve does not necessarily lead to being a good manager, especially in large organizations. People with high achievement needs are usually interested in how well they do personally and not in influencing others to do well. On the other hand, the best managers are high in their needs for power and low in their needs for affiliation.

(f) **Equity theory:** According to the equity theory, based on the work of J. Stacy Adams, workers compare the reward potential to the effort they must expend. Equity exists when workers perceive that rewards equal efforts (see figure).

Figure 10.2: The Equity Theory

But employees just don't look at their potential rewards; they look at the rewards of others as well. Inequities occur when people feel that their rewards are inferior to the rewards offered to other persons sharing the same workloads. Employees who feel they are being treated inequitably may exhibit the following behaviors:

- Put less effort into their jobs
- Ask for better treatment and/or rewards
- Find ways to make their work seem better by comparison
- Transfer or quit their jobs

The equity theory makes a good point - People behave according to their perceptions. What a manager thinks is irrelevant to an employee because the real issue is the way an employee perceives his or her situation. Rewards perceived as equitable should have positive results on job satisfaction and performance; those rewards perceived as inequitable may create job dissatisfaction and cause performance problems.

Every manager needs to ensure that any negative consequences from equity comparisons are avoided, or at least minimized, when rewards are allocated. Informed managers anticipate perceived negative inequities when especially visible rewards, such as pay increases or promotions, are allocated. Instead of letting equity concerns get out of hand, these managers carefully communicate the intended values of rewards being given, clarify the performance appraisals upon which these rewards are based, and suggest appropriate comparison points.

(g) **Reinforcement Theory:** The theory suggests that behaviour is a function of its consequences and explains how the consequences of past action influence future action in a cyclical manner. For example, if a particular behaviour leads to a rewarding consequence the same behaviour is likely to be repeated.

Stimulus $\longrightarrow$ Response $\longrightarrow$ Consequence

The stimulus triggers a response (behaviour) and the consequences of that response (behaviour) determine whether the same response (behaviour) will or will not be repeated.

The reinforcement theory, based on E. L. Thorndike's law of effect, simply looks at the relationship between behavior and its consequences. This theory focuses on modifying an employee's on-the-job behavior through the appropriate use of one of the following four techniques:

- Positive reinforcement rewards desirable behavior. Positive reinforcement, such as a pay raise or promotion, is provided as a reward for positive behavior with the intention of increasing the probability that the desired behavior will be repeated.
- Avoidance is an attempt to show an employee what the consequences of improper behavior will be. If an employee does not engage in improper behavior, he or she will not experience the consequence.
- Extinction is basically ignoring the behavior of a subordinate and not providing either positive or negative reinforcement. Classroom teachers often use this technique when they ignore students who are “acting out” to get attention. This technique should only be used when the supervisor perceives the behavior as temporary, not typical, and not serious.
- Punishment (threats, docking pay, and suspension) is an attempt to decrease the likelihood of a behavior recurring by applying negative consequences.

The reinforcement theory has the following implications for management:

- Learning what is acceptable to the organization influences motivated behavior.
- Managers who are trying to motivate their employees should be sure to tell individuals what they are doing wrong and be careful not to reward all individuals at the same time.
- Managers must tell individuals what they can do to receive positive reinforcement.
- Managers must be sure to administer the reinforcement as closely as possible to the occurrence of the behavior.
- Managers must recognize that failure to reward can also modify behavior. Employees who believe that they deserve a reward and do not receive it will often become disenchanted with both their manager and company.

(h) **Goal-setting theory:** The goal-setting theory, introduced in the late 1960s by Edwin Locke, proposed that intentions to work toward a goal are a major source of work motivation. Goals, in essence, tell employees what needs to be done and how much effort should be expanded. In general, the more difficult the goal, the higher the level of performance expected.

Managers can set the goals for their employees, or employees and managers can develop goals together. One advantage of employees participating in goal setting is that they may be more likely to work toward a goal they develop. No matter who sets the goal, however, employees do better when they get feedback on their progress. In addition to feedback, four other factors influence the goals-performance relationship:

- The employee must be committed to the goal.
- The employee must believe that he is capable of performing the task.

- Tasks involved in achieving the goal should be simple, familiar, and independent.

If the goal-setting theory is followed, sales managers need to work with their employees in determining goal objectives in order to provide targets for motivation. In addition, the goals that are established should be specific rather than general in nature, and sales managers must provide feedback on performance.

(i) **Expectancy Model:** Victor Vroom introduced one of the most widely accepted explanations of motivation. The expectancy model, developed by Vroom, conceptualizes motivation as a process governing choices of behavioral activity. The reasoning is that the strength of a tendency to act in a certain way depends upon the strength of an expectation that the act will be followed by a given outcome and on that outcome's attractiveness to the individual. Put differently, an individual's desire to perform at a given time depends on that individual's specific goals and perception of the relative worth of performance. Very simply, the expectancy theory says that an employee will be motivated to exert a high level of effort when he or she believes that:

- Effort will lead to a good performance appraisal.
- A good appraisal will lead to organizational rewards.
- The organizational rewards will satisfy his or her personal goals.

The key to the expectancy theory is an understanding of an individual's goals and the relationships between effort and performance, between performance and rewards, and finally, between the rewards and individual goal satisfaction. When an employee has a high level of expectancy and the reward is attractive, motivation is usually high. Therefore, to motivate workers, managers must strengthen workers' perceptions of their efforts as both possible and worthwhile, clarify expectations of performances, tie rewards to performances, and make sure that rewards are desirable.

Salespeople's needs, their evaluation of rewards, their perceptions of the conditional links are influenced by personal characteristics. Age, family size, income and education all affect the value that salespeople place on various rewards. For example, salesmen relatively satisfied with their current income level may be more interested in such things as status, freedom, and self-development than in pay and benefits.

Some psychological traits are linked to how the sales rep evaluates rewards. For example a sales-rep with a high need for achievement will be motivated by greater responsibility and Challenges. At early age of their career, sales reps are very achievement oriented and are particularly interested in advancement and growth opportunities. During the middle of the career cycle, sales reps usually become committed to their occupation, striving to succeed, to get ahead. At the fag end of their careers sales reps are valuable to the company because they generally account for large volume of their company's sales.

10.5 Methods of Motivating Sales Force

In order to motivate sales force, sales mangers should begin by getting to know each individual in order to understand his or her specific needs. Managers then should determine the most effective combination of motivation methods for their sales people. Motivation tools or methods may be divided in to two categories:

(i) Financial rewards - Money is often used as an incentive for salespeople. Many companies use cash as an incentive to motivate sales people. Sales contests are also run to motivate sales people. The person who sells more gets more.

(ii) Non- financial rewards - Managers often assume that financial incentives are the best motivators and developing a good compensation package is only thing they must do to motivate their sales force. However evidence suggests that sales rep are motivated by both financial rewards and Non- financial rewards like: job enrichment and support; recognition and honour; promotions; encouragement and praise; and corporate cultures etc.

Some of the main methods of motivation are as follows:

- **Higher Monetary Remuneration:** The salesmen who achieve higher targets are given commission at higher rates, increase in salary, more increments, special allowances, special bonus, etc. For getting these monetary incentives, sales force work with more zeal, more energy, devote more time to their selling activities, use their personal relationship for attracting customers.
- **Promotions:** Promotion increases the rank of sales force in the organization. It improves status by giving higher authority and responsibility. It increases the working area of sales person. Promotion is given to that salesman whose performance level is higher in comparison to others.
- **Recognition and Rewards:** Rewards, recognition, appreciation letters are given to those salesmen who achieve higher sales level. It satisfies the status and esteem needs of sales force. The salesmen who have achieved higher level of sales are appreciated by publishing their names, photos, and achievements in the institution's magazines. It motivates the sales force.
- **Job-Security:** The salesmen who achieve higher sales level are ensured job-security. This satisfies their security needs. Moreover, other sales force also put more efforts to ensure continuity of their employment.
- **Good Working Conditions:** Sales force expects good working conditions which should not only satisfy their needs but also encourage them to work more sincerely and efficiently. Good working conditions influence the attitude towards work and performance of workforce. Working conditions here refer to facility of conveyance, comfortable stay when salesmen go to outstations, facility of mobile phones, laptops, timely reimbursements of traveling bills and other contingent expenses etc.
- **Sales Conferences:** Sales conferences are an open-discussion type meeting of people with similar experience, working in the same field, under the supervision of experienced conference leader. The conference solves the problems of sales force. Salesmen learn from mutual exchange of information and can take advice from conference leader to solve different problems related to selling activities. These conferences motivate the sales force as they feel sense of belongingness and pride by attending these conferences.
- **Sales Contests:** It is a special selling campaign offering incentives in the form of prizes or awards in addition to the routine compensation plan. In these contests, the salesmen or group of salesmen who achieve highest sales level or exceed the sales quota are given prizes or awards. The main purpose

of these contests is to motivate the sales force by providing extra incentive to increase sales and to attract new customers.

- **Free or Concessional Travels:** Some organizations offer free or concessional travel awards to the salesmen who achieve their sales targets. In these awards, winning salesmen are given the facility of free or concessional travels to places of luxury resorts, hill stations and sometimes to other countries. To make the award more attractive, generally these travel awards are given to the winners as well as for their spouses.

- **Opportunity for giving Suggestions:** If organizations give opportunity to the salesmen for self expression, and for giving suggestions, then it motivates sales force and they feel that they are part of total organization. It increases job-satisfaction among sales-force and they work with their full talents and abilities.

- **Participation in Management:** Some organizations give opportunity to the salesmen for participation in management. The efficient salesmen are offered membership in various committees related to different selling activities like-sales promotion committee, advertising committee, consumer's-complaint committee, Budget committee etc. In this way salesmen participate in decision making and formulation of sales programmes.

- **Correspondence with salesmen:** Regular correspondence with salesmen working at different places motivates the sales force. This correspondence is done by higher officials with individual salesmen. Such correspondence may be through letters or through telephonic talks. The sales officers enquire about the difficulties, problems, inconveniences faced by salesmen working at distant places.

- **Freedom in Working:** Some organizations offer freedom in working to efficient salesmen. They are subject to less supervision, and they are given freedom in planning their sales activities, making sales calls, timing of sales call etc. It motivates the hard working sales force, as they feel free in their working. It increases their morale.

- **More Responsibility:** Giving more responsibility also works as motivator for the sales force. The salesmen who are given more responsibility feel importance in their role and they feel themselves as important member of the organization. This increases their dedication, attentiveness, creativity towards the work. It also satisfies esteem needs of sales force.

- **Merchandise Prizes:** Sometimes merchandise prizes are given to winner-sales force as compared to cash prizes. Merchandise prizes are given in kind. It may include some vehicle, like scooter, motorcycle, home appliances, computer, laptops, handbags, watches, mobile phones etc. These prizes are more effective than cash prizes because these have permanent evidence of achievements of sales force. Wherever salesmen use such products, they feel pride.

- **Competent Leadership:** If higher officials of sales department are honest, hard working, competent, sympathetic and understand the problems of sales force, then they will be able to win the confidence, cooperation and loyalty of sales force. Salesmen respect such competent sales officials and work with full energies and initiatives. Thus competent leadership of high sales officials motivates sales force to work hard.

10.6 Motivation Strategies

To some extent, a high level of employee motivation is derived from effective management practices. To develop motivated salesmen, a sales manager must treat people as individuals, empower them, provide an effective reward system, redesign jobs, and create a flexible workplace.

Empowering employees: Empowerment occurs when individuals in an organization are given autonomy, authority, trust, and encouragement to accomplish a task. Empowerment is designed to unshackle the employee and to make a job the employees' responsibility.

In an attempt to empower and to change some of the old bureaucratic ideas, managers are promoting corporate intrapreneurships. **Intrapreneurship** encourages employees to pursue new ideas and gives them the authority to promote those ideas. Obviously, intrapreneurship is not for the timid, because old structures and processes are turned upside down.

Providing an effective reward system: Managers often use rewards to reinforce employee behavior that they want to continue. A *reward* is a work outcome of positive value to the individual. Organizations are rich in rewards for people whose performance accomplishments help meet organizational objectives. People receive rewards in one of the following two ways:

- **Extrinsic rewards** are externally administered. They are valued outcomes given to someone by another person, typically a supervisor or higher level manager. Common workplace examples are pay bonuses, promotions, time off, special assignments, office fixtures, awards, verbal praise, and so on. In all cases, the motivational stimulus of extrinsic rewards originates outside the individual.
- **Intrinsic rewards** are self-administered. Think of the "natural high" a person may experience after completing a job. That person feels good because he has a feeling of competency, personal development, and self-control over his work. In contrast to extrinsic rewards, the motivational stimulus of intrinsic rewards is internal and doesn't depend on the actions of other people.

To motivate behavior, the organization needs to provide an effective reward system. An effective reward system has four elements:

- Rewards need to satisfy the basic needs of all employees.
- Rewards need to be included in the system and be comparable to ones offered by a competitive organization in the same area.
- Rewards need to be available to people in the same positions and be distributed fairly and equitably.
- The overall reward system needs to be multifaceted. Because all people are different, managers must provide a range of rewards—pay, time off, recognition, or promotion. In addition, managers should provide several different ways to earn these rewards.

This last point is worth noting. With the widely developing trend toward empowerment in Indian industry, many employees and employers are beginning to view traditional pay systems as inadequate. In a traditional system, people are paid according to the positions they hold, not the contributions they make. As organizations adopt approaches built upon teams, customer satisfaction, and empowerment, workers need to be paid differently. Many companies have already responded by designing numerous pay plans, designed by employee design teams, which base rewards on skill levels.

Rewards demonstrate to employees that their behavior is appropriate and should be repeated. If employees don't feel that their work is valued, their motivation will decline.

Redesigning jobs: Many people go to work every day and go through the same, unenthusiastic actions to perform their jobs. These individuals often refer to this condition as burnout. But smart managers can do something to improve this condition before an employee becomes bored and loses motivation. The concept of *job redesign,* which requires knowledge of and concern for the human qualities people bring with them to the organization, applies motivational theories to the structure of work for improving productivity and satisfaction.

When redesigning jobs, managers look at both job scope and job depth. Redesign attempts may include the following:

- **Job enlargement.** Often referred to as *horizontal job loading,* job enlargement increases the variety of tasks a job includes. Although it doesn't increase the quality or the challenge of those tasks, job enlargement may reduce some of the monotony, and as an employee's boredom decreases, his or her work quality generally increases.
- **Job rotation**. This practice assigns people to different jobs or tasks to different people on a temporary basis. The idea is to add variety and to expose people to the dependence that one job has on other jobs. Job rotation can encourage higher levels of contributions and renew interest and enthusiasm. The organization benefits from a cross-trained workforce.
- **Job enrichment.** Also called *vertical job loading*, this application includes not only an increased variety of tasks, but also provides an employee with more responsibility and authority. If the skills required to do the job are skills that match the jobholder's abilities, job enrichment may improve morale and performance.

Creating flexibility: Today's employees value personal time. Because of family needs, a traditional nine-to-five workday may not work for many people. Therefore, **flexi time,** which permits employees to set and control their own work hours, is one way that organizations are accommodating their employees' needs. Here are some other options organizations are trying as well:

- A **compressed workweek** is a form of flextime that allows a full-time job to be completed in less than the standard 40-hour, five-day workweek. Its most common form is the 4/40 schedule, which gives employees three days off each week. This schedule benefits the individual through more leisure time and lower commuting costs. The organization should benefit through lower absenteeism and improved performance. Of course, the danger in this type of scheduling is the possibility of increased fatigue.

- **Telecommuting,** sometimes called *flex place,* is a work arrangement that allows at least a portion of scheduled work hours to be completed outside of the office, with work-at-home as one of the options. Telecommuting frees the jobholder from needing to work fixed hours, wearing special work attire, enduring the normal constraints of commuting, and having direct contact with supervisors. Home workers often demonstrate increased productivity, report fewer distractions, enjoy the freedom to be their own boss, and appreciate the benefit of having more time for them. Of course, when there are positives, there are also negatives. Many home workers feel that they work too much and are isolated from their family and friends. In addition to the feelings of isolation, many employees feel that the lack of visibility at the office may result in the loss of promotions.

10.7 Practical Tips for Motivating Sales Persons

Given below are a few useful and practical tips, advocated by HR Chally Group (2007) and others, to motivate sales persons:

- Encourage individuals to explore new challenges so that the salesperson does not feel like he or she is stuck in a rut or stuck in the same routine. Giving them freedom to try something different even though it may be risky or turn out to be a failure may keep them engaged.
- Provide opportunities to meet and interact with new people that may not always blossom into a business relationship, but may have benefits in keeping sales person engaged.
- Involve sales people and give them a voice. Decisions handed down without input are not likely to be followed, and may lower morale.
- Give them an opportunity to develop their expertise. Coaching, training, and professional development opportunities are likely to be appreciated.
- Create opportunities for sales people to experience how their expertise has benefited customers.
- Reward sales people on the basis of their performance.
- Provide time to time trainings to keep them updated.

10.8 Summary

Best way to improve commitment and enhance productivity is to stimulate employees and take them to the next level of performance. This task is possible by the process of motivation. But motivation is defined as the force that causes an individual to behave in a specific way. Simply put, a highly motivated person works hard at a job; an unmotivated person does not. In order to motivate sales force, sales mangers should begin by getting to know each individual in order to understand his or her specific needs. Managers then should determine the most effective combination of motivation methods for their sales people. Money is often used as an incentive for salespeople. Many companies use cash as an incentive to motivate sales people. Sales contests are also run to motivate sales people. Managers often assume that financial incentives are the best motivators and developing a good compensation package is only thing they must do to motivate their sales force. However evidence suggests that sales rep are motivated by both financial rewards and Non- financial rewards like: job enrichment and support; recognition and honour; promotions; encouragement and praise; and corporate cultures etc.

10.9 Self Assessment Questions

1. Discuss the needs of motivating sales force. How can we motivate them?
2. Discuss some of the theories that may help us in motivating sales force.
3. What is Motivation? What does Maslow's need hierarchy tell us about needs?
4. Discuss some of the methods of motivating sales force.
5. What strategies you recommend for motivating sales force?
6. Which theory of motivation, according to you, is best in today's scenario and why?
7. Provide a few practical tips to motivate sales persons.

10.10 Reference Books

- Anderson, R.E., J.F. Hair, and A.J. Bush, 'Professional Sales Management' McGraw Hill Publications, 3rd edition, 1999, New Delhi.
- Lancaster G. and D. Jobber, 'Selling & Sales Management' Pearson Education, 8th edition, 2009, New Delhi.
- Churchill, G.A., N.M. Ford, and O.C. Walker, 'Sales Force Management', McGraw Hill Publications, 2009, New Delhi.
- Cundiff, E.W., R.R. Still, and N.A.P. Govoni, 'Sales Management – Decision, Strategies and Cases', Pearson Education, 5th edition, 2009, New Delhi.
- Manning, G.L. and B.L. Reece 'Selling Today – Building Quality Partnerships', Pearson Education, Inc., 8th edition, 2002, New Delhi.
- Spiro, R.L., W.L. Stanton, and G.A. Rich, 'Management of a Sales Force', Tata McGraw Hill Publishing Co. Ltd., 11th edition, 2003, New Delhi.

Unit – 11: Performance Evaluation

Structure of Unit

11.0 Objectives

After completing this unit, you would be able to:

- Understand the value and uses of the performance evaluation in organizations;
- Explain the steps followed in an evaluation system;
- Understand performance evaluation techniques;
- Learn about the benefits of performance in the working of an organization;
- Find out the role of manager in effective performance evaluation;
- Know about the latest techniques and tools of performance evaluation.

11.1 Introduction

In simple terms, performance evaluation may be understood as the assessment of an individual's performance in a systematic way, the performance being measured against such factors as job knowledge, quality and quantity of output, initiative, leadership abilities, supervision, dependability, co-operation, judgment, versatility, health and the alike. Assessment should not be condensed to past performance alone. Potentials of the employee for future performance must also be assessed. A performance evaluation is basically a process which not only evaluates an employee for his present performance but also helps to improve his performance in his future jobs. The other terms used for performance evaluation are: Performance rating, employee assessment, employee performance review, personnel appraisal, employee evaluation and (perhaps the oldest of the terms used) merit rating. In a formal sense, employee assessment is an old as the concept of management, and in an informal sense, it is probably as old as mankind. Nor performance appraisal is done in isolation. It is linked to Job Analysis and Performance Standards. It describes work and translates job requirements and its relevance.

11.2 Advantages of Performance Evaluation

It is said that performance evaluation is an investment for the company which can be justified by following advantages:

1. **Promotion:** Performance evaluation helps the supervisors to chalk out the promotion programmes for efficient employees. In this regards, inefficient workers can be dismissed or demoted in case.
2. **Compensation:** Performance evaluation helps in chalking out compensation packages for employees. Merit rating is possible through performance evaluation. Performance evaluation tries to give worth to a performance. Compensation packages which include bonus, high salary rates, extra benefits, allowances and pre-requisites are dependent on performance evaluation. The criteria should be merit rather than seniority.
3. **Employees Development:** The systematic procedure of performance evaluation helps the supervisors to frame training policies and programmes. It helps to analyze strengths and weaknesses of employees so that new jobs can be designed for efficient employees. It also helps in framing future development programmes.
4. **Selection Validation:** Performance evaluation helps the supervisors to understand the validity and importance of the selection procedure. The supervisors come to know the validity and thereby the strengths and weaknesses of selection procedure. Future changes in selection methods can be made in this regard.
5. **Communication:** For an organization, effective communication between employees and employers is very important. Through performance evaluation, communication can be sought for in the following ways:
    a. Through performance evaluation, the employers can understand and accept skills of subordinates.
    b. The subordinates can also understand and create a trust and confidence in superiors.
    c. It also helps in maintaining cordial and congenial labour management relationship.
    d. It develops the spirit of work and boosts the morale of employees.

    All the above factors ensure effective communication.
6. **Motivation:** Performance evaluation serves as a motivation tool. Through evaluating performance of employees, a person's efficiency can be determined if the targets are achieved. This very well motivates a person for better job and helps him to improve his performance in the future.

A few uses of performance evaluation are as follows:

(a) Feedback and Development Applications - Performance appraisal helps in the following:

- Controlling the performance of subordinates
- Assessing training needs and skill gaps
- It is input to goal setting

(b) Basis for Administration Decisions - Performance appraisal acts as the:

- Basis for pay increases based on performance
- Basis for promotions (or demotions)
- Basis for layoffs (or retention)
- Basis for work assignments

- Used for legal defense of HR practices

11.3 Performance Evaluation System

Traditional performance evaluation systems are often based on historical financial measures such as earnings per share, return on investment, and budget variances. These measures do not provide information to evaluate management effectiveness, manufacturing productivity, product quality, or asset utilization. Traditional performance measures do not indicate whether an operation's performance is aligned with the organization's goals. Traditional performance measures can also lead employees to make decisions to benefit themselves instead of the company as a whole.

11.3.1 Developing a new Performance Evaluation System

The first step in developing the new performance evaluation system is to identify customer satisfaction problems. Four areas and defined goals for each are identified. They are as follows:

1. **Product quality** - achieve zero defects and incorporate the features, performance, reliability, and durability customers expect.
2. **Delivery** - increase the percentage of products delivered on schedule to the external customer or internal user.
3. **Production lead tim**e - reduce the sum of processing, material movement, inspection, queuing, and storage times for a particular product.
4. **Waste** - eliminate all non-value-added activities and resources incurred during the process of meeting customer requirements.

The next step is to identify ways to improve customer satisfaction. To do this, employees are asked to make suggestions for improvements throughout the process. Four areas for improvements are identified:

1. Workplace organization.
2. Visual controls.
3. Waste and lead time reduction.
4. Pull system implementation.

Finally, performance evaluation measures are identified for each customer satisfaction area:

1. **Product quality** - measured by:
    a. Statistical process control performance.
    b. Product defects per million.
    c. Customer complaints
2. **Delivery** - measured by the percentage of time the plant meets customer requirements during a month.
3. **Production lead time** - measured by the average time spent manufacturing one unit of product.
4. **Waste** - measured by the average monthly scrap cost per unit.

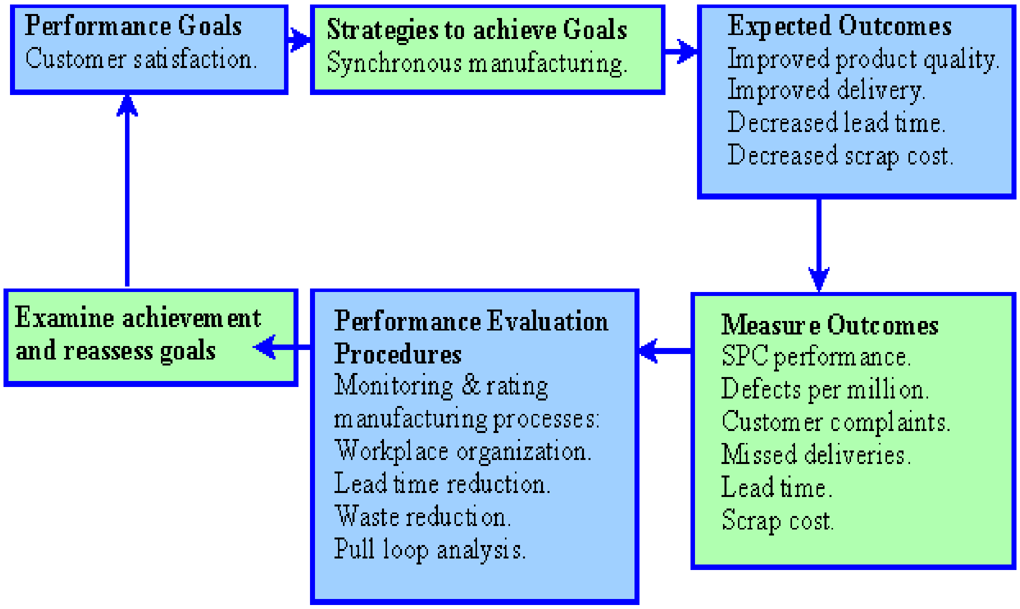


Figure 11.1: Performance Evaluation System

11.4 Performance Evaluation Process

Discussed below are the steps of performance evaluation process:

1. Set Goals Effectively - Goals are the basis of an effective process. There are two key elements to consider when developing goals. First, are goals written clearly and objectively? Second, are they directly contributing to the achievement of business strategy?

Clearly communicating strategic business objectives is the first step to creating alignment. Providing visibility to goals set by departments across the organization furthers alignment. Typically the process begins with departmental managers setting goals for their departments, based upon organization-wide goals, which support the general business strategy. Making departmental goals accessible to all managers ensures there is no overlap, reduces conflict, and allows members of different departments to see where they support each other and ensure they are not working at cross purposes. Each manager in turn shares the overall goals with his/her department and meets with employees to identify individual performance goals and plans.

When setting goals, key job expectations and responsibilities should act as the main guide and reference. Goals should be set that not only address what is expected, but also how it will be achieved. For example, the "what" covers quality or quantity expected, deadlines to be met, cost to deliver, etc. The "how" refers to the behavior demonstrated to achieve outcomes, for example, focus on customer service. In addition, some organizations choose to include competencies within performance expectations, to reinforce the link to business strategy, vision and mission.
An accepted framework to use to help write effective goals is the "SMART" goal:

S – Specific, M – Measurable, A - Achievable/Attainable,

R – Results oriented/Realistic/Relevant, T - Time bound

The inclusion of the above criteria results in a goal that is understandable and easily visualized and evaluated. Making a goal specific, measurable, and time bound contributes to the ability to make progress on the goal and track that progress. Some managers choose to further define goals with a start and finish date with milestones in between. As we have mentioned, goals must be achievable and realistic. An unachievable goal is just that. An employee knows when he/she does not stand a chance of reaching it, and their effort to achieve the goal will be affected. In addition, goals must reflect conditions that are under the employee's control and the R's (results oriented, realistic and relevant) should definitely consider these conditions. Sometimes the focus on the outcome of the goals can overshadow the necessary steps to achieve them. Action plans to support each goal can include documentation of the steps necessary to achieve a goal. By keeping goals relevant, a manager reinforces the importance of linking to strategic objectives and communicating why the goal is important. Some organizations have suggested the use of SMARTA, or SMARTR with the additional A standing for aligned and the R standing for reward.

A focus on objective, behavioral-based, and observable outcomes that are job-related helps ensure fairness of the process and reduces discrepancy. Although sometimes difficult to hear, objective feedback supported with regular documentation is difficult to dispute. This is also where an understanding of the organization's overall objectives and goals and how individual efforts contribute becomes essential. If for example, an individual understands that their actions support an area of the business then it is easier to understand the impact when deadlines are not met. Using the SMART framework provides clarity up front to employees who will be evaluated against these goals.

2. Begin with Performance Planning - Using established goals as a basis, performance planning sets the stage for the year by communicating objectives, and setting an actionable plan to guide the employee to successfully achieve goals.

Performance planning, as with all other steps, is a collaborative process between the manager and employee, although there will always be some elements that are non-negotiable. Begin with the job description and identify major job expectations; expectations then can be clarified for each major area. Under each key contribution area, it is important to identify long-term and short-term goals, along with an action plan around how they will be achieved. Goals can be weighted to identify priorities. Discuss specific details related to how progress against goals will be evaluated. Next steps include determining any obstacles that would stand in the way of these goals being achieved. If an obstacle is knowledge, skills or behavior–a plan should be developed to overcome, i.e.; training, mentoring, etc.

Using the performance planning document as a reference document, the employee and manager then should regularly monitor progress against goals, problem solve road blocks, re-assess goals, change goals as business direction changes, and re-evaluate training and resource needs. This is where the conversation is critical and often where the follow through sometimes falls down. Performance planning and ongoing performance feedback are critical because they facilitate continuous improvement and aid open communication.

3. Ensure an Ongoing Process - As the following diagram illustrates, goal setting, performance planning, performance monitoring, feedback and coaching is ongoing and supports the creation of the performance appraisal, which in turn supports processes related to rewards, learning and development. Performance monitoring, feedback and coaching creates a separate feedback loop within the larger loop which should take place more often, allowing for necessary adjustments to performance planning as conditions dictate.

4. Improve Productivity through Better Goal Management - Regular goal tracking allows for the opportunity to provide feedback as needed, make adjustments to performance plans, tackle obstacles and prepare contingencies for missed deadlines. Without a mechanism to regularly track progress against goals, the ongoing, cyclical nature of the process falls apart.

Goal progress discussions, along with all performance feedback, should be delivered with respect and should be objective and supportive. Specific examples provide clarity and help the employee focus on future improvements. It is crucial that the manager listens to the employee's perspective and incorporates the employee's observations into future plans– the employee often experiences roadblocks the manager may not see.

5. Gather Information from a Number of Sources - Gathering performance information from a variety of sources increases objectivity and ensures all factors impacting performance are considered. This information should include objective data like sales reports, call records or deadline reports. Other valuable information includes: feedback from others, results of personal observation, documentation of ongoing dialogue, records of any external or environmental factors impacting performance. Many reviews also include an employee self-evaluation. Other documents that help define performance objectives include: past performance appraisals, current departmental and organizational objectives and documented standards related to career goals.

In order to gather feedback from other employees, organizations will often use a 360° feedback process. Along with the completion of a self-assessment, selected peers, subordinates, and manager(s) are asked to contribute feedback around pre-identified areas. The feedback is based upon specifically identified skills or competencies and the final results are compared against the employee's self-assessment. This type of feedback increases self-awareness and in some cases is used to support the performance evaluation process.

Objectivity is essential when evaluating performance and it begins with clarity about job expectations and evaluation methods. Certain checks and balances can be built in to ensure objectivity. Managers commonly make mistakes when they conduct evaluations and the first step to minimizing those errors is to acknowledge they exist. Consistent processes organization-wide contribute to fairness and objectivity. Access to information allows others to check the validity of the process. Obviously, not all employees need access to other employees' performance appraisal results, but processes like calibration meetings will help ensure consistency. In the calibration process, managers with employees in similar positions meet and discuss the appraisals before they are finalized and shared with the employees. A calibration meeting helps establish the reasons individuals are awarded various performance rankings educates managers about the process across the organization and promotes consistency. It also provides validation for manager's decisions, if appropriate. Reporting is very valuable to assess the fairness/consistency of the process–for example, to compare ratings in one division to the next or for one manager to the next.

6. Documents - Note taking must be consistent and include all significant occurrences, positive or negative. Documentation is important to support performance decisions, and notes should be written with the intent to share. In addition to documenting the details of an occurrence, any subsequent follow up should be detailed.

The performance log is a record that the manager keeps for each employee and is a record of performance "events." The maintenance of a performance log serves a number of purposes. The manager can record successes or performance that requires improvement. When it comes time to complete the appraisal, the manager has a historical record of events and will not have to rely on recent memory. In addition, this documentation can be used to support performance decisions or ratings. But it also can be used as a reminder for the manager–if the log has no recordings for a period of time, perhaps it is time to check in. If an employee does exceptionally well, or meets deadlines consistently, the log can be used as a reminder to provide recognition for a job well done. In addition, if a manager notices an area of deficiency, the log can serve as a reminder and a record of circumstances. The performance log can also act as a reminder for coaching i.e.: record of upcoming tasks, manager can make note to discuss with the employee to ensure he/she is prepared for the individual for a task ahead, and then follow up discussion can promote learning and continuous improvement. This log should be created using the same principles of performance management and should be objective, based on observable, job-related behaviors, including successes, achievements and, if applicable, any documentation related to disciplinary actions taken.

7. Adequately Prepare and Train Your Managers - Managing the performance of another individual is not an easy task and requires many skills. Training may be required to ensure managers feel adequately prepared to effectively complete all the tasks related to performance management. This is especially the case for newly promoted supervisors. Managers need to understand human behavior, how to motivate, how to develop, provide coaching and deal with conflict. To a great extent, managers must be observers and able to assess a situation, provide motivation and identify problems that interfere with performance. In addition, managers must understand that individuals at different levels of comfort, ability and experience with their jobs will require different levels of input, support and supervision. A manager who feels adequately prepared to provide and receive feedback, deliver a performance evaluation and conduct a performance evaluation meeting will be a major contributor to a successfully functioning process.

8. The Review - The employee performance appraisal or review should be a summary of all that has been discussed. Based upon job expectations and key areas of contribution, and previously discussed goals and evaluation methods, the appraisal should be a written confirmation of what has already been discussed with the employee. The form should include key job responsibilities, current project work, relevant competencies, goals and achievements. Previously completed performance appraisals should be used as reference documents. It should also contain an area to allow employees to record their comment and input. All comments included on the appraisal form need to be job-related and based upon observable behaviors.

For the appraisal meeting, it is imperative to prepare ahead of time. Schedule an appropriate place and time with no interruptions. Ensure the employee has the information necessary to allow them to prepare adequately. Begin the discussion with job requirements and strengths/ accomplishments. The focus, as pointed out previously, should be forward looking. The way the manager approaches this meeting conveys a message related to its importance and should be approached with the appropriate level of seriousness and an open mind. The manager must be prepared in regard to what he/she wants to discuss, but just as importantly must be prepared to listen.

Many suggest that it is important to first define the purpose of the meeting and provide an agenda. A factual discussion with a focus on job-related behaviors will keep the discussion objective. At the end of the meeting, key points should be summarized. It is important to note that the employee will be asked to sign the appraisal, whether or not there is agreement.

9. Link Performance Management with Rewards and Recognition - More and more, organizations are linking performance to compensation. This link, however, cannot effectively be established without the existence of sound performance management processes that are seen as fair and equitable. Clear documentation of progress against performance expectations also allows proper recognition for a job well done. This can be provided a number of ways, i.e.: formal recognition events, informal public recognition or privately delivered feedback.

It is important also to note the benefits of a consistent process across the organization. A consistent process creates a sense of fairness and significantly increases job satisfaction. This is even more critical if compensation is linked to performance. Employees need to know that if an individual in one department is identified as a top performer and compensated accordingly, then an employee performing at the same level in another department will receive similar rewards.

10. Evaluate and Encourage Full Participation and Success - There is widespread recognition that an annual meeting to evaluate progress does not have the same benefits as ongoing dialogue and feedback. Feedback that is delivered when it is most relevant enhances learning and provides the opportunity to make necessary accommodations in order to meet objectives. Some organizations are moving towards conducting performance reviews twice a year, while a small portion is trying to conduct them more frequently. Regardless of frequency, the attitude towards ongoing feedback is crucial. If there is organizational recognition and support for the need to build constructive feedback into the fabric of day-to-day interactions combined with increased visibility into goals, then the environment will encourage development and drive goal-directed performance improvement. The performance management process must add value, otherwise problems with resistance and non-participation will surface. In addition, the process itself must be efficient and as simple as possible, while still providing the necessary value. Automated reminders and scheduling tools can help keep the process on track.

Another element to consider that contributes to success is upper level management support. This support needs to take not only the form of verbal support, but also through participation in the same performance management process for evaluations. In addition, consider the current culture of your organization when it comes to performance appraisals and performance management. Is the "atmosphere" supportive of an effective process? Is there a culture of open honest communication or are employees fearful when they make a mistake? Employees must be able to honestly discuss performance and consider how to make improvements in order to move forward. Another thing to consider is the provision of a mechanism to evaluate the process itself, whether it consists of an annual survey, focus groups, manager feedback, reporting, or a combination of these and other methods.

11.5 Methods of Performance Evaluation

There are three main methods used to collect performance evaluation data: objective production, personnel, and judgmental evaluation. Judgmental evaluations are the most commonly used with a large variety of evaluation methods.

(a) Objective production Method - The objective production method consists of direct, but limited, measures such as sales figures, production numbers, the electronic performance monitoring of data entry workers, etc. The measures used to appraise performance would depend on the job and its duties. Although these measures deal with unambiguous criteria, they are usually incomplete because of criterion contamination and criterion deficiency. Criterion contamination refers to the part of the actual criteria that is unrelated to the conceptual criteria. In other words, the variability in performance can be due to factors outside of the employee's control. Criterion deficiency refers to the part of the conceptual criteria that is not measured by the actual criteria. In other words, the quantity of production does not necessarily indicate the quality of the products. Both types of criterion inadequacies result in reduced validity of the measure. Regardless of the fact that objective production data is not a complete reflection upon job performance, such data is relevant to job performance.

(b) Personnel Method - The personnel method is the recording of withdrawal behaviors (i.e. absenteeism, accidents). Most organizations consider unexcused absences to be indicators of poor job performance, even with all other factors being equal; however, this is subject to criterion deficiency. The quantity of an employee's absences does not reflect how dedicated he/she may be to the job and its duties. Especially for blue-collar jobs, accidents can often be a useful indicator of poor job performance, but this is also subject to criterion contamination because situational factors also contribute to accidents. Once again, both types of criterion inadequacies result in reduced validity of the measure. Although excessive absenteeism and/or accidents often indicate poor job performance rather than good performance, such personnel data is not a comprehensive reflection of an employee's performance.

(c) Judgmental evaluation Method - Judgmental evaluation appears to be a collection of methods, and as such, could be considered a methodology. A common approach to obtaining PAs is by means of raters. Because the raters are human, some error will always be present in the data. The most common types of error are leniency errors, central tendency errors, and errors resulting from the halo effect. Halo effect is characterized by the tendency to rate a person who is exceptionally strong in one area higher than deserved in other areas. It is the opposite of the Horns effect, where a person is rated as lower than deserved in other areas due to an extreme deficiency in a single discipline. These errors arise predominantly from social cognition and the theory in that how we judge and evaluate other individuals in various contexts is associated with how we “acquire, process, and categorize information”.

An essential piece of this method is rater training. Rater training is the “process of educating raters to make more accurate assessments of performance, typically achieved by reducing the frequency of halo, leniency, and central-tendency errors”. Rater training also helps the raters “develop a common frame of reference for evaluation” of individual performance. Many researchers and survey respondents support the ambition of effectual rater training. However, it is noted that such training is expensive, time consuming, and only truly functional for behavioral assessments. Another piece to keep in mind is the effects of rater motivation on judgmental evaluations. It is not uncommon for rating inflation to occur due to rater motivation (i.e. “organizationally induced pressures that compel raters to evaluate rates positively”). Typically, raters are motivated to give higher ratings because of the lack of organizational sanction concerning accurate/inaccurate appraisals, the rater's desire to guarantee promotions, salary increases, etc., the rater's inclination to avoid negative reactions from subordinates, and the observation that higher ratings of the rates reflect favorably upon the rater.

The main methods used in judgmental performance appraisal are:

- **Graphic Rating Scale:** graphic rating scales are the most commonly used system in Performance Evaluation. On several different factors, subordinates are judged on 'how much' of that factor or trait they possess. Typically, the raters use a 5- or 7-point scale; however, there are as many as 20-point scales.
- **Employee-Comparison Methods:** rather than subordinates being judged against pre-established criteria, they are compared with one another. This method eliminates central tendency and leniency errors but still allows for halo effect errors to occur. The rank-order method has raters ranking subordinates from “best” to “worst”, but how truly good or bad one is on a performance dimension would be unknown. The paired-comparison method requires the rater to select the two "best" subordinates out of a group on each dimension then rank individuals according to the number of times each subordinate was selected as one of the "best". The forced-distribution method is good for large groups of ratees. The raters evaluate each subordinate on one or more dimensions and then place (or”force-fit”, if you will) each subordinate in a 5 to 7 category normal distribution. The method of top-grading can be applied to the forced distribution method. This method identifies the 10% lowest performing subordinates, as according to the

forced distribution, and dismisses them leaving the 90% higher performing subordinates.

- **Behavioral Checklists and Scales:** behaviors are more definite than traits. The critical incidents method (or critical incident technique) concerns "specific behaviors indicative of good or bad job performance". Supervisors record behaviors of what they judge to be job performance relevant, and they keep a running tally of good and bad behaviors. A discussion on performance may then follow. The behaviorally anchored rating scales (BARS) combine the critical incidents method with rating scale methods by rating performance on a scale but with the scale points being anchored by behavioral incidents. Note that BARS are job specific. In the **behavioral observation scale (BOS)** approach to performance appraisal, employees are also evaluated in the terms of critical incidents. In that respect, it is similar to BARS. However, the **BOS** appraisal rate subordinates on the *frequency* of the critical incidents as they are observed to occur over a given period. The ratings are assigned on a five-point scale. The behavioral incidents for the rating scale are developed in the same way as for BARS through identification by supervisors or other subject matter experts. Similarly, **BOS** techniques meet equal employment opportunity because they are related to actual behavior required for successful job performance.

(d) Peer and Self Assessments - While assessment can be performed along reporting relationships (usually top-down), net assessment can include peer and self-assessment. Peer assessment is when assessment is performed by colleagues along both horizontal (similar function) and vertical (different function) relationship. Self-assessments are when individuals evaluate themselves. Peer Assessments: members of a group evaluate and appraise the performance of their fellow group members. There are three common methods of peer assessments. *Peer nomination* involves each group member nominating who he/she believes to be the "best" on a certain dimension of performance. *Peer ratings* have each group member rate each other on a set of performance dimensions. *Peer ranking* requires each group member rank all fellow members from "best" to "worst" on one or more dimensions of performance.

- **Self-Assessments:** For self-assessments, individuals assess and evaluate their own behavior and job performance. It is common for a graphic rating scale to be used for self-assessments. Positive leniency tends to be a problem with self-assessments.
- **360-Degree Feedback:** 360-degree feedback is multiple evaluations of employees which often include assessments from superior(s), peers, and one's self.

(e) Performance appraisal interviews - The performance evaluation interview is typically the final step of the appraisal process. The interview is held between the subordinate and supervisor. The performance evaluation interview can be considered of great significance to an organization's performance evaluation system. It is most advantageous when both the superior and subordinate participate in the interview discussion and establish goals together. Three factors consistently contribute to effective performance evaluation interviews: the supervisor's knowledge of the subordinate's job and performance in it, the supervisor's support of the subordinate, and a welcoming of the subordinate's participation.

11.6 Focal Points of Performance Evaluation

Discussed below are few focal points of performance evaluation:

- **Personal traits and characteristics**
- ✓ inexpensive to develop and use
- ✓ not specialized by position; one form for all workers
- ✓ high potential for bias and rating errors
- ✓ not very useful for feedback or development
- ✓ not easily justifiable for reward/promotion decisions
- **Job behavior and activity**
- ✓ can focus on specific duties listed in the job description
- ✓ intuitively acceptable to employees and superiors
- ✓ useful for providing feedback
- ✓ seem fair for reward and promotion decisions
- ✓ are time consuming to develop and use
- ✓ can be costly to develop
- ✓ have some potential for rating error and bias
- **Work results and outcomes**
- ✓ less subjectivity bias
- ✓ acceptable to employees and superiors
- ✓ links individual performance to organizational objectives
- ✓ seem fair for reward and promotion decisions
- ✓ are time consuming to develop and use
- ✓ may encourage a short-term perspective
- ✓ may use deficient or inappropriate criteria

Discussed below are a few legal requirements for performance evaluation:

1. The overall evaluation process should be formalized, standardized and made as objective as possible.

2. The performance evaluation system should be as job related as possible.

3. A thorough, formal job analysis for all employment positions being rated should be completed.

4. Although useful, subjective supervisory ratings should be considered as only one component of the overall evaluation process.

5. Evaluators should be adequately trained in the use of appraisal techniques that employ written qualification criteria for transfer or promotion decisions.

6. Evaluators should have substantial daily contact with the employee being evaluated.

7. If the evaluation involves various measures of performance, the weight of each measure in relation to the overall assessment should be fixed.

8. Opportunities for promotion or transfer should be posted and the information made available to all interested individuals.

9. Whenever possible, the evaluation should be conducted by more than one evaluator or include a review process. All such evaluations should be conducted independently.

10. The administration and scoring of performance evaluations should be standardized and controlled.

11.7 Problems of Performance Evaluation

Problems in Performance Evaluation are what make the task difficult for managers. Problems arise for different reasons. The important reasons of problems are as follows:

a. People often misunderstand the purpose: employees may see them as a form of harassment and managers may see them as a time-consuming source of grief.
b. Improper system design makes the evaluations useless; involve employees in the process for greater success.
c. Use of improper methods or those not based on valid, objective measurements should be avoided; the tool should evolve from a job analysis.
d. Lack of evaluator training with proper follow-up is an important way to avoid problems.
e. Lack of effective communication is a problem across the board. Managers need to know how to provide constructive feedback on a regular basis, not just during an evaluation.
f. Subjective evaluations lead to problems like central tendency, leniency, regency effect, halo/born effect, discriminatory stereotyping, and the fear of complaints.

Discussed below are some of the reasons for intentionally inflating/deflating ratings during performance evaluation:

Reasons for intentionally inflating ratings during Performance Evaluation

- Believe accurate ratings would damage subordinate's motivation and performance.
- Improve employee's eligibility for merit raises.
- Avoid airing department's "dirty laundry."
- Avoid creating negative permanent record that might haunt employee in future.
- Protect good workers whose performance suffered because of personal problems.
- Reward employees displaying great effort even when results were relatively low.
- Avoid confrontation with hard-to-manage employees.
- Promote a poor or disliked employee up and out of department.

Reasons for intentionally deflating ratings during Performance Evaluation

- Scare better performance out of employee.
- Punish difficult or rebellious employee.

- Encourage problem employee to quit.
- Create strong record to justify planned firing.
- Minimize amount of merit increase a subordinate receives.
- Comply with organizational edict that discourages managers from giving high ratings.

11.8 Opposition to Performance Evaluation

Not everyone is in favor of formal performance appraisal systems. Many employees, especially those most affected by such ratings are not very enthusiastic about them. There are many critics of these appraisals including labor unions and managers.

Labour Unions - Labour unions represent 11% (7% in the private sector) of the work force in the United States. In some cases they may require that seniority be taken as one of the main criteria for promotion. However, length of job experience may not always be a reliable indication of the ability to perform a higher level job. That is why some employers give senior people the first opportunity for promotion, but the employer may seek to further qualify the employee for that promotion because of their abilities (not solely because of length of service). Performance appraisals may provide a basis for assessment of employee merit as a component of these decisions.

Managers - Managers who have had unsatisfactory experiences with inadequate or poorly designed appraisal programs may be skeptical about their usefulness.

- Some managers may not like to play the role of a judge and be responsible for the future of their subordinates.
- They may be uncomfortable about providing negative feedback to the employees.
- This tendency can lead them to inflate their assessments of the workers' job performance, giving higher ratings than deserved.

11.16 Summary

The main purposes of employee assessment are to effect promotions based on competence and performance; to confirm the services of probationary employees upon their completing the probationary period satisfactorily; to assess the training and development needs of employees; to decide upon a pay raise where (as in the unorganized sector) regular pay scales have not been fixed; to let the employees know where they stand insofar as their performance is concerned and to assist them with constructive criticism and guidance for the purpose of their development; and to improve communication. Performance evaluation provides a format for dialogue between the superior and the subordinate, and improves understanding of personal goals and concerns. This can also have the effect of increasing the trust between the rater and the rate. Finally, performance appraisal can be used to determine whether HR programmers such as selection, training, and transfers have been effective or not.

11.17 Self Assessment Questions

1. What do you mean by performance evaluation? State its importance in an organisation.
2. Write Short Notes on:
   (a) Objectives of Performance Evaluation
   (b) Advantages of Performance Evaluation
3. Write a detail note on Performance Evaluation Process
4. "Performance Evaluation System determines the success of the organisation." In the light of this statement, define performance evaluation system in detail.
5. Briefly discuss methods of performance evaluation.
6. Write brief notes on:
   (a) Focal points of performance evaluation
   (b) Problems associated with performance evaluation
7. What are the reasons for inflating or deflating ratings during performance evaluation?
8. Write brief notes on:
   (a) Suggestion to make performance evaluation programme successful
   (b) Summary Guidelines for Performance Evaluation

11.18 Reference Books

- Bittel, L. R., and J. W. Newstrom, 'What Every Supervisor Should Know', McGraw-Hill Book Co.
- Carrell, M. R., 'Human Resources Management', John Wiley & Sons, Inc.
- Certo, S. C., Human Relations Today: Concepts and Skills', Richard D. Irwin, Inc.
- Ally, M., Foundations of recruitment theory for companies, 'The theory and practice of recruitment', 2006, pp. 13–31.
- Angelina, P., Recruitment: The alternative selection processes', 'The Star Tech Plus, 29 August, 2007, pp.9-12.
- Benson, A. Using recruitment to meet workforce demand: A case study of stakeholder influence, 'Quarterly Review of Recruitment and Selection', 3(4), 2002, pp. 443–452.
- Clark, R., Six principles of effective human resource management: What works and why, the recruitment, 'Developer's Journal', 2002, pp. 41–50.
- Clark, R. E., Reconsidering research on training from media, 'Review of Educational Research', Vol. 53, 1983, pp. 145–1160.
- Conrad, D., Recruitment and social change: An apparent contradiction, 'Perspectives on human resource in the digital age', 2006, pp. 21–33.
- Dede, C., The evolution of recruitment: Emerging technologies and distributed methods, 'The American Journal of selection', 10(2), 1996, pp.4–36.
- Evans, J.R., and I.M, Haase, Recruitment in the twenty-first century: an analysis of potential target markets, 'Internet Research: Networking Applications and Policy', Vol.11, No.3, 2001, pp. 246-260.

- Guilar, J. and A. Loring, Dialogue and community in human resource: Lessons from Royal Roads University, 'Journal of Distance Education', 2008, pp. 29–49.
- Homan, G. and A. Macpherson, E-learning in corporate universities, 'Journal of European Industrial Training', Vol. 29, No.1, 2005, pp. 75-90.
- Kember, D. A., Et. Al., Orientation to enrollment of part-time students: A classification system based upon their perceived lifelong learning needs, 'Higher Education Research and Development', Vol. 20, No.3, 2001, pp. 265-280.
- Laws, R.D., S.L. Howell, and N.K. Lindsay, Scalability in Distance Education: Can we Have Our Cake and Eat it Too? "Online Journal of Distance Learning Administration', Vol.6, No.4, 2003.
- Rivera, J.C., and M.L. Rice, A Comparison of Student Outcomes & Satisfaction between Traditional & Web Based Course Offerings, 'Online Journal of Distance Learning Administration', Vol. 5, No. 3, 2002.
- Rosenberg, M., 'E-Learning: Strategies for Delivering Knowledge in the Digital Age' McGraw-Hill, 2001, New York.
- Sam Brook, S., E-learning in Small Organizations, 'Education + Training', Vol. 45, No. 8/9, 2003, pp. 506-516.

Unit – 12: Channel Management

Structure of Unit

12.0 Objectives

After completing this unit, you would be able to:

- Learn recruiting and selecting channel members;
- Understand the role and importance of motivating channel members;
- Understand how to evaluate channel performance;
- Understand the need of modifying channel arrangement;
- Know about various conflict management techniques;
- Understand the strategic importance of maintaining channel relationship

12.1 Introduction

Marketing channels have traditionally been viewed as a bridge between producers and users. These are a set of interdependent organizations that ease the transfer of ownership as products move from producer to business user or consumer. Since the core of marketing is the exchange process, marketing channels can be viewed as exchange facilitators and can be defined as an array of exchange relationships that create customer value in the acquisition, consumption, or disposition of goods and services. Exchange relationships, and thus marketing channels themselves, emerge from market needs as a way of more efficiently serving market needs. Managing channel in such a competitive and demanding scenario is critical. Channel Management encompasses a number of activities right from designing the structure to Managing Channel Relationships.

Value network and marketing channel decisions are among the most complex and challenging decisions facing the firm. Each channel system creates a different level of sales and costs. Once a particular marketing channel is chosen, the firm usually must adhere to it for a substantial period. The chosen value network or channel will significantly affect and be affected by the other elements in the marketing mix. Middlemen typically are able to perform channel functions more efficiently than the manufacturers. The most important channel functions and flows are information, promotion, negotiation, ordering, financing, risk taking, physical possession, payment and title. These marketing functions are more basic than the particular retail and wholesale institutions that may exist at any time, and when a channel member no longer provides value-added service it can and often is replaced by another channel member or a new means of distribution.

Manufacturers face many channel alternatives for reaching a market. They can choose selling direct or using one, two, three or more intermediary channel levels. Channel design calls for determining the service outputs (lot size, waiting time, spatial convenience, and product variety), establishing the channel objectives and constraints, identifying the major channel alternatives (types and number of intermediaries, specifically intensive, exclusive, or selective distribution), and the channel terms and responsibilities. Each channel alternative has to be evaluated according to economic, control, and adaptive criteria.

Channel management calls for selecting particular middlemen and motivating them with a cost-effective trade relations mix. The aim is to build a “partnership” feeling and joint distribution programming. Individual channel members must be periodically evaluated against their own past sales and other channel members’ sales. Channel modification must be performed periodically because of the continuously changing marketing environment. The company has to evaluate adding or dropping individual middlemen or individual channels and possibly modifying the whole channel system.

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.

12.2 Channel Decisions

Strategic marketing plan form a part of the product or service having the decisions relating to the channel distribution. The target market under the specified plan will have different target levels of market share, market coverage, customer service and so on. Organization uses different channels of distribution which are capable to achieve the targets. Thereafter the establishment of the distribution system can take a long time this may be years too; hence these decisions can’t be taken lightly and should be considered for a longer term as it is not easy to switch between channels.

Distribution channel can be defined as: A collection or set of firms and individuals that take title, or assist in transferring title to a good or service as it moves from the producer to final consumer. Recognition of channel decision’s importance is not always conducted. Product development takes place after the proper channels of distribution are carried out. Therefore, Bennett asserts that Global marketplace is increasing and creating competition, managers plan for their product distribution as they plan products. Bennett has also claimed that “Strategic planning has modern distribution systems considering the marketing concept, focusing on target markets and are always consistent and flexible.”

12.2.1 The value of middlemen

From moving product from producer to consumer many functions are taken in consideration. These functions require funding and expertise knowledge of a specialized person. There are few producers who have either the resources or the expertise knowledge to carry out all the necessary functions to get a product or service to the ultimate consumer. Remuneration of the middlemen depend on the number of marketing functions performed by a personnel and knowing the efficiency of performing the function.

The advantages of using middlemen as opposed to marketing direct to end users can be illustrated very easily. Efficiency of mist of the marketing systems can be improved and enhanced by the presence of effective intermediaries. This result can be illustrated in the figure given below. Hence, it shows that an intermediary between the number of consumers and producers can reduce the no of transactions and by this the selling and procurement cost are reduced

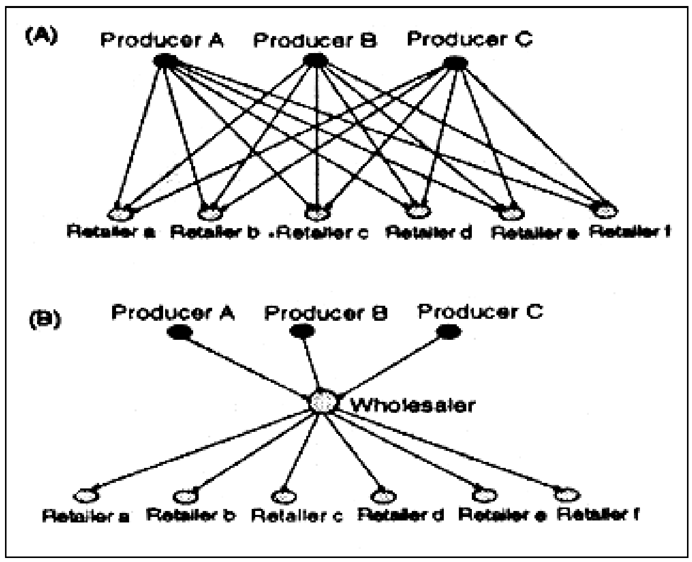


Figure 12.1: Direct marketing system and a marketing system with intermediaries

The advantages of using middlemen as opposed to marketing direct to end users can be illustrated very easily. Efficiency of mist of the marketing systems can be improved and enhanced by the presence of effective intermediaries. This result can be illustrated in the figure given below. Hence, it shows that an intermediary between the number of consumers and producers can reduce the no of transactions and by this the selling and procurement cost are reduced.

12.2.2 Channel Functions

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. The channel flows are as follows:

Possession: Possession represents the flow of goods from the producer to the final consumers through intermediaries. The possession of goods gets transferred from the manufacturers to consumers. Possession flow consists of various activities pertaining to storage of goods and their transportation from one channel member to another.

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.

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.

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: 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.

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.

12.3 Managing Distribution Channels

In regard with operations and provision of special services, the distributors are becoming more organised and efficient to meet the growing expectations of the customers which can manage the channels efficiently. Channel management also helps companies in minimising their costs, reach the potential customers and to make profit. Convenience and service factors are not under the direct control in the key role of manufacturers as intermediaries provided to customers. Specialization of customers takes place to have an effective management and organization.

Some aspects should be kept in mind while consideration of managing channels and they are, the company should select and recruit the right channel. When this task is completed, it should focus on motivating channel members while increasing their profitability. Thereafter the company has to evaluate the channel member's performance to ensure that they remain competitive in market. Market changes should be properly settled and the managers should modify their channel arrangements effectively. Broadly the aspects that are considered in channel management are discussed in the following paragraphs.

12.4 Recruitment of Channel Members

Distribution channel members are the key area that are outsourced, and have to be selected carefully. The selection of channel members therefore is an important task and should ensure the selection of a deserving channel partners who will serve the right customer at the right time with right attitude. Thus a carefully designed recruitment and screening is essential.

Recruiting involves those plans and actions aimed at actively soliciting participation by a new channel member. Before active recruiting can begin, key personnel from the recruiting organization must consider and reach agreement on several important issues, including:

- The precise role of the prospective channel members.
- The specific qualifications necessary for success in this channel role.
- The precise products or channel assignments for which the prospective channel member will be responsible.
- The bounds of authority of the prospective channel member.
- The way in which the role might be expected to change over time.

Key decisions in channel management - Appointment of intermediaries requires a lot of decision making processes to be carried out. This may include: price policy, term and condition of sale, territorial rights and definition of responsibilities. In addition, a choice has to be made between extensive and intensive coverage of market.

Price policy: Wholesale or retail margins, list of prices and a specified discount have to be developed. These may reflect the interest of the intermediary as well as the interest of the producer and supplier if they have to form a stage for channel members.

Terms and conditions of sale: With the addition of price schedules the producer/supplier must explicitly state payment terms, guarantees and restrictions on where and how the product is to be sold. If the product has a sizeable demand then the very producer/supplier may evaluate intermediaries on the basis of performance criteria such as the attainment of targets, inventory levels, customer delivery etc. The intermediaries whose performance is below the target decided may have the right to handle the product withdrawn.

Territorial rights: Some products and distributors will be given exclusive rights to market a product in a specified territory. It may happen with the agricultural equipment which is used to decide the boundaries of territories which the manager or supplier have to strike maintaining a balance between defining territories which are large enough to provide good sales to the distributors but are small enough to allow the distributors for providing better service to customers within the territory.

Definition of responsibilities: Duties and responsibilities of the supplier and the customer have to clearly define. For example, if the customer encounters some problem with the product and requires technical advice or repair of the product then it should be immediately clear to both the supplier and the distributor as to which the party is responsible for responding the consumer. As concluded, in the same way, the agreement between the producer and supplier and the distributor should clearly be specified stating that which party is responsible for the cost of product training when new employees join the distributor or new products are introduced.

Recruitment as a Continuous Process: For several reasons, the recruitment of new channel members should be viewed as a continuous process. One reason is that an organization's intermediaries sometimes withdraw from the channel relationship of their own accord, and the organization needs to be prepared to respond quickly. Another reason for viewing recruiting as a continuous process is that marketers may need to contract with new intermediaries to help launch new products.

Organizations, particularly producers, also may have to change intermediaries as their products pass through stages in their product life cycle, when buyer behaviour changes, or in response to changes in the distribution strategies of competitors.

12.4.1 Screening Channel Members

Screening involves the systematic consideration, evaluation, and, ultimately, rejection of most of a set of people, things, or ideas. Screening is inherently a negatively oriented process.

First, the organization should think about market segments. Too many marketers think primarily in terms of geographic coverage when screening intermediaries, rather than considering market or customer segments. Second, the selling and distribution requirements for a product change during its life cycle, yet marketers frequently fail to account for these changes in their distribution strategies. Third, manufacturers and retailers tend to recruit distributors that are already overloaded with products, while shying away from smaller, newer, or temporarily underfinanced intermediaries. The fourth criteria that should be weighed by channel members engaged in this screening process pertain to the level of support required by the various prospects. Clearly, this support may be financial in nature. It may involve the exchange of technical or marketing expertise between the recruiting firm and its prospective channel partner. Or, the support might merely involve some "hand-holding" or positive-reinforcement during an extended start-up period.

The channel partners should be judge on the following points:

- Credit Reports.
- Business age of the candidate.
- Reputation among customers, other manufacturers the distributor currently represents, peers, trade publications, trade organizations and local community.
- Business and managerial stability.
- Financial strength.
- Sales revenue performance.
- Locations.
- Number of active customer accounts.
- Present territorial coverage.
- Complementary manufacturer value offer lines represented.
- Competitive value offer lines represented.

- Knowledge of existing Product Lines.
- Repair and service capabilities.
- Knowledge of local market conditions.
- Employee quality.
- Overall condition of facilities.
- Type of market coverage offered.
- Sales force compensation.
- Sales competency.
- Number and quality of salespeople.
- Technical competence of salespeople.
- Sales and marketing aggressiveness.
- Local marketing activities.
- Customer and order pursuit.
- Dealing with their competition.
- Internal sales and marketing support resources and capabilities.
- Ordering and payment policies.
- Price integrity.
- Ability to develop new markets.
- Distributor advertising and sales promotional programs.
- Training programs.
- Consent to sign a contract.
- Agreement to accept a sales quota.
- Willingness to share data and local market information.
- Willingness to participate in joint sales and marketing programs.
- Inventory management expertise.
- Adequate inventory commitment.
- Future growth prospects.
- "Coup de Grace" Factors That Indicate a Motivated Candidate.
- True desire for your value offer line.
- Willingness to share key customer list.
- Willingness to participate in strategic business planning with your organisation.

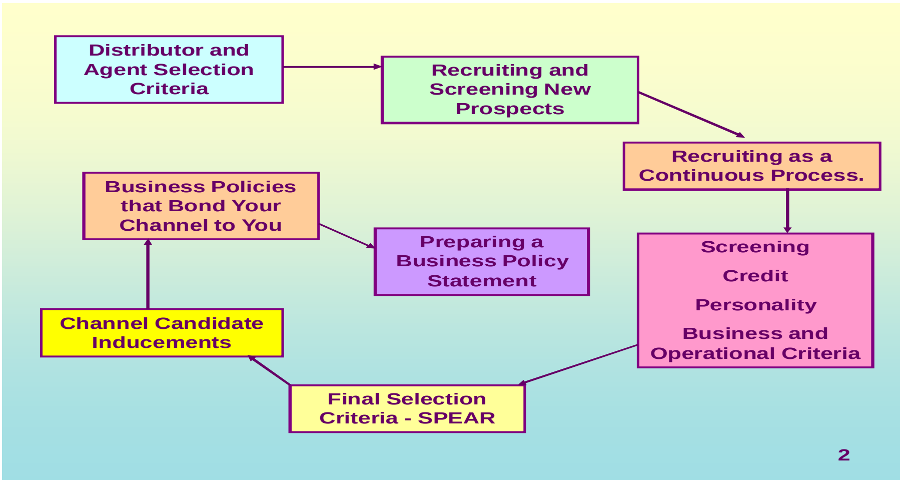


Figure 12.2: Key areas in managing Distribution Channel

12.4.2 Selecting the Right Channel Partners

The goal in channels development, as always, should be to find the best channel partner available from among a small pool. So the selection process continues and is now conducted at a more refined level.

Several selection criteria should be considered during this final evaluation of channel members. Recruiting channel members therefore might be described as seeking to *spear* the best channel partner from among of the remaining pool of prospects. Various Selection Criteria are as follows:

- **Sales factors:** The ultimate justification for using intermediaries is to improve market share, sales, and profitability. Thus, sales and market factors head the list of evaluative criteria.
- **Product factors**: Product factors include the intermediary's knowledge of the product and of its service or stocking requirements. The quality of the prospect's service staff should also be considered.
- **Experience factors:** Indicators of intermediary experience and expertise can be obtained by evaluating the prospect's previous customers' satisfaction, whether the prospect has worked successfully with similar products in the past, the prestige of its prior or current channel partners, and the prospect's current technology.
- **Administrative factors:** The administrative and contractual conformance of prospects can be evaluated by examining the prospect's workload and determining whether it is overworked.
- **Risk factors:** Considerations of risk include evaluations of a prospect's commitment to the relationship and of how much the proposed channel arrangement will cost the recruiting organization. The prospect's enthusiasm for the product should also be considered. Costs, the extent of a prospect's dealing with competitors, and the career histories of its key personnel should likewise be evaluated.

Recruiting organizations can exert only limited influence over the business conduct of their intermediaries. This is true even when recruiters enjoy dominant channel positions and are willing to exercise power in pursuit of their interests.

The business policy statement should describe policies regarding the presale, post-sale, and transaction phases of channel business, including:

- Contracts and agreements
- Authorized primary area of sales and service responsibility
- Penalties for selling outside the authorized sales territory
- Organisation marketing plans, including space advertisements, public relations releases, direct mail, national and local exhibits, and cooperative advertising
- Pricing, pricing assistance, and price protection
- Value offer quality and warranties
- Required inventory levels
- Order size in units or total dollars
- National house or special accounts
- Major account support

- Value offer customization, private labels, and original equipment manufacturer (OEM)
- New value offer launches
- Discontinued Products
- Priority replacement
- Billing and payment terms, credit procedures
- Freight and shipment, including drop shipment
- Delivery guarantees
- How performance will be evaluated
- Grounds for termination

12.4.3 Designing a Channel System

Channels are not formed through an arbitrary process. Instead, an underlying structure shapes members' behaviors. This structure makes it possible to explain and predict how channel members will perform in market settings. This framework is termed as Channel Design.

Good channel design is often the key to market leadership and overall business success. Because they generally require years of continuous attention to develop, sound manufacturer-intermediary-end-users linkages are often barriers to competitive entry. Without the benefits that accrue from solid market channels, even marketers with superior products can fail in the marketplace. Channel design decisions are among the most critical facing marketing managers. The type of channel chosen directly influences each of the other marketing decisions

Components of Channel Design - The various channel structural alternatives available to a producer firm can be identified in terms of the following three dimensions:

i. The number of levels in the channel.

ii. The number of intermediaries operating at the various levels.

iii. The types of intermediaries used at each level.

Each intermediary that performs a function necessary to convey the market offering closer toward the final user represents a channel level. A channel's length is described by the number of its intermediary levels.

Second, companies must determine the number of intermediaries to be used at each channel level within a given market area. Three basic designs are available: intensive, exclusive or selective distribution.

Finally, firms must identify the types of intermediaries that are available at each channel level. The following distribution alternatives are generally available: manufacturer's sales force, manufacturer's representatives or industrial suppliers. In most instances, producers will be able to identify several intermediary alternatives. The intermediary alternatives need to be evaluated against expected sales and costs, control and resources and flexibility criteria.

A) **Levels of Channels**: A distribution channel can have several stages depending on how many organizations are involved in it:

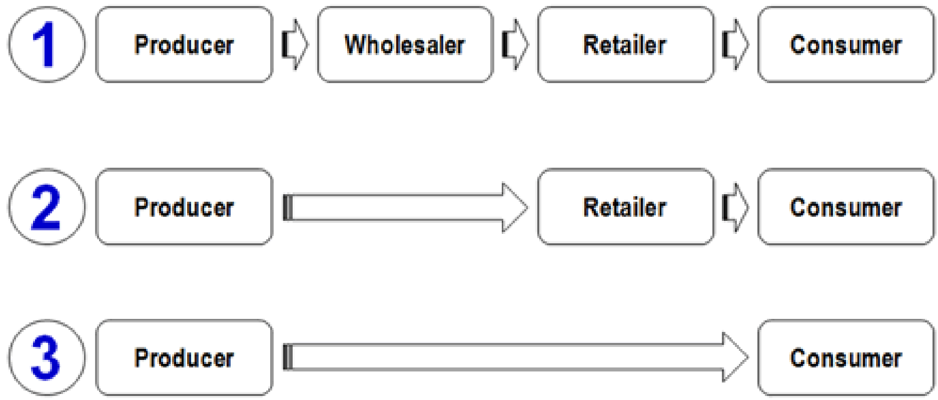


Figure 12.3: Level of Channels

i. Channel 1 contains two stages between producer and consumer - a **wholesaler** and a **retailer.** A wholesaler typically buys and stores large quantities of several producers' goods and then **breaks into bulk** deliveries to supply retailers with smaller quantities. For small retailers with limited order quantities, the use of wholesalers makes economic sense.

ii. Channel 2 contains one intermediary. In consumer markets, this is typically a **retailer**. The consumer electrical goods market in the UK is typical of this arrangement whereby producers such as Sony, Panasonic, Canon etc. sell their goods directly to large retailers such as Comet, Tesco and Amazon which then sell onto the final consumers.

iii. Channel 3 is called a "**direct-marketing" channel**, since it has no intermediary levels. In this case the manufacturer sells directly to customers. An example of a direct marketing channel would be a factory outlet store. Many holiday companies also market directly to consumers, bypassing a traditional retail intermediary - the travel

B) Channel Intensity: The intensity of distribution i.e. the total proportion of the market covered will depend upon decisions made in the context of the overall marketing strategy. In simple terms there are two alternatives: skimming the market and market penetration. It will be remembered that a skimming strategy involves being highly selective in choosing target customers. Normally, these will be relatively affluent consumers willing and able to pay premium prices for better quality, sometimes highly differentiated products. It will also be recalled that a penetration strategy is one where the decision has been made to mass market and the object is to make the product available to as many people as possible. The decision as to which of these is adopted as with immediate implications for distribution strategy. Three principal strategies these being; intensive, selective and exclusive distribution.

Intensive distribution: An intensive distribution policy is driven by the belief that every exposure to a customer is an opportunity to buy. Those responsible for the marketing of FMCG and other low unit value products, are, typically, seek distribution. This is possible where the product is fairly well standardized and requires no particular expertise in its retailing. Mass marketing of this type will almost invariably involve a number of intermediaries because the costs of achieving extensive distribution are enormous. Where commercial organisations do opt for extensive distribution, channels are usually long and involve several levels of wholesaling as well as other middlemen.

Selective distribution: Suppliers, who appoint a limited number of retailers, or other middlemen, are chosen to handle a product line, have a policy of selective distribution. Limiting the number of intermediaries can help contain the supplier's own marketing costs and at the same time enables the grower/producer to develop closer working relations with intermediaries. The distribution channel is usually relatively short with few or no intermediaries between the producer and the organisation which retails the product to the end user. Selective distribution is common among new businesses with very limited resources. Their strategy is usually one of concentrating on gaining distribution in the larger cities and towns where the market potential can be exploited at an affordable level of marketing costs. As the company builds up its resource base, it is likely to steadily extend the range of its distribution up to the point where further increases in distribution intensity can no longer be economically justified.

Exclusive distribution: Exclusive distribution is an extreme form of selective distribution. That is, the producer grants exclusive right to a wholesaler or retailer to sell in a geographic region. Caterpillar Tractor Company, for example, appoints a single dealer to distribute its products within a given geographical area. Some market coverage may be lost through a policy of exclusive distribution, but this can be offset by the development and maintenance of the image of quality and prestige for the product and by the reduced marketing costs associated with a small number of accounts. In exclusive distribution producers and middlemen work closely in decisions concerning promotion, inventory to be carried by stockists and prices. The details of an exclusivity agreement can have important ramifications for both producer and distributor. Some involve tied-agreements where an enterprise wishing to become the exclusive dealer for a given product must also carry others within that product line.

C) The major types of channel partners which are commonly appointed are wholesaler, retailer, distributors etc. the detail explanation of various types of channel partners are discussed in chapter fourteen.

Thus we can conclude that designing a channel involves deciding on the following points.

A. Channel levels—zero to three levels, can be longer

B. Number of intermediaries

   a) Exclusive distribution—one or a select few

   b) Selective distribution—more than a few, less than all

   c) Intensive distribution—as many outlets as possible

C. Types of intermediaries

12.5 Motivating Channels

Motivating the management involves the actions taken by the manufacturers to foster channel member cooperation in implementing the manufacturer's distribution objectives.

Basic Framework involves in motivating the channel members is Finding Out Channel Member Needs & Problems, Offer support to the channel members that matches with their needs and problems, Provide leadership through the effective use of power.

Channel Members Needs and Problem can be identified through:

- Marketing research: A very less percent of manufacturers' research budgets is spent on channel member research. Outside Agencies/Professionals may be hired as manufacturer-initiated research can be useful because certain types of needs or problems may not be at all obvious. Research studies by outside parties, provide a higher assurance of objectivity and provide a level of expertise that the manufacturer may not possess
- Marketing channel audits: Gather data on how channel members perceive the manufacturer's marketing program and its component parts. Locate the strengths and weaknesses in the relationships. Learn what is expected of manufacturers to make the channel relationship viable and optimal. It must be conducted periodically so as to capture trends & patterns.
- Distributor advisory councils: Distributor advisory councils are necessary to determine the needs and problems of channel partners. They help in information exchange between channel partners 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 partners to contribute significantly to the planning process and improve channel performance. Thus, these councils give channel partners a sense of belonging, which motivates them to put in their best performance. Personal contact with channel partners also provides sufficient information to manufacturers about their needs and problems.

12.5.1 Means to Motivate Channel Members

A) **Cooperative Arrangement -** Intermittent interactions between manufacturer and channel members. Focuses on identifying channel needs and Problem. Typical types of cooperative Programs provided by Manufacturers to channel members:

- Cooperative advertising allowances
- Payments for interior displays
- Contests for buyers, salespeople, etc.
- Allowances for warehousing functions
- Payments for window display space
- Detail men who check inventory
- Demonstrators
- Coupon-handling allowance
- Free goods

B) **Partnerships & Strategic Alliances**: Continuing & mutually supportive relationship. Focus on a continuing and mutually supportive relationship between the manufacturer and its channel members establish mainly for an Elite Group of Distributors:

- The Process involves: Manufacturer should make explicit statement of policies in areas such as product availability, technical support, pricing, etc.
- Manufacturer should assess all existing distributors as to their capabilities for fulfilling their roles
- Manufacturer should continually appraise the appropriateness of the policies guiding his or her relationship with the channel members

C) **Distribution Programming**: Deals with virtually all aspects of the channel relationship. It is a comprehensive set of policies for the promotion of a product through the channel

D) **Developed as a joint effort** between the manufacturer and the channel members to incorporate the needs of both parties. The following Steps can be followed for developing a program:

1. Analysis of marketing objectives & the kinds of levels of support needed from channel members.
2. Formulate specific channel policies that offer price concessions to channel members, financial advice and ome kind of protection for channel members.

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 partners 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. The successful agreements and alliances that companies have entered into with different channel partners in recent time have made managers realize the potential of cannel integration to reduce costs and improve productivity

a) Conventional marketing channel comprises an independent producer, wholesaler(s) & retailer(s). Each is a separate entity. No channel member has complete or substantial control over the other members.

b) Vertical Marketing Systems (VMS) is one in which the main members of a distribution channel—producer, wholesaler, and retailer—work together as a unified group in order to meet consumer needs. In conventional marketing systems, producers, wholesalers, and retailers are separate businesses that are all trying to maximize their profits. When the effort of one channel member to maximize profits comes at the expense of other members, conflicts can arise that reduce profits for the entire channel. To address this problem, more and more companies are forming vertical marketing systems.

The concept behind vertical marketing systems is similar to vertical integration. In vertical integration, a company expands its operations by assuming the activities of the next link in the chain of distribution. For example, an auto parts supplier might practice forward integration by purchasing a retail outlet to sell its products. Similarly, the auto parts supplier might practice backward integration by purchasing a steel plant to obtain the raw materials needed to manufacture its products. Vertical marketing should not be confused with horizontal marketing, in which members at the same level in a channel of distribution band together in strategic alliances or joint ventures to exploit a new marketing opportunity. A VMS can hold both advantages and disadvantages for small businesses. The main advantage of VMS is that your company can control all of the elements of producing and selling a product. In this way, you are able to see the whole picture, anticipate problems, make changes as they become necessary, and thus increase your efficiency. However, being involved in all stages of distribution can make it difficult for a small business owner to keep track of what is happening. In addition, the arrangement can fail if the personalities managing of the different areas do not fit together well.

Thus the main feature can be summarized as follows:

1. Producer, wholesaler(s) & retailer(s) act as a unified system.
2. They all cooperate.
3. Can be dominated by any of the three members of the system.
4. It arose as a result of strong channel members' attempts to control channel behavior & eliminate the conflict that results when independent channel members pursue their own objectives.
5. Has become the dominant mode of distribution in the U.S. consumer marketplace.

Types of VMS - Vertical marketing systems can take several forms. In a corporate VMS, one member of the distribution channel owns the other members. Although they are owned jointly, each company in the chain continues to perform a separate task. In an administered VMS, one member of the channel is large and powerful enough to coordinate the activities of the other members without an ownership stake. Finally, a contractual VMS consists of independent firms joined together by contract for their mutual benefit. One type of contractual VMS is a retailer cooperative, in which a group of retailers buy from a jointly owned wholesaler. Another type of contractual VMS is a franchise organization, in which a producer licenses a wholesaler to distribute its products.

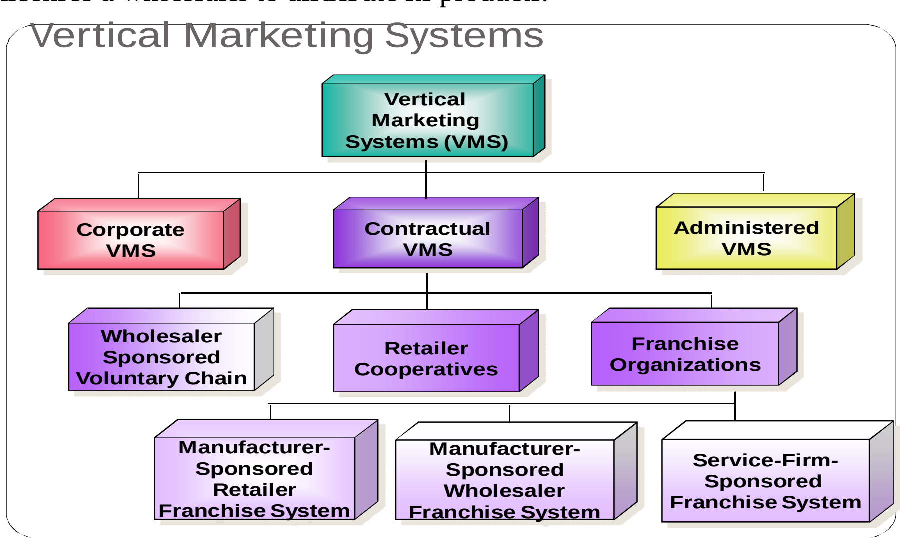


Figure 12.4: Types of VMS

1. Corporate VMS - Combines successive stages of production & distribution under single ownership. (Sears).
2. Administered VMS - Coordinates successive stages of production & distribution through the size & power of one of members (Kodak, Gillette, P&G)
3. Contractual VMS – These are
    - Wholesaler-sponsored voluntary chains
    - Retailer cooperatives
    - Franchise organizations

   Independent firms at different levels of production & distribution integrating their programs on a contractual basis to obtain more economies &/or sales impact than they could achieve alone. 3 types:

c) Horizontal Marketing Systems - Two or more unrelated companies put together resources or programs to exploit an emerging marketing opportunity. A **horizontal marketing system** is a distribution channel arrangement whereby two or more organizations at the same level join together for marketing purposes to capitalize on a new opportunity. For example: a bank and a supermarket agree to have the bank's ATMs located at the supermarket's locations, two manufacturers combining to achieve economies of scale, otherwise not possible with each acting alone, in meeting the needs and demands of a very large retailer, or two wholesalers joining together to serve a particular region at a certain time of year.

According to businessdictionary.com, Horizontal Marketing System is a merger of firms on the same level in order to pursue marketing opportunities. The firms combine their resources such as production capabilities and distribution in order to maximize their earnings potential

d) Multichannel Marketing Systems - A single firm uses two or more marketing channels to reach one or more customer segments. By adding more channels, companies can gain 3 important benefits: increased market coverage, lower channel cost, more customized selling.

12.6 Evaluating Channel Performance

The importance of channel member performance equals that of employee evaluations within the firm. Except that they are the channel manager works with individual firms rather than with individual employees and the setting is inter-organizational rather than intra-organizational. Scope & Frequency of Evaluations Involves discussion on the following points:

1. **Degree of Control:** It implies the Control that a producer manufacturer, or franchisor has over members and is based on strong contractual agreements. Channel manager can demand a great deal of information on member operations. However Manufacturer lacks strong market acceptance for its products & strong channel control based on contractual commitments *Manufacturer can exert little control over channel members.* Evaluation of channel members is more comprehensive for manufacturers who sell all of their output through intermediaries than for manufacturers who rely less on intermediaries. Because the firm's success in the market is directly dependent on the channel members' performance.

1) **Nature of the Product:** The more complex the product, the broader the scope of evaluation

2) **Number of Channel Members:** Manufacturers who use intensive distribution: Channel member evaluation may be cursory. Manufacturers who use highly selective distribution: Channel member evaluation is comprehensive

Performance Audit - Phases of Performance audit includes:

- Developing criteria for measuring channel member performance
- Periodically evaluating the channel members' performance against the criteria
- Recommending corrective actions to reduce the number of inadequate performances

Key Criteria to be considered for Performance Audit include:

- Sales performance of channel members
- Inventory maintenance of channel members
- Selling capabilities of channel members
- Attitudes of channel members
- Competition faced by channel members
- General growth prospects of channel members
- Net profit margin- is defined as % net profit divided by net sales however net profit margin actually measures the proportion of each sales rupees that is kept by firm as net profit
- Asset turn over- is a ratio of total sales divided buys total assets. It actually measures the efficiency of management in utilizing assets. Its shows how much money in total sales volume is generated by each dollar that the firm has spent.
- Leverage – the result by multiplying net profit margin percentage times asset turnover ratio in return on assets (ROA). For OR, ROA is a critical measure of performance because it especially tells how well they have used all the resources at their disposal to achieve profit.

12.7 Managing Channel Relationships

Marketing channels are characterized by continuous and sometimes dramatic change, especially with the changes brought by the growth of the Internet as a major marketing tool and channel of distribution. For example, the new competition no longer involves competition between individual firms but rather between retail systems. Three of the most significant trends are the growth of vertical, horizontal, and multichannel marketing systems. All channel systems have a potential for vertical, horizontal, and multichannel conflict stemming from such sources as goal incompatibility, unclear roles and rights, differences in perception, and high dependence. Managing these conflicts can be sought through super-ordinate goals, exchange of persons, co-optation, joint membership in trade associations, diplomacy, mediation, and arbitration. Marketers should continue to explore and respond to the legal and moral issues involved in channel development decisions

Partner relationships have only increased in complexity, so it is time to look toward enterprise applications' providing a broader range of capabilities. VAR Business labs-testing partner Doculabs examines this trend and the products that are available.

Partner-relationship management (PRM) solutions have traditionally focused on maximizing sales revenue and increasing the effectiveness of sales and marketing initiatives through the coordination of channel partnerships. The earliest PRM tools used simple contact databases and the posting of product and pricing information through an extranet portal. But the extended enterprise has resulted in new types of partnerships, leading to new challenges in managing multiple facets of partner relationships and information flows that extend across a broad range of constituencies.

PRM applications go beyond customer-relationship management (CRM) and supplier-relationship management (SRM) solutions by providing visibility and control into multiple tiers of partners. At the same time, they provide a portal framework for the aggregation of back-end systems, content repositories and collaboration tools, as well as secure access to a broad range of employees and partners.

Improving the efficacy of sales and marketing activities is also no longer the sole objective of PRM. Now, instead of merely improving channel effectiveness, many organizations seek to improve the way they work with their partners.

In addition, the new definition of PRM differentiates between supply-side partners and demand-side partners. Supply-side partners provide information, tools, products or services that impact partners. Demand-side partners focus on increasing sales of products or services. By acknowledging the need for solutions that address both sets of relationships--often involving parties that play dual roles--organizations have raised the bar for PRM solutions.

12.7.1 Channel Conflict

Types of conflict & competition include the following:

- **Vertical** channel conflict exists when there is conflict between different levels within the same channel.
- **Horizontal** channel conflict exists when there is conflict between members at the same level within the channel.
- **Multichannel** conflict exists when the manufacturer has established two or more channels that compete with each other in selling to the same mkt.

Causes of channel conflict - Conflict between channel members can arise for one or more of the following reasons:

Incompatibility of goals: Organisations can have conflicting goals. A grower may want to grade the produce in order to achieve a price premium for the top quality produce or to develop a brand image, but the wholesaler may only be interested in selling large volumes of undifferentiated produce.

Confusion over roles and rights: For example, a grower may sell part of the produce through local agents and part direct to supermarkets. This may cause conflict because the local agent believes that all sales should go through him/her.

Differences in perceptions: Among the many potential differences in perceptions, which can result in conflict, are: who the customer is; what the market wants; the objectives of other channel members in participating in the market; and the role which other channel members play in helping the organisation achieve its own objectives.

Members of a distribution channel can also differ in how they perceive themselves. There is an argument as to whether the 'distribution channel' is more than an abstract academic concept. Whilst manufacturers and producers may think in terms of a distribution system, intermediaries do not necessarily see themselves as part of some other party's 'system', but instead consider themselves as independent operators. If intermediaries do lack a systems orientation, then there are additional prospects of conflict since they will be, naturally, reluctant to compromise their own interests in deference to those of the distribution system as a whole.

Degree of interdependence: The greater the degree of interdependence between two members of the distribution channel, the greater the potential for conflict. This is because the actions of one directly impinge upon the performance of the other

Managing channel conflict – Following may help in managing channel conflict:

- Some channel conflict can be constructive. It can lead to more dynamic adaptation to a changing environment. But too much is dysfunctional.
- Perhaps the most important mechanism is the adoption of super ordinate goals. Working closely together might help them eliminate or neutralize the threat.
- Exchange of persons between two or more channel levels is useful.
- Cooptation is an effort by one organization to win support of the leaders of another organization by including them in advisory councils, boards of directors, etc.
- Encouraging joint membership in & between trade associations.
- When conflict is chronic, the parties may have to resort to diplomacy, mediation or arbitration.

12.7.2 Legal & Ethical Issues in Channel Relations

Legal and ethical issues in channel relations include:

- Exclusive dealing: Arrangement between manufacturer and e-marketing intermediary that prohibits the intermediary from handling competing product lines.
- Exclusive territories: Exclusive geographic selling region of a distributor.
- Tying agreements: Arrangement that requires a marketing intermediary to carry items other than those they want to sell.
- Dealers' rights

12.7.3 Long-Term Inter-firm Relationships

Long term inter-firm relationships raise the following:

- While individual transactions are the economic cornerstone of exchange, they do not always describe the complex relationships that often emerge between channel members. Individual transactions may be referred to as exchange episodes. Four elements are invariably associated with marketing exchange episodes: products and services, and information, financial, and social exchange. The sum of all the costs and benefits associated with these exchange episodes is called exchange utility. Each party to a transaction both gives and receives utility. It is important to differentiate between exchange episodes and longer-term aspects of exchange.
- All transactions range from discrete (or transactional) to relational exchange. Discrete exchange describes highly impersonal, one-time transactions. In discrete exchange, there is only minor social exchange with little concern for

the possibility of future interactions. Conversely, relational exchange may be compared to the behavioral actions and reactions that occur in a successful marriage. It addresses the long-term, ongoing relationships that develop between exchange partners. More and more companies are engaging in relational exchange with each other. These companies are more concerned with sustaining exchange relationships and less concerned with enforcing the precise terms of an exchange episode. Ongoing relationships are customized over time to the particular needs associated with each exchange partner.

- On their path to the preferred state of relationalism, relationships move through four stages: awareness, exploration, expansion, and commitment. The norm of reciprocity, reflective of the *give* and *take* that sometimes develops between exchange partners, provides the impetus necessary to move from awareness through to the commitment stage. Reciprocity can be facilitated or inhibited within an exchange relationship by the type of communication processes that evolve between channel members. In autonomous communication strategies, exchange between channel members is infrequent. This strategy is typically associated with discrete exchange. By contrast, collaborative communication strategies generally prevail within highly relational exchange. Collaborative strategies are associated with more frequent communication and more information sharing. Collaborative strategies are consistent with the cooperative character of relational exchange.
- The importance of developing and preserving exchange relationships can be demonstrated in buyer–seller interactions. The relational orientation has become known as relationship selling. In relationship selling, sellers actively engage customers as partners. For instance, buyers and sellers might co-design product offerings so they can each benefit directly from the exchange association.

12.8 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.

12.9 Self Assessment Questions

1. Discuss the criticality in Managing Channel Intermediaries.
2. Explain the channel selection process.
3. List out the various criteria to be considered for Performance Audit.
4. Discuss the several selection criteria should be considered during this final evaluation of channel members
5. Discuss the various means to motivate channel members.
6. Explain the dynamics of Channel Relationships.

12.10 Reference Book

- Agrawal, D.K., 'Textbook of Logistics and Supply Chain Management', MacMillan India Limited, 2010, New Delhi.
- Raghuram G., and N. Rangaraj, 'Logistics and Supply Chain Management - Cases and Concepts', MacMillan India Ltd., 2005, New Delhi.
- Shah, J., 'Supply Chain Management: Text and Cases', Pearson Education, Inc., 1st edition, New Delhi.
- Stern, L., A. El-Ansary, and A. Coughlan, 'Marketing Channels', Prentice Hall of India Pvt. Ltd., 5th edition, 1996, New Delhi.

Unit – 13 : Channel Intermediaries

Structure of Unit

13.0 Objectives

After completing this unit, you would be able to:

- Learn about various types of Channel Intermediaries;
- Understand the concept and elements of Channel Design;
- Define retailing and understand its current role and contribution in the economy;
- Understand various formats of retail store and their management;
- Understand the concept of wholesaling and its role in the present context;
- Know the latest trend in wholesaling.

13.1 Introduction

Distribution of goods takes place by means of channels, and the intermediaries are the independent groups or organizations within the channel that make the product available for consumption. Distribution intermediaries**,** or marketing intermediaries, or middlemen, are an extremely important parties involve in a company's product distribution strategy. Without intermediaries, it would be next to impossible for the business to function at all. This is because intermediaries are external groups, individuals, or businesses that make it possible for the company to deliver their products to the end user. They share the sales pressure and also help the company in meeting out customer demand and satisfaction.

There are four generally recognized broad groups of intermediaries: agents, wholesalers, distributors, and retailers. The next section however discusses the various types of intermediaries available.

13.2 Type of Intermediaries

Discussed below are a few types of intermediaries:

- **Agents/Brokers -** Agents or brokers are individuals or companies that act as an extension of the manufacturing company. Their main job is to represent the producer to the final user in selling a product. Thus, while they do not own the product directly, they take possession of the product in the distribution process. They make their profits through fees or commissions.
- **Wholesalers -** They simplify the product and information flows between the manufacturer and the end users. Maintain large inventories of the

goods which are both uneconomical and impractical for Manufacturers. Unlike agents, wholesalers take title to the goods and services that they are intermediaries for. They are independently owned, and they own the products that they sell. Wholesalers do not work with small numbers of product: they buy in bulk, and store the products in their own warehouses and storage places until it is time to resell them. Wholesalers rarely sell to the final user; rather, they sell the products to other intermediaries such as retailers, for a higher price than they paid.

- **Distributors -** Distributors function similarly to wholesalers in that they take ownership of the product, store it, and sell it off at a profit to retailers or other intermediaries. However, the key difference is that distributors ally themselves to complementary products. For example, distributors of Coca Cola will not distribute Pepsi products, and vice versa. In this way, they can maintain a closer relationship with their suppliers than wholesalers do.
- **Retailers -** Retailers come in a variety of shapes and sizes: from the corner grocery store, to large chains like Wal-Mart and Target. Whatever their size, retailers purchase products from market intermediaries and sell them directly to the end user for a profit.
- **Franchisee** - A franchisee is an individual who purchases the rights to use a company’s trademarked name and business model to do business. The franchisee purchases a franchise from the franchisor. The franchisee must follow certain rules and guidelines already established by the franchisor, and in most cases the franchisee must pay an ongoing franchise royalty fee to the franchisor.
- **Mail order -** Goods are ordered by catalogue, and delivered to the home by post or parcels carrier. The physical distribution channel is thus from manufacturer to mail order house as a conventional trunking (line-haul) operation, and then to the consumer's home by post or parcels carrier, bypassing the retail store.
- **Factory direct to home** - It can occur by direct selling methods, often as a result of newspaper advertising. It is also commonly used for one-off products that are specially made and do not need to be stocked in a warehouse to provide a particular level of service to the customer.
- **Internet and shopping from home** - Initial physical distribution channels were similar to those used by mail order operations - by post and parcels carrier. The move to internet shopping for grocery products has led to the introduction of specialist home delivery distribution operations. These are almost all run by third-party companies. In addition, it is now possible to distribute some products, such as music, software and films, directly, computer to computer.
- **Factory to factory/business to business** - The factory-to-factory or business-to-business channel is an extremely important one, as it includes all of the movement of industrial products, of which there are very many. This may cover raw materials, components, part-assembled products, etc. Options vary according to the type and size of product and order, may range from full loads to small parcels, and may be undertaken by the manufacturers themselves or by a third party.

13.3 Retailing

13.3.1 Meaning and Concept

Retailing is the business where an organization directly sells its products and services to an end consumer and this is for his personal use. By definition whenever an organization be it a manufacturing or a whole seller sells directly to the end consumer it is actually operating in the Retail space. Retailing is one of the most common forms of small entrepreneurship that deals with all the activities involved in selling goods and services directly to the customers.

Effective retail marketing is vitally important for today's manufacturers. Without a presence in retail stores, businesses rarely achieve the high level of exposure or widespread product distribution that retail stores offer. Retailers can help small businesses by performing a wide range of marketing services, from promoting products directly to customers to giving customers a chance to view and test products

The India Retail Industry is the largest among all the industries, accounting for over 10 per cent of the country's GDP and around 8 per cent of the employment. The Retail Industry in India has come forth as one of the most dynamic and fast paced industries with several players entering the market. But all of them have not yet tasted success because of the heavy initial investments that are required to break even with other companies and compete with them. The India Retail Industry is gradually inching its way towards becoming the next boom industry.

There is a huge change in whole concept and idea of shopping in terms of format and consumer buying behavior has made a revolutionized shopping in India. Modern retailing has entered into the Retail market in India; it can be seen in the form of bustling shopping centers, multi-storied malls and the huge complexes that offer shopping, entertainment and food all under one roof.

Growth of the organized Retail sector in India has various key factors as large young working population with average age of 23 years, nuclear families in urban areas, along with increasing workingwomen population and emerging opportunities in the services sector. If new businessmen wants to enter in the Indian retail industry, it will be because of the growth pattern in organized retailing and in the consumption made by the Indian population will follow a rising graph.

In India the vast middle class and its almost untapped retail industry are the keen forces for global retail giants wanting to enter into newer markets, which in turn will help the India Retail Industry to grow faster. It is expected to grow by 25 per cent annually in Indian retail. Modern retail in India could be worth US$ 175-200 billion by 2016. The Food Retail Industry in India dominates the shopping basket. The Mobile phone Retail Industry in India is already a US$ 16.7 billion business, growing at over 20 per cent per year. Growing market ensures the very bright future of the India Retail Industry, with the emerging technologies facilitating operations and government policies will become more favorable in near future.

A) **Importance to 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**

  They bear the cost 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 installments. 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 taste 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 manufacturer in bulk and convert them into smaller units to suit consumers. 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. Retail stores, through in-store displays and sales personnel, disseminate information about new products launched in the market.

B) Importance to Other Channel Members - 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.

C) **Source of Employment** - Retailing is a labour- intensive activity and employs a large number of people. It accounts for 15-20 per cent of 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 growing business sentiment. 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.

13.3.2 Functions performed by Retailing

Discussed below are a few functions of retailing:

1. Buying: A retailer buys a wide variety of goods from different wholesalers after estimating customer demand. He selects the best merchandise from each wholesaler and brings all the goods under one roof. In this way, he performs the twin functions of buying and assembling of goods.

2. Storage: A retailer maintains a ready stock of goods and displays them in his shop.

3. Selling: The retailer sells goods in small quantities according to the demand and choice of consumers. He employs efficient methods of selling to increase his sales turnover.

4. Grading and Packing: The retailer grades the goods which are not graded by manufacturers and wholesalers. He packs goods in small lots for the convenience of consumers.

5. Risk-bearing: A retailer always keeps stock of goods in anticipation of demand. He bears the risk of loss due to fire, theft, spoilage, price fluctuations, etc.

6. Transportation: Retailers often carry goods from wholesalers and manufacturers to their shops.

7. Financing: Some retailers grant credit to customers and provide the facility of return or exchange of goods. In some cases, home delivery and after sale service are provided by retailers.

8. Sales promotion: A retailer displays goods. He carries out publicity through shop decoration, window display, etc. He maintains direct and personal contacts with consumers. He persuades consumers to buy goods through personal selling.

9. Information: Retailers provide knowledge to consumers about new products and uses of old products. They advise and guide consumers in better choice of goods. They also provide market information to wholesalers and manufacturers.

13.3.3 Classification and Types of Retailers

One way of making a distinction between different types of retailers is by looking at the organization in terms of ownership and control. Most retail organizations can be placed into one of four categories, the independent retailer, the small multiple retailer, the large multiple retailer and the retail conglomerate.

- **An Independent Retailer** is a small scale retail organization owned and managed by private individuals, with a network of less than 10 branch stores. Many independents are sole traders, or family-run business operation out of a single site. The store may offer a specialized product range, such as a butcher or a greengrocer, or a wide variety of product items as in a village store.

- **Small Multiple Retailer**: Most 'high-street' retailers fall into the category of the multiple retailer, which is the term applied to retail organizations that have a central operational headquarters and a collection of branch stores under common ownership. Most, although by no means all, multiple retailers are public limited companies and are therefore owned by a collection of share holders to whom the directors of the companies are responsible. Private multiple retailers are sometimes family-owned and run businesses, and allow for a greater degree of personal operational control than in a publicly owned business. The size of the business will be related to the number of branch stores and the size of those stores. A small multiple retailer is one which runs between 10 and 50 stores, after which is termed a large retailer.
- **Large Multiple Retailer**: One way in which independent retailers have been able to fight against the might of the multiple retailer is by becoming a member of a voluntary retail group. Such groups operate in a variety of ways, but the main objective is to gain some of the buying power advantages of multiple retailers by collating orders from a number of independent retailers and negotiating with suppliers through a central buying organization. Members pay a subscription that may also cover the provision of additional retail services such as marketing and training. Some voluntary groups have a strong brand identity brought about by the requirement of members to trade under a common fascia and to stock a range of own-label products.

- **The Retail Conglomerate**: As retailers become increasingly powerful corporations, there has been a growing amount of financial organizational activity in term of mergers, takeovers, alliances and joint ventures. In many cases companies have been amalgamated under one retail brand, but in others separate brands or fascias have been retained with the holding company trading as separate identity, giving rise to the retail conglomerate franchisee

Retailers can also be classified in different ways. The further classification is based on Types of Ownership, Store and Non Store based classification, and Non Traditional Retailers:

A) Classification based on Type of Ownership

Given below is the classification of retailer on the basis of type of owner ship:

1. Independent Retailer: An independent retailer is the one who builds his or her business from ground up. It starts from the business planning stage to the opening day; all things are carried out by the independent retailer. This can be done by hiring consultants, staff and other to assist in the business deals. The opportunities are vast and never ending.

   Advantage of this is that no restrictions are created on who, how or where an entrepreneur should set up there business. It gives one freedom to do what he wants to do for taking advantage from the business. It is extremely rewarding.

   Disadvantage is that as it can be started easily and with flexibility, it can create a lot of competition in a specific area for certain type of customer.

Every business rests on the owner. Branding is not done and there are no preset guidelines.

2. Chains: Many outlets are operated by a single retailer in a common manner. Under developed economies, there is almost a quarter of retail outlets and above 50 percent of retail sales. Retail chains can range from two stores to 1000 stores to retailers. Larger cooperation's or holding companies have many divisions of retail chains. There are large retail chains in shopper's stop and lifestyle in India.

   Advantage is that wholesalers are bypassed. There is direct buying from the manufacturers. Many of the suppliers service the orders from chains promptly and extend higher level of proper service and selling support. New brand can now reach their stores faster. Most of these chains are private. Chains can attain efficiency through the centralization of purchasing and warehousing and computerization. Geographic areas are widely covered in the market to allow chains to utilize many forms of media. Considerable time and resources is invented in long term planning, monitoring opportunities and threats.

   Disadvantage is that chain retailers suffer from limited flexibility, but they need to be consistent in terms of prices, products, promotions and product assortments. Chain retailers also invest in multiple leases, fixtures, products assortments and employees. As they are spread in most of the parts, these retailers have reduced control, lack of communication and time delays. Therefore, many retailers focus on managing a specific retail format for a better strategic advantage and increased profitability. Most of the retailers capitalize on their widely known image and they adopt flexibility to market changes.

3. Franchisee: Franchise is purchased with the right to use a name, product, concept and business plan. Franchisee will receive a proven business model from an established business. Advantages: These business processes are well established. Franchisee can receive help from a network and customers who are already familiar with this product. Marketing strategy is already put in place. Risks are taken into consideration when a retail business is started so that they van be reduced.

   Disadvantage is that Franchisees pay a fee or royalty based on sales every year. Startup costs relating to any franchisee is high. The biggest disadvantage of being a franchise is lack of flexibility and freedom.

4. Leased Department Store: Leased department means a department in a retail store rented by a manufacturer. In this case the lease is responsible for all the aspects of business and also pays the rent of the store. This store also provide with various restrictions for the leased department to ensure overall consistency. Leased departments can choose to operate in various categories that are mainly on the fringe of the stores major product lines i.e. in store beauty salons, banks, studios, food courts etc. these leased departments help the stores in generating greater traffic and providing one stop shopping. Personal management, merchandise displays, the recording of items are the benefit from expertise in a store personnel which may lack the merchandising ability to handle and sell the goods and services. Tesco, the UK based supermarket chain takes the help of the leased departments to sell its variety of products and reposition itself.

The operators of these leased departments benefit as the main store generates immediate sales for these departments. Thus, this arrangement reduces expenses through economies of scale (like pooled advertising) and shared facilities (like security equipment and display windows). Lease's images are aided by their relationships with the stores.

Disadvantage is that inflexibility may arise due to restrictions imposed by the operation on store. It can always have the threat that rent may raise or may not renew leases when they expire even if leases are successful.

5. Consumer Co-operatives: Consumer Cooperative is said to be a retail firm in which a group of consumers invest in the enterprise. In this the officers are selected.

Advantage is that all the consumers and members share the profits and savings. These retailers are many in number but small in size and are very popular in food retailing. The process is started mainly to guard against the malpractice that many retailers indulge in and either charge higher prices or offer inconsistent quality of merchandise.

These consumer cooperatives' are limited because the consumers are not expert in buying, selling and handling goods and services and the cost savings and low selling prices have not been expected in many cases.

B) Store-Based Retailers

Retail organizations can be classified according to strategy and products handled. Store formats can be divided into food-based retailers and general merchandise retailers. With the advent of retail formats like hypermarkets, the traditional distinction between food and merchandise formats is disappeared. Hypermarkets can care for both the categories. However the various types of store formats that come under these categories are:

I. **Food retailers -** Foodstuffs are the products sold by food retailers. There are different types of food retailers like convenience stores, food-based superstores, combination stores, limited line stores and warehouse stores etc.

- ***Convenience store* -** A convenience store is defined as the store which is kept open for long hours. It carries a limited addition of product assortment and occupies space around 3000-8000 square feet. These stores sell snack foods, soft drinks, car wash, lottery tickets, courier service, gasoline, ATM services and many more.
- ***Conventional supermarkets*** - This type of market is self-service departmental store that sell a variety of food and non-food items. These stores are also called 'mom and pop-stores' in the US. Dollar Tree, Family Dollar and '99 Cents Only' are some examples in US.
- ***Food-based superstores* -** Food based stores are larger than conventional supermarkets but smaller in size and product range than combination stores. Floor space covered by these stores is around 25,000-50,000 square feet and it carries a reasonable stock of non-food items like kitchen appliances, prescription drugs, flowers, video tape rentals and etc. over 50 percent of the products stocked by these superstores are their own brands. Tesco Plc. gets over 75 per cent of its profits from such 'conforming' super stores.

- ***Combination stores*** **-** Combination store is defined as a mix of a conventional supermarket and a general merchandise store. They are very large and cover an area of 30,000-100,000 square feet. These stores have the advantage of economies of scale and operational efficiencies. This helps to reduce costs and improve profitability. Wal-Mart, Kmart and Meijer are among the successfully operating combination stores in the US.
- ***Limited-line stores*** **-** They are known as limited assortment box stores and offer a short list of items. These stores should not be confused with other 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.
- ***Warehouse stores*** **-** These stores are discount food retailers and offer a wide range of products in a simple environment. Unlike limited-line stores, these usually cater to national brands. Many of these retail formats are favored by one-stop food shoppers and customers seeking low prices so that they can provide services easily. They are also called super warehouse. Home Depot, the American retailer used the warehouse format to expand.

II **General Merchandise Retailers** - Another major category of retail stores is the General Merchandise Retailers Which has experienced a study growth? The department stores are the most successful among the mass merchandisers. Argos and Woolworth are two of the biggest general merchandisers in the UK. A brief discussion on each type of general merchandiser's retailer follows.

- ***Department Store*** **-** Department store is defined as a large retail unit with a large assortment of goods and services that are organized into separate departments for purposes of buying, promotion, service and control. Selection of many general merchandise retailer and also offers as the anchor store in a shopping centre. These stores are very exclusive in terms of the shopping experience which they offer, the services they provide and the atmosphere of the store. Wide range of service is provided from altering clothes to home delivery. From many histories it is known as that the departmental stores are all about new innovations, including advertisement of prices, enacting a one-price policy, developing computerized checkouts, offering money back guarantee, adding branch stores and decentralized management. Departmental stores have increased in a very high speed in the past few years lagged behind with discount stores. Brand exclusivity is not big issue now for the sale of product; manufacturer brands are also available at discount outlets. Many brands have signed contract with the stores for selling their product in the store. This creates customer loyalty to the designers and brands but not the stores. Many price conscious consumers are there in the market and they are attracted to discount retailers. The popularity of shopping malls has aided specialty stores since consumers can accomplish one-stop shopping through several specialty stores in the same mall or shopping centre. Most of the department stores are very big and have unproductive selling space and low turnover of merchandise.
- ***Full –line Discount Store*** **-** These type of store targets the middle-class and lower middle-class shoppers who looking for good price. It also conveys an image of high-volume, low cost and fast turnover outlet. It is selling lot of

commodities for less conventional prices. Products are normally sold via self-service with minimal assistance in any single department. Highly equipped checkout service is provided. Traditional department stores provide buildings, equipment and fixtures which are less expensive and operating cost is also lower. To respond to category specialists, full –line discount retailers are creating more attractive shopping environments, placing more emphasis on apparel, developing private label merchandise, and increasing store visits by offering easily accessible convenience store merchandise.

- ***Speciality Stores* -** This store basically concentrates on a limited number of complementary commodities and provides a high level of service. This store is smaller in size.

- Drugstores - It is a specialty store that concentrates on health and personal grooming commodities. Pharmaceuticals often represent over 50 percent of sales in the drugstore and gain large profits. These stores have a quite considerable competition from the discount stores and supermarkets adding medicines. Therefore, the major drugstore chains are building largest and-alone stores offering a wider range of products and more frequently purchased consumer products and drive through windows for picking prescriptions. Customer loyalty is build up and the chains are also changing the role of their pharmacists from dispensing pills to providing health care services. For example: Planet Health, Subhiksha
- Category Killers - This concept was originated in U.S. as lot of cheap land was available and there was dominant car culture. Category specialist is a discount store that offers limited variety but large assortment commodities. These are basically discount specialty stores. Through offering a complete assortment in a category at low prices, category specialists can "kill" a category of merchandise for other retailers. They have a self-service approach. For negotiating low price, excellent terms and assured supply in a short span, they use buying power. They are facing lower profits as the competition is arising for prices. Many of they have difficulty differentiating themselves on other elements of retail mix. Mainly all the competitors provide similar assortments and same level of service. According to a report given in the European Retail Digest, there are some people who believe that the category killer format will burn out, leaving only a few hardened experts, as happened with the warehouse club sector. With its increasing competitive intensity, it concentrates mainly on reducing costs by increasing its proficiency. France, Germany, Spain and the UK provide attractive markets for expanding category killers. Interestingly, with the clampdown on out-of-town developments in the UK, homegrown category killers that are typically located in town centre will benefit from legislative changes in this area. Some out of town category killers are choosing to downsize their format to make it fit small towns.
- DIY Store - This centres if basically for home improvement and is a category specialist offering proper equipments and material used by do-it-yourselfers and contractors to make improvements in home. The focus is mainly on providing material and information that enables consumers to maintain and improve their homes. While merchandise in these stores, warehouse atmosphere lies. They are not facing the same level of competitive environment as other category specialists, because the commodities vary

considerably across the country and there are opportunities for differentiation on customer service.

- ***Off-Price Stores*** **-** This chain offers brand-names and designer labels and sells them at lower price to the consumer making it effective and having a limited service environment. These stores buys the orders from retailers which were cancelled earlier, irregular's from manufacturer's and end of season items which they sell at a wholesale price. Due to this pattern of classified buying, the same type of commodities may not be in stock when customers visit the store. Typically, different bargains will be available on each visit. Their inventory turnover is quite higher as compared to that of departmental stores. Its most crucial aspect used in strategy planning is to maintain long term relationships with the customers and suppliers. There are three special types of off-price retailers are outlet, closeout, and single-price retail stores.

- **Factory Outlet Stores -** Factory outlets stores are off-price stores owned by manufacturers or by department or specialty store chains and thus are frequently referred to factory outlets. A factory outlet is a manufacturer–owned store selling manufacturer closeout product, irregulars, cancelled orders etc. they most of the times resemble to shopping centre's in terms of size and layout and providing manufacturing units on a single occupied site. Many of the additional amenities include car parking, restaurant and leisure facilities. They are located out of town in low development and operating costs and distribution of some channels is shortened for many commodities and having profits for all the retailers. It is useful as: It helps in the disposal of surplus stock due to untrustworthy accounts and cancelled orders. It allows a manufacturer to control where its discounted merchandise is sold. Therefore a manufacturer can decide on store visibility, set promotion policies, remove labels and be sure that the discontinued items are disposed properly.

- **Variety Stores -** These stores handles a variety of low and popularly priced goods and services, such as stationery products, gift items, women accessories, health and beauty aids, toys, house ware and etc. variety store do not carry full product lines and do not deliver products. Transactions carried out on cash basis. There are few salesman/ saleswomen.

- **Membership Club** - Membership club also known as 'Warehouse clubs' membership discount stores, 'wholesale cash and carry warehouse'. Consumers who shop here have to be members of the clubs and pay a monthly or annual membership fee. These buyers make up a majority of the members but buy less than the wholesale members. Membership Club have blurred distinction between large retailers and large wholesalers While many retailers now operate formats such as wholesale clubs and super-centers that perform many wholesale functions, many large wholesalers are setting up their own retailing operations.

  Sam's wholesale club is the biggest US –based operator in the category. Other major players are Costco Wholesale Club, Price Club, and Pace membership warehouse.

- **Flea Market -** This market has many retail vendors offering a wide range of products at discounted prices in an area. There is a trend of street selling-shoppers touch, sample and haggle over the price of goods. many consumers are price conscious who have found retail formats of commodities and serives for customers. These markets are mostly located in the non traditional areas where they are not associated with retailing; racetracks, stadiums and arenas. Others are at sites abandoned by supermarkets and department stores. It may be outdoor or indoor. Web based flea market such as eBay and Amazon are newest trend in the market. These markets easily avoid taxes and operating costs are quite low.

C) Non-Store Based Retailers

It is a form of retailing in which sales are made to consumers without physical stores. These retailers can be known from the way they communicate with their customers like direct marketing, direct selling and vending machines or e-tailing. These stores are time conscious and they provide 24 hours service seven days a week and providing delivery at location and time of their choice. Non-store sales are now growing at a much higher rate than sales in retail stores. This high growth rate is primarily due to the growth of e-retailing.

- ***Vending Machines*** - It is a retailing format involving the coin or card operated dispensing of goods (such as beverages) and services (such as life insurance sales at airports), eliminating the use of sales personnel and allows for round the clock sales. Machines can be placed anywhere, they are most convenient to the consumers –inside or outside a store, in a hotel corridor, at a station, airport or a street corner. Hotels, restaurants and at train stations are highly visible spots for selling but they accommodate a small proportion of sales. Higher priced items have not sold well in vending machines because too many coins are required for the transaction and many vending machines are not equipped with currency note changers. Growth in employment has been limited.
- **Direct and online marketing are the fastest-growing forms of marketing** - Many of the consumers are now having a broad array of non-store alternatives, including mail order and online shopping. People are increasingly avoiding the crowds at malls by doing more of their shopping by phone, mail or computer. Direct marketing has emerged as a powerful non store communication and distribution medium for selling a host of products to consumers. It is form of retailing where product selling is targeted to specific customers. Catalog retailing and direct mail are common form of s of direct marketing. Over the years, several new form of selling like tele-marketing, direct radio and TV and internet shopping have gained widespread acceptance.
- **World Wide Web** - Furthermore, in today’s world there is advanced technology which is easier to use Web sites, improved online service, and the increasing sophistication of search technologies, online retailing is increasing.
- **Internet** - Internet retailing is a retail format in which the retailer and customer communicate which each other through an interactive electronic network. After an electronic dialogue between the retailer and customer, the customer can order commodities directly through the interactive network or

by telephone. The commodity is then delivered to the customer's given address.

- **Direct Selling** - Direct selling is a method of marketing and retailing goods to the consumers. Though direct seller 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 t0 65 percent growth rate in sales turnover. Over 200 direct selling companies operate in the country and 70 percent of them are regional operators. Eureka Forbes was the pioneer of direct selling in India.
- **Vide kiosks** - Video kiosks comprise stand mounted with a television monitors or a computer terminal, which use touch screen 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. Home Depot, the second largest retailer in the US, uses video kiosks in its self checkout lanes, where customers can bill their products and make their payment without help. Video kiosk enables retailers to add value and enhance customer relationships while simultaneously providing an interactive forum to display products. Dell computers have established its kiosk in malls to sell its computer brands.

TYPE	LOCATION	ASSORTMENT	SERVICES	PRICES AND PROMOTIONS
Traditional department Store	Business district shopping centre Or isolated store	Extensive width and depth of assortment; average to good quality	Good to excellent	Average to high Prices Heavy ad and catalogue use, direct mail; personal selling
Full –line discount store	Business district shopping centre Or isolated store power strip centres	Extensive width and depth of assortment; average to good quality	Slightly below average-to average	Low Prices; Heavy use of newspapers, price oriented, moderate sales force
Specialty store	Business district Or shopping centre Regional malls	Very narrow width of assortments; extensive depth of Assortments; average to good quality	Average to high excellent	High Prices, Heavy use of displays; extensive sales force
Hypermarkets	Stand-alone	Average L	Low	Low
Variety Store	Business district shopping centre Or isolated store	Good width and depth of assortment; below average to average quality	Below Average	Heavy use of newspapers, self service
Off-price Chain	Business district, suburban shopping strip or isolated store.	Moderate width, but poor depth of assortment; average to good quality, low continuity	Below Average	Use of newspapers, brands not advertised; limited sales force

Factory Outlet	Out-of –the –way site or discount mall	Moderate width but poor depth of assortment; some irregular merchandise; low continuity	Very low	Little; self-service
Membership Club	Isolated store or Secondary site	Moderate width but poor depth of assortment; low continuity	Very low	Little; some direct mail; limited sales force
Flea market I	Isolated site, race track Or arena	Extensive width, but poor depth of assortment; variable quality; low continuity	Very low	Limited ; self service
Drugstore	Stand alone, strip Centers	Very deep L	Average	Average to high

Figure 13.1: Classification General Merchandise Store

13.3.4 Retailing Strategies

Retailers have always been searching for new marketing strategies to attract and hold their customers. However, in the past decades, the retailers attracted consumers with unique product variety and better services. Today, retail variety and services are looking more and more comparable; it's now more difficult for any one retailer to offer exclusive products. Service differentiation among retailers has also eroded. Customers have become smarter and price conscious. They see no reason to pay more for identical brands, especially when service differences are shrinking. For many of these reasons, the retailers have adopted marketing strategies.

a) First segmentation, Targeting, Differentiation and Positioning Decisions - Now the retailer must first understand there segment and define their target market stand and then decide how they will differentiate and position themselves in these markets. This focus can be on upscale, midscale, or downscale shoppers, the question arises. Do target shoppers want variety, depth of variety, convenience, or low prices? Unless they define and profile their markets, retailers cannot make unfailing decisions about product range, services, pricing, advertising, store decoration, or any of the other decisions that must support their positions.

   Many of the successful retailers define their target markets in a proper manner and position themselves strongly. Wal-Mart is a good example for positioning itself very strongly on low price supermarket. It promises that customers will "Save money. Live better." One more example is Whole Foods Market. When the large Wal-Mart owns the low-price position, Whole Foods Market targets a small select group of upscale customers and offers them "organic, natural, and gourmet foods, successfully positioning itself away from Wal-Mart.

b) Second. Product Assortment and Services Decision - Retailers must decide on three major product variables: product assortment, services mix, and store atmosphere.

   (1) The Retailer's Product Assortment - This assortment should differentiate the retailer while matching with target shopper's expectations. There are three strategies for retailers to differentiate their product assortment.

First strategy is to offer stock that no other competitor carries, such as store brands or national brands on which it holds exclusives. Like for example, Saks gets exclusive rights to carry a well-known designer's labels. It also offers its own private-label lines-the Saks Fifth Avenue Signature, Classic, and Sport Collections. At JC Penney, Private-label accounts for 52 percent of its sales turnover.

Second strategy is to target blockbuster merchandising events. Bloomingdale's is known for running spectacular shows featuring goods from a specific country, such as India or China. Or the retailer can offer surprise merchandise while Costco offers surprise assortments of seconds, overstocks, and closeouts.

Last strategy state that, the retailer can differentiate itself by offering a highly positioned product assortment: Lane Bryant carries plus-size clothing; Brookston offers an unusual assortment of gadgets and gifts, and Battery Depot.com offers about every imaginable kind of replacement battery.

(2) The Services Mix - It helps in setting up retailer apart from another. Like for example, some retailers invite consumers to ask questions or consult service representatives in a person or via phone. Nordstrom is a service that promises to 'take care of the customer, no matter what it takes.'

(3) The Store's Atmosphere - Under this head we can explain that retailers should create an ethnic environment in the store which can target as much customers it can. Most of the retailers practice 'experiencing retailing.' Like for example, at several REI stores, consumers can get hands-on experience with commodities before buying it through the store's mountain bike test trail, gear-testing stations, a huge rock climbing wall, or an in-store simulated rain shower.

13.3.5 Operational Issues in Managing Retail

Discussed below are a few operational issues in managing retail:

Supply Chain Management: This chain emphasis on the flow of material from supplier’s suppliers to the final target. Retailers need to maintain a grip on that whole chain in order to control the maintenance and delivery cost. This will help them to choose the right supplier for the commodity.

Pricing: It is a key targeting factor which must be decided in relation to the target market competition. Strategic pricing has become an important strategic tool to the retailers.

♦ Retail stores bring down their prices for few items to attract people, this is called traffic building. They also run storewide reduction sell.

♦ It is observed that a shoe Retail outlet sells 50% of the product at normal root up, 25% of the product at 30% root up and remaining 25% at cost. It may also lead to lower advertising cost, greater pricing stability and higher retail profits. Wal-Mart uses this kind of pricing strategy.

Sales Channels: Various new trends have emerged:

♦ Internet and e-commerce are gaining popularity in the non retail stores. The consumers can purchase their goods by just clicking on one button from their drawing room.

♦Call centre or catalogue marketing is an emerging trend.

♦ For acquiring more customer centricity the retailers should choose different sales channel. The main goal is to offer a consumer a tailor made shopping experience and to provide more easy access to the product and service offered

13.3.6 The Future of Retailing

Future of retailing seems bright. The arguments given below also support this viewpoint.

1) New retail forms and Shortening Retail Life Cycles - Many of the retail stores are appearing different but selling the same products at the same prices to the same consumers. Thus, through this merging of consumers, products, prices, and retailers is called retail convergence. This convergence means greater competition for retailers and greater difficulty in differentiating the product assortments of different types of retailers.

There is new retail forms are emerging and competition may arise between customers. The emerging and growing on-line retailers are promoting this trend. For example, you can buy brand-name home appliances at department stores, discount stores, home improvement stores, off-price retailers and electronics superstore for the same customers. If you can't find the microwave oven at Sears, step across the street and find one for a better price at Lowe's or Best Buy or just order online from Amazon.com.

Many of the new situations and consumer needs are rising at every point and so are the new retail forms to meet these brand new situations and consumer needs. Life cycle is becoming shorter due to this. For example, Department stores took about 100 years to reach the constant stage of the life cycle; more recent forms, as compared to warehouse stores who reached maturity in about 10 years. Therefore, in such an environment, seemingly solid retail positions can fall apart quickly.

2) Growth of Non-store Retailing - Direct and online marketing are the fastest-growing forms of marketing. Many of the consumers are now having a broad array of non-store alternatives, including mail order and online shopping. People are increasingly avoiding the crowds at malls by doing more of their shopping by phone, mail or computer.

Furthermore, in today's world there is advanced technology which is easier to use Web sites, improved online service, and the increasing sophistication of search technologies, online retailing is increasing.

Retailer online sites also influence a large amount of in-store buying. All types of retailers can now employ direct and online channels. The online sales of large brick-and-mortar retailers, such as Wal-Mart, Sears and Best Buy, are increasing rapidly. Most of the online-only retailers-Amazon.com, Zappos.com, online travel companies such as Travelocity.com and Expedia.com and others-are now making it big on the web. Much of the targeted growth in online sales will go to multichannel retailers, the click-and-brick marketers who can eventually merge the virtual and physical worlds. As acquired from the recent ranking of the top

500 online retail sites, 58 percent were only multichannel retailers. Like many retailers, Macy's has discovered that its best customers shop both online and offline.

E-Retailing opens up many doors for companies. E-Retailing provides a greater range of people to sell the products to. This can lead to increase in profits and a decrease in costs. The web site can also lead to opportunities of better and cheaper products to sell thought globalisation.

There is range of benefits to the company: Lowered cost- there is a lowered cost due to not having to pay shop rent and wages of people working in the actual store. Less chances of stock being shop lifted when the physical store is running and also after hours.

A greater range of customers which can lead to greater profits. As shown by the table below there is increase assess to the internet

3) 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, economics of scale and modern operations, woo the consumers by offering low price and better shopping experience. 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 supplier to adopt the EDI (Electronic Data Interchange) system, other major players followed suit.

4) The Rise of Mega-Retailers - Many of the huge commodities and specialty superstores have risen, the formation of vertical marketing systems, and a hives of retail mergers and acquisitions have created a hub of superpower mega-retailers." In this stage there are superior information systems and buying power, these giant retailers can offer better commodity selections, good service, and normal price savings to consumers.

Finally resulting at last, they grow even larger by squeezing out their smaller, weaker competitors. Therefore, small handful of retailers can now control access to enormous number of consumer, giving them the upper hand in their dealing with manufacture. Hopefully now the mega-retailers have shifted the balance of power between retailers and producers.

5) Growing Importance of Retail Technology - Retail technologies have become critically important as competitive tools. Progressive retailers are using new advanced It technology and software systems to produce further forecasts, control inventory costs, interact electronically with suppliers, send information between stores, and even sell to customers within stores. They have adopted automated systems for checkout scanning, RFID inventory tracking, merchandise handling, information sharing, and interacting with customers. The most startling advances in retail technology concern the ways in which retailers are connecting with their consumers. In today's scenario customers have gotten used to the speed and convenience of buying online and to the control that the Internet gives them over the buying process. Ever more, retailers are attempting to meet these new consumer expectations by bringing Web-style technologies into their stores. Many retailers now routinely use technologies ranging from touch-screen kiosks, mobile handheld shopping assistants, and customer-loyalty cards to self-scanning checkout systems and in-store access to store inventory databases.

6) Global Operation - 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 customer preference for non store retailing, which as partially reduced the concept of store location. Consumers are introduced to new products through TV; telephone, Internet, Catalogs, direct mail etc. This has enabled retailers to expand globally. Global operations increases profit levels of retailers and help establish credibility among consumers

13.3.7 Retailing in India some Highlights

Given below are some of the highlights and emerging trends of retailing in India:

- A very huge revamping exercise is witnessed in retailing in India.
- India is been rated the fifth most attractive emerging retail market: a potential goldmine.
- India has been ranked second in a Global Retail Development Index of 30 developing countries.
- Food and apparel retailing are key forces of growth
- Estimated to be US$ 200 billion, of which organized retailing (i.e. modern trade) makes up 3 percent or US$ 6.4 bill
- Multiple drivers leading to a consumption boom:
    - Favorable demographics
    - Growth in income
    - Increasing population of women
    - Raising aspirations: Value added goods sales
- Organized retailing in India has been seen very largely as urban
- Phenomenon with affluent classes and growing number of double-income households.
- Differences in consumer buying behavior to cost of real estate and taxation laws is seen more successful in cities in the south and west of India.
- Rural marketing is emerging as a huge opportunity for retailers reflected in the share of the rural market across most categories of consumption
    - Mahamaza is leveraging technology and network marketing concepts to act as an aggregator and serve the rural markets
    - ITC is experimenting with retailing through its e-Choupal and Choupal Sagar rural hypermarkets.
    - HLL is using its Project Shakti initiative leveraging women self-help groups ï¿½ to explore the rural market.
- For changing buying behavior across the globe, IT is used as main tool that has been used by retailers ranging from Amazon.com to eBay.
- Online Retail sites recorded 37.5 million visitors in July 2012, up from 26.1 million in July 2011. Apparel is the fastest online retail category in the country, recording a 362% Year on Year growth and a total audience reach of 13.4%, followed by Consumer goods which recorded 119% Year

on Year growth and has 2.9% audience reach, and sports/outdoor goods which recorded 100% Year on Year growth and has 2.8% audience reach.

13.3.8 Challenges and Opportunities

A huge transformation has been seen in retailing over the past decade that its very definition has undergone a universe change. A manufacturer no longer can rely on sales to take place by ensuring mere availability of his product. Today, retailing is about so much more than mere merchandising. Its about casting customers in a story, reflecting their desires and aspirations, and forging long-lasting relationships. An Indian consumer expects more and more at each and every time when they steps into a store. Retail today has been changed vastly from selling a product or a service to selling a hope, an aspiration and above all an experience that a consumer would like to repeat again in their lives.

Emerging opportunities in urban markets for manufacturers and service providers seem to lie in capturing and delivering better value to the customers through retail. Manufacturers and service providers face an exploding rural market yet only marginally tapped due to difficulties in rural retailing. In the test of time and investments, only innovative concepts and models may survive. However, manufacturers and service providers will also increasingly face a host of specialist retailers, who are characterized by use of modern management techniques, backed with seemingly unlimited financial resources. Organized retail appears inevitable.

Retailing in India is currently estimated to be a US$ 200 billion industry, of which organized retailing makes up a paltry 3 percent or US$ 6.3 billion. By 2016, organized retail is projected to reach US$ 23 billion. Things have never looked better and brighter for retail industry in India. Challenges to the manufacturers and service providers will increase, when market power shifts to organized retail.

13.4 Wholesaling

They simplify the product and information flows between the manufacturer and the end users. Maintain large inventories of the goods which are both uneconomical and impractical for Manufacturers. Unlike agents, wholesalers take title to the goods and services that they are intermediaries for. They are independently owned, and they own the products that they sell

13.4.1 The Functions of Wholesaling

Discussed below are the functions of wholesaling:

- Selling – In order to provide retailers with products, the wholesaler must have a well-trained sales force to visit the retailers and potential buyers to establish business relationships. Wholesaler's sales representative - make regular visits to retail store buyers, industrial firms, schools, hospitals, etc. They carry samples, catalogs, and displays that show the wholesaler's complete line of products.
- Providing Marketing Information - Wholesalers are in contact with many retailers/buyers and can be a valuable resource of information to the retail industry about trends in each industry
- Buying – To be able to stock the products that the retailers/buyers want,

the wholesaler studies fashion trends, consumer demand, and retail prices. This research enables the wholesaler to buy the product that the retailer will most likely want and in the right quantities.

- Warehousing - This is the process of storing goods in one place. The wholesaler provides the service of warehousing the product that the retailer wants. The retailer does not have the space for storage and can order product from the wholesaler as needed.
- Bulk-Breaking - This is the process of dividing large shipments into smaller ones. This is a service provided by the wholesaler that is advantageous to the manufacturer and the retailer. Manufacturers don't want to deal with small deliveries, and retailers can't afford big orders. The wholesaler is the perfect middleman in this instance.
- Transporting – Large, frequent deliveries can be made to wholesalers from the manufacturers. If the manufacturer had to deliver to all surrounding retailers who purchased its goods, it would be very costly and the delivery would be unpredictable. Wholesalers pass along the savings of the transportation costs to retailers in smaller shipments.
- Extending Credit - Retailers may pay wholesalers for merchandise with the money earned from the sale of that same merchandise. An example of this would be a retailer ordering Easter decorations in January, and not paying for them until May. This is known as extending "terms" for payment, such as 2/10, net 30.
- Providing Promotional Assistance - A variety of promotional assistance ranging from help in designing the store layout to sharing in the costs of local advertising may be offered by the wholesaler. This is called cooperative advertising.

13.4.2 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 producers. Wholesalers can be divided into three broad categories – merchant wholesalers, agents wholesalers, 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.

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.

1. Full-service merchant wholesaler – full-service wholesalers provide most of the services of a wholesaler like storing, delivery, providing credit facility, warehousing, taking title to goods etc.

a. General merchandise wholesalers – carry a wide range of products that are resold to retailers. They mostly cater to the needs of small retailers and carry almost all the products that customer need.

b. 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.

c. 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.

2. Limited-service merchant wholesaler – limited-service merchant wholesalers do not undertake all the functions of a wholesaler. They specialize and so offer only limited services to retailers. They include cash & carry wholesalers, drop shippers, rack jobbers, and truck jobbers.

a. Cash & carry wholesaler - maintains warehouse where retailers use their own trucks to pick up merchandise. Neither transportation nor credit is provided. Lower prices are offered because of the limited services.

b. Drop shipper - takes the order from retailers and arranges for delivery of goods directly from the producer. They take ownership but not possession. Freight costs are minimal. Sometimes they operate with a small office and phone. They deal with bulky items such as lumber and coal.

c. Rack jobber - sells specialized lines of merchandise to retailers. Common in the food industry, the rack jobber supplies non-food items, such as greeting cards. They assume ownership, order the merchandise, set up displays, remove old merchandise, and mark prices. Sometimes the retailer pays the rack jobber in cash for the items sold.

d. Truck jobber - uses trucks for storage, selling, delivery, and collection. Both sales and delivery are made to the retailer on the same trip. The truck jobber sells for cash and limits stock to nationally advertised specialties and fast moving items, such as candy, cheese, and potato chips. Their costs are usually high.

Agent Wholesalers - Agent wholesalers do not take title to the goods. Their main function is to assist the manufacturers and the retailers in the buying and selling process.

1. *Broker* - can represent the buyer or seller. They do not physically handle the goods or take ownership. Only brings the buyer and seller together.

a. Usually specializes in one type of product such as real estate, securities, or some food items that are seasonal and don't have long before they spoil - the distribution must be fast and short.

b. They may not continue relationships with the buyer after a transaction.

2. *Selling agent* - product specialist of only one product from one manufacturer, such as sound systems for a sports complex.

a. They have authority to make deals for the manufacturer and usually maintain an educated sales force regarding the product;

b. The goods they sell usually are not kept in a warehouse but are shipped directly from the manufacturer to the final end customer.

3. *Manufacturer's agent* - handles part or all of the output of one or more manufacturers within a given sales territory. They do not have the authority like the selling agent to make deals to the customers. They are bound by prices and conditions set by the manufacturers.

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. Westinghouse Electric Supply Company and General Electric Supply Company are examples of manufacturer’s sales branches in electrical equipment.

13.4.3 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.

- **Target Market Decision** - 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 transaction.

  The target for a wholesaler can be identified on the basis of size (large, medium, or small retailer), type of customer (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 customer (high income, or low income) or requirements to fulfill in terms of products and services offered

- **Marketing Mix Decisions** - Yet another key area that requires strategic decision-making by the wholesaler is that of the marketing mix. Wholesaler must decide on the products to offer, their pricing and positioning, the promotional activities required, and the means to reach the target market.

- **Product of offer** - A wholesaler must decide on the assortment of products to offer to his customer. Wholesaler should carefully analyze 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 manufacture 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.

- **Products positioning** - Wholesaler have to find ways to clearly differentiate their products from others available in the market.
- **Promotion -** Promotional activities aim at increasing the brand awareness of the customer and persuading them to buy the products. Promotional activities also help a customer become brand loyal in the case of high quality products.
- **Place** - The products have to be made available at places that are convenient to customer. Wholesaler have to take into consideration the transportation costs involved as well as the customer reach as criteria for taking the place decision.

13.4.4 Trends Shaping Wholesaler Distribution

The wholesaler 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. Manufacturer's attitude towards wholesaling has also contributed to the growth of the wholesale business. There has 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 distribution in the U.S., are now targeting new industrial and commercial markets in order to supplement their sales efforts in the established electrical-contractor markets. The basic trends that are responsible for bringing about a significant change in the business of wholesaling are discussed below.

- **Functional Overlap -** 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 markets 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.
- **Increased Services -** Wholesalers have re designed 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 service 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 further retailers, etc.
- **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 systems contracting that offer better services to customers at a lower cost. Another key factor in attracting customer is the credit terms that the wholesaler offers. The quest of

wholesalers for new pricing mechanisms and credit alternatives has brought about a signification change in wholesaling over the years.

- **Regional Coverage** - Wholesalers use their subsidiaries to cater to the needs of the local markets 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 distribution of plumbing, heating, and cooling equipment. Wholesalers are also making use of a leapfrogging strategy that involves implementing backfire tactics. Under this strategy of markets penetration, the wholesalers set up branches that are about 1000 miles away from the main office so that sales spread backward towards the home base.
- **Organizational Form and Size** - In the past, the wholesale market was dominated by sole proprietorships, partnership and family run businesses. The current trend among wholesaling establishments has been to grow in size and assume a corporate form. Wholesalers have moved towards assuming a corporate form through the options of public finance, takeovers, and mergers & acquisitions.
- 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.

The trends just discussed show wholesalers' responsiveness to market forces and how they transformed themselves to meet the growing demands of both manufacturers and resellers for improved service at lower costs.

13.4.5 Trends in Wholesaling

1. The distribution between large retailers and large wholesalers continues to blur. While many retailers now operate formats such as wholesale clubs and super-centers that perform many wholesale functions, many large wholesalers are setting up their own retailing operations. For example, with a majority of its business derived from supplying grocery products to independent grocery retailers, SuperValu has been classified as a food wholesalers at the same time becoming the nation's third-largest food retailer (behind Wal-Mart and Kroger) by starting or acquiring several retail food chains of its own. Thus, SuperValu is now classified as a retailer because 75 percent of its $33 billion in sales come from retailing, even though it remains the country's largest food wholesaler.

2. Wholesalers will continue to increase the services they provide to retailers--retail pricing, cooperative advertising, marketing and management information reports, accounting services, online transactions, and others.

3. Both the recently sluggish economy and the demand for increased services have put the squeeze on wholesaler profits. However, the increased use of computerized, automated, and Web-based systems will help wholesalers contain the costs of ordering, shipping, and inventory holding, thus boosting their productivity. Wholesalers who do not find efficient way to deliver value to their customers will soon drop by the wayside

13.5 Franchisee

A franchise is a business system in which private entrepreneurs purchase the rights to open and run a location of a larger company. The franchising company, or franchisor, signs a contractual agreement with the franchisee, explaining in detail the company's rules for operating the franchise. In the United States, franchises are typically organized under state laws, although the Federal Trade Commission requires that franchisors provide full disclosure of franchise contracts in advance, to allow franchisees the opportunity to make a good business decision. Franchise businesses come with a number of pros and cons that franchisees must take into account before signing the contract.

When the franchisee signs the franchise agreements, he or she agrees to the terms of operating that franchise. The business owner is required to operate the business according to the franchisor's requirements. The specifics of these requirements are often dictated by the business itself and the expectations of the parent company. In general, though, the contract will include elements, such as location, advertising, owner and staff training, trademark and copyright obligations, renewal opportunities and termination.

Advantages - Benefits of owning a franchise include the familiarity of the company name and image and training from the parent company in operating the franchise successfully. Failure rates among franchises tends to lower than among other new businesses, largely because customers generally recognize the company name and know what to expect from the location. What is more, the training usually includes extended support from the parent company: they cannot prevent the franchise from failing completely, but they do provide a support system for the franchise owner.

Disadvantages - The primary disadvantage of owning a franchise is usually the initial cost of buying the rights to operate it. For instance, a McDonald's franchise can now cost between $1 million and $2 million. In addition, the franchise owner might be liable for ongoing expenses–including royalties for using the company's name–that can cut into profits. Franchise contracts are usually strict and can become restrictive for some business owners, but franchise owners must follow the contract to the letter or risk termination and losing the business.

13.6 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. Retailing is the business where an organization directly sells its products and services to an end consumer and this is for his personal use. Retiling is going a sea change. Growth of the organized Retail sector in India has various key factors as large young working population with average age of 23 years, nuclear families in urban areas, along with increasing workingwomen population and emerging opportunities in the services sector. The retail environment has evolved over the year. Retail stores are classified according to the kind of product and service, extent of ownership, type of store strategy etc. The unit discovers the latest market trends and uncovers sources of future market growth for the Retailing industry in India, the various formats of retails. The unit also discuss the crucial aspects Important in managing retail. However only innovative concepts and models may survive. However, manufacturers and service providers will also increasingly face a host of specialist retailers, who are characterized by use of modern management techniques, backed with seemingly unlimited financial resources. Organized retail appears inevitable. 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.

Wholesalers have overcome various limitations of the past but they still have more challenges to overcome in the near future 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

13.7 Self Assessment Questions

1 Discuss the dynamic and strategic role played by channel Intermediaries in present business world.
2 What are the factors that have contributed to the rise of retail in India? Explain the challenge that global retail will face in India?
3. Explain the different type of Retail Formats.
4. Discuss the changing role of wholesaling in present scenario
5. Differentiate between wholesaling and retailing activities.
6. Discuss the various challenges of wholesaling in post recession era.

13.8 Reference Book

- Gibert, D., ‘Retail Marketing Management’ Prentice Hall, 1999.
- Dunne, P., and R. F. Lusch, ‘Retailing’, Dryden Press, 3rd Edition, 1999, Florida.
- Raghuram G., and N. Rangaraj, ‘Logistics and Supply Chain Management - Cases and Concepts’, Mac Millan India Ltd., 2005, New Delhi.
- Shah, J., ‘Supply Chain Management: Text and Cases’, Pearson Education, Inc., 1st edition, New Delhi.
- Mangan, J., C. Lalwani, and T. Butcher, ‘Global Logistics and Supply Chain Management’, John Wiley & Sons, 2008, Hoboken, New Jersey.

Unit – 14: Channel Control

Structure of Unit

14.0 Objectives

After completing this unit, you would be able to:

- Understand the concept and tools for channel control;
- Understand the role and importance of performance management in channel control;
- Know the models to diagnose channel profitability;
- Understand the source and types of channel conflict;
- Learn about various conflict management techniques;
- Understand the importance and elements of Information System;
- Understand the impact of Information System on Channel Relationship.

14.1 Introduction

Channel Control is the ability of the manufacturer to influence the behavior of channel intermediaries. It includes foreseeing actions that helps to check the intermediaries' actions and performance so that the mutual goals of the two organizations can be achieved in a desired manner. This can be exercised through effective leadership, exercising power, evaluating channel performance, managing channel conflict and with a proper information system.

14.2 Channel Leadership and Power

Channels usually perform better if a party is in charge, providing some level of leadership. Essentially, the purpose of this leadership is to coordinate the goals and efforts of channel institutions. The level of leadership can range from very passive to quite active. The style may range from very negative, based on fear and punishment, to very positive, based on encouragement and reward. In a given situation, any of these leadership styles may prove effective.

Power is our willingness to use force in a relationship. It is often the means by which we are able to control or influence the behavior of another party. In the channel mechanism, power refers to the capacity of a particular channel member to control or influence the behavior of another channel member. For instance, a large retailer may want the manufacturer to modify the design of the product, or perhaps be required to carry fewer inventories. Both parties may attempt to exert their power in an attempt to influence other's behavior. The ability of either of the parties to achieve this outcome will depend upon the amount of power that each can bring.

Effective channel management can be achieved if channels 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.

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 dysfunction conflict in the channel. Channel leaders can use different methods to resolve channel's conflicts. They include coercion, rewards and the use of legitimate expert and referent power.

- **Reward Power** is the ability to offer a reward. Channel leaders can use reward power to resolve channel conflicts.
- **Coercive Power** is a threat of punishment. The channel leader can use coercive power to control the actions of channel members. For example, a manufacturer might threaten a retailer with loss of exclusive distribution if it does not agree to do the desired tasks.
- **Legitimate Power** is power from contract agreement or organizational relationships. Channel leaders can reduce conflicts by using this power, which gives them the right to make certain decisions and ensure that other channel members follow them.
- **Expert Power** is power resulting from technological expertise or proprietary reasons. 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.
- **Referent Power** results from ability to influence further action. Channel leader have the right to permit the other members to be associated with certain trade associations.

14.3 Measuring Channel Performance

While designing or structuring a distribution channel, an analysis of the performance of channel partners by suppliers becomes necessary. A distribution channel can be assessed in terms of performance dimension such as channel effectiveness, channel efficiency, productivity, channel equity and channel profitability.

In the following section, we will try to 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.

14.3.1 Measurement of Channel Performance at Macro Level

Performance may be defined as 'the sum of all processes that will lead managers to taking appropriate actions in the present that will create a *performing* organisation in the future' or in other words, 'doing today what will lead to *measured value outcomes tomorrow'*

At macro level questions such as the following become important

- Does distribution cost too much?
- Are there people who are disadvantaged by the current distribution system?
- How do channel members at various levels of distribution compare, in aggregate, productivity per employee?
- Has productivity been increasing more rapidly in manufacturing, wholesaling, or retailing?

Macro level performance dimensions are:

a) **Effectiveness:** It refers to the channel members' ability to provide the required service at least cost and its ability to satisfy customer needs. It focuses on issues like Lot size, delivery time, location convenience and assortment breadth and his role in stimulation of demand, that is, what are the efforts made by the channel member to increase customer base or increase the usage of the product.

b) **Equity**: Extent to which marketing channel serves the market or customer with equitable opportunities, especially to disadvantaged or geographically isolated consumers.

c) **Efficiency:** Judges the ability of intermediaries to perform necessary channel functions by incurring minimal costs. Productivity deals with the extent to which the total channel investment in the form of input have been optimized to yield maximum output.

d) **Profitability:** It is concerned with a channel's financial efficiency with respect to R.O.I. over

    a. Stock turns and margins
    b. Control on overhead costs
    c. Cost and use of funds

14.3.2 Measurement of Channel Performance at Micro Level

Question here focus on profitability and costs

- Which channel member are solid run?
- Which channel seems to produce highest returns?
- Which suppliers/intermediaries will help the firm generate the greatest end user satisfaction?
- Which of the marketing flows is best performed by specific channel member?

Performance Dimensions at Micro Level are:

a) **Goal Attainment**: They look at how an individual channel member should go about evaluating its own performance. How the channel member (Manufacturer)will evaluate the performance of another channel member (wholesaler)

b) **Pattern maintenance** involves coordination of process and function among organizational units to help the system function smoothly.

c) **Integration** refers to the coordination among the components of a channel to meet common objectives and maintain the entity's one single objective.

d) **Adaptation** is the modification of resources required to meet system objectives

14.4 Diagnosing Channel Profitability

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. The Strategic Profit Model (SPM) functions as an efficient tool to evaluate the profitability of channel Members.

- Cost and revenue of distribution channels can be used by a firm to determine the relative profitability and financial performance of channels.
- As a result of the financial analysis one or more appropriate managerial action may be taken.

Changes in frequency of sales calls, the size of minimum order, promotional expenses might lead to changes in profitability

14.4.1 Strategic Profit Model (SPM)

SPM is an analytic tool frequently used to determine ROI in a business firm. It is a tool that incorporates both income and balance sheet data and demonstrates how these data relate to each other to result in RONW (return on net worth)& ROA (return on assets)

$\boxed{\text{Profit Margin}}$ X $\boxed{\text{Asset Turnover}}$ = $\boxed{\text{Return on Assets}}$

$\boxed{\text{Return on Assets}}$ X $\boxed{\text{Financial Leverage}}$ = $\boxed{\text{Return on Net}}$

The formula can be broken down as:

Profit margin = Net Profit / Net Sales

Asset Turnover = Net Sales / Total Assets

Return on Assets = Net Profit / Total Assets

Financial Leverage = Total Assets / Net Worth

Return on Net Worth = Net Profit / Net Worth

Hence, the formula for the strategic profit model can be simplified into:

Net Profit / Net Sales x Net Sales / Total Assets = Net Profit / Total Assets

Net Profit / Total Assets x Total Assets / Net Worth = Net Profit / Net Worth

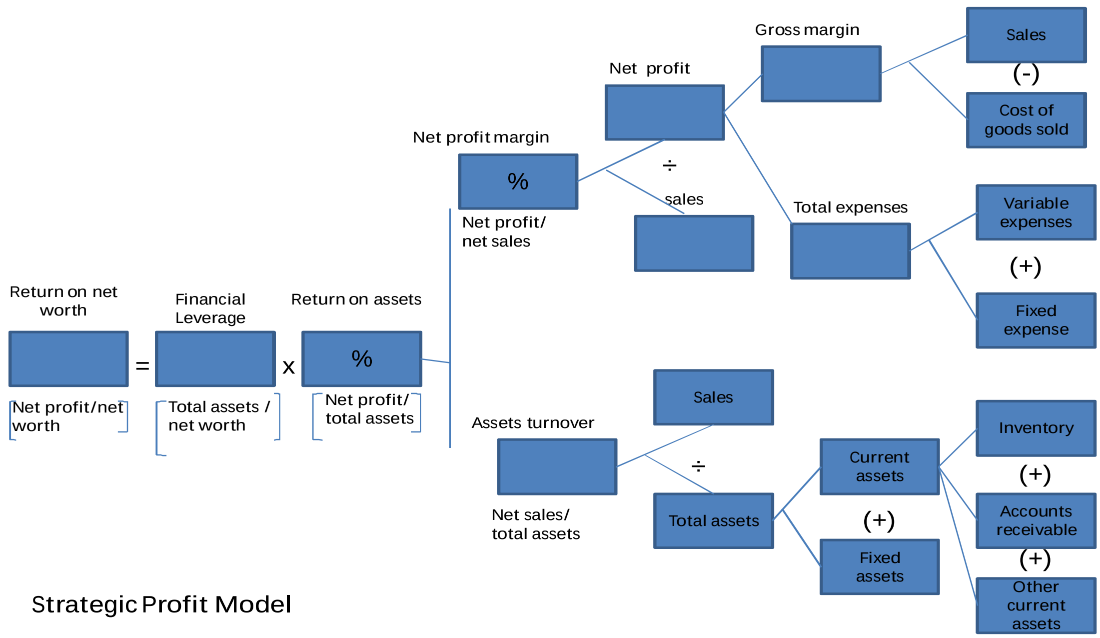


Figure 14.1: Strategic Profit Model

- Net profit margin is defined as % net profit divided by net sales. However, net profit margin actually measures the proportion of each sales rupees that is kept by firm as net profit.
- Asset turn over is a ratio of total sales divided by total assets. It actually measures the efficiency of management in utilizing assets. Its shows how much money in total sales volume is generated by each dollar that the firm has spent.
- Leverage – the result by multiplying net profit margin percentage times asset turnover ratio in return on assets (ROA). For OR, ROA is a critical measure of performance because it especially tells how well they have used all the resources at their disposal to achieve profit.
- Financial Leverage – 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.
- Economic Value Analyses- Managers use EVA as a tool to determine the true cost of capital to determine financial resource allocations. EVA considers the cost of both debt and equity. Eva ensures that capital is allocated most efficiently. It is extensively used that require decisions on cost justification. It is determined as the difference 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.

Appraisal of channel Members' Contribution

A firm's financial performance is analyzed through the SPM and economic value analysis. However, to study channel performance in details, activity based costing and direct product profitability have to be used.

14.4.2 Activity Based Costing

Activity-based costing (ABC) emerged during the 1980s as a means to more accurately assign costs within an organization. ABC is a technique for assigning the direct and indirect costs of an organization to the activities consuming the organization's resources and then subsequently tracing the costs of performing these activities to the products, customers, or distribution channels consuming the activities. ABC has gained considerable attention as a potential tool for evaluating supply chain performance. The fragmentation or tailoring logistics services offers an opportunity to obtain a competitive advantage

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

14.4.3 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.

DPP represents a products contribution to channel members' profit. DPP is a method used to derive contribution to profits on the basis of an item's gross margin.

14.5 Managing Channel Conflict

A channel conflict may be defined as "A situation in which one channel member perceives another channel member(s) to be engaged in behavior that prevents it from achieving its goals". Conflict is opposition, disagreement or discord among the organizations.

Conflict is an inherent behavioral dimension in all social system including the marketing channel. In any social system, when a component perceives the behavior of the other component to be impending the attainment of its goal or the effective performance of its instrumental behavior pattern, an atmosphere of frustration prevails. When this frustration is not resolved by the other component, a stage of conflict may exist. More over if the other component also perceives it as the blockage in its attainment of goal then both the components become objects of each other frustration and the conflict arises. In distribution channel, the same is also applicable. Here the conflict may be sales man versus distributor, distributor versus wholesaler, wholesaler versus retailer and so on. Some time in bigger organizations the conflict may arise between product company versus supply company, sales department versus production department. This type of channel conflict is more common in the organizations where every department is an independent cost center or profit center and its effectiveness are monitored separately.

Causes of Marketing Channel Conflicts

Various channel analysts have advanced a number of causes of conflicts. Robert Little point to such cause as misunderstood communication, divergent functional specialization and goals of the channel member and failing in joint decision making process. Some other experts suggest different economic objective and ideological differences among channel members as cause of conflict.

The most comprehensive list of conflict causes in the marketing channels is:

1. Role incongruities: A role is a set of perception defining what the behavior of position member should be. When applied to the marketing channel, any given member of the channel has a series to role to which he is expected to fulfill. For example a franchiser is expected to provide extensive management assistance and promotional support for his franchises. In return the franchisees are expected to operate in strict accordance with the franchiser standards operating procedure. If either of the franchisee or franchiser deviates from his role, conflict situation may result.

2. Resource scarcities: This refers to conflict stemming between channel members over the allocation of some valuable resources needed to achieve their respective goals. A common example of this is the allocation of resources between the wholesaler and the salesman. In the case both wholesaler and salesman as a valuable resource necessary to achieve their target view the retailer. Frequently the wholesale distributor decides to keep some of high volume retailers for himself as his accounts. This leads to objection by salesperson over what they consider to be an unfavorable allocation of resources. This kind of disputes is often one of the conflicts.

3. Perceptual difference: Perceptions refers to the way an individual selects and interprets environmental stimuli. The way stimuli are perceived however is often quite different from objective reality. In a marketing channel context, the various channel members may perceive the same stimuli but attach different interpretation to them. A common example of this is the case of sale material provided by manufacturing company for their retailer to put on at their retail counters. From the company point of view these sale materials are valuable promotional tools needs to move their products of the retailer shelves. Whereas the retailer often perceives the material as useless junk which serves only to take up its valuable space.

4. Expectational difference: Various channel members have expectations about the behavior of the other channel members. In practice, these expectations are predictions or forecast concerning the future behavior of the other channel members. Sometimes this forecast turns out to be inaccurate but the channel members who make the forecast will take action based on the predictive outcome. By doing so, he can elicit a response behavior from other channel member which might now have occurred in the absence of the original action. An example of this could be seen at the retail end where a retailer expects stock on credit due to his past experience, now if the salesman, upon instructions of the distributor, tries to tighten the credit suddenly the retailer might refuse to oblige, resulting in possible conflict.

5. Decision domain disagreement: each channel member explicitly or implicitly carves out for himself an area of decision making which he feels is exclusively his own. In contractual channel system such as franchise, the decision domain is quite explicit and usually spelled out clearly in franchise contract. But in more traditional loosely aligned channels made up of independent firms, the decision domains are sometime up for grabs. Hence conflicts can arise over which member has the right to moves to make the decision.

6. Goal incompatibilities: Each member of the marketing channel has his own set of goals and objectives that are very often incompatible with those of other channel members. When goals of two or more members are incompatible, conflicts may result and incompatible goals often arise between channel members for example the most common conflict issues, which arise between manufacturer and industrial distributor.

- How to handle large accounts
- The required inventory stocking levels
- The quality of distributors management
- Size of distributor’s margin

Clearly underline many of these issues, are the difference in goals, aims and values among channel members involves. Furthermore in consumer goods market there are literally items of thousands of small retailer served by large manufactures. Large manufacturers tend to be growth oriented where as small retailers are more interested in status quo. The likelihood of the conflict is high in such situation is because in their pursuit of policies that re congruent with their dynamic goal. The former would likely adopt innovative programs that contradict the more static orientation of the latter.

7. Communication difficulties: Communication is the vehicle for all interactions among these channel members. Whether such interactions are cooperative or conflictive. A foul up or break down in the process of communication can turn quickly a cooperative relationship into a conflicting one. For example manufacture often makes changes in product design, prices and promotional strategies. The resellers generally feel that they are entitled to ample advance notice of such changes so that they can make appropriate strategic adjustments, if necessary. If adequate communication is not provided and these failing results in negative consequences for a channel member, severe conflict can result.

14.5.1 Types of Conflict

Each channel member views the conflict, the relationship and the tensions differently. Following are the types of channel conflicts:

- **Latent conflict** – The channel members may be unaware about the opposition. They do not fully sense the conflict. This is due to the separate or un-conflicting goals.
- **Perceived conflict** – The channel members sense that some sort of opposition of perceptions, of interest, or of intensions exists. It is more psychological, i.e. two organizations can perceive that they are in disagreement but their individual members do not consider it as a very serious issue.
- **Felt conflicts** – When channel members not only perceive the opposition or disagreement but also feel it actually they are felt or affective conflicts. This needs to be sorted out at an early stage to avoid further consequences.
- **Manifest Conflict** – If felt conflicts are not managed in time and properly, they can become manifest or overt conflicts and these conflicts stop the cooperation and understanding between two organizations and block the other from achieving its goals.
- **Functional Conflict** – When channel members accept that there is opposition and disagreement but actually, this opposition will improve their relationship, it becomes functional conflict. It is common, obvious and sometimes desirable too due to the interdependence of channel members on each other.

Conflicts can also be classified as:

A) Vertical conflicts: Vertical conflicts occur due to the differences in goals and objectives, misunderstandings, and mainly due to the poor communication

Lack of role clarity and over dependence on the manufacturers. For e.g. today the large retailers dominate the market and dictate the terms. Hence there are often conflicts between these giant retailers and the manufacturers

- Wholesalers expect manufacturers to maintain the product quality and production schedules and expect retailers to market the products effectively. In turn, retailers and manufacturers expect wholesalers to provide coordination functional services. If they fail to conform each others expectations, channel conflict results.
- Wholesalers expect manufacturers to maintain the product quality and production schedules and expect retailers to market the products effectively. In turn, retailers and manufacturers expect wholesalers to provide coordination functional services. If they fail to conform each others expectations, channel conflict results.

Some common reasons for vertical conflict are:

- Dual distribution i.e. manufacturers may bypass intermediaries and sell directly to consumers and thus they compete with the intermediaries.
- Over saturation, i.e. manufacturers permit too many intermediaries in a designated area that can restrict, reduce sales opportunities for individual dealer and ultimately shrink their profits.
- Partial treatment, i.e. Manufacturers offer different services and margins to the different channels members even at same level or favor some members.
- New channels, i.e. manufacturers develop and use innovative channels that create threat to establish channel participants.
- Wholesalers expect manufacturers to maintain the product quality and production schedules and expect retailers to market the products effectively. In turn, retailers and manufacturers expect wholesalers to provide coordination functional services. If they fail to conform each others expectations, channel conflict results.
- No or inadequate sales support and training to intermediaries from the manufacturers.
- Irregular communication, non co-operation and rude behavior with the channel members.
- Stipulation of ordering in advance, high stock holding and dumping the stock at the intermediaries.
- Delays in delivering the products or sometimes dispatching the products without confirmed order.
- Refusal to replace or take back the goods damaged in transit. Non co-operation in replacement of faulty goods, repairing services, and installations.
- No co-operative advertisements. Manufacturers do not share any expenses of advertisements.
- No or inadequate credit offered to the intermediaries. Margins / commissions are not sufficient and there is no periodic revision of commission and other terms

Conflicts due to the Intermediaries Actions are:

- Intermediaries promote and sell more private labels than promoting the manufacturer’s brands.
- Intermediaries encourage customers to switch to private labels / competitive products.
- Intermediaries carry competing lines and give more showroom space.
- No support in the manufacturer’s promotional efforts.
- Intermediaries fail to get the expected / promised efforts.
- Intermediaries refuse to service and install manufacturer’s products.
- No appropriate and timely market feedback and report to the manufacturers.

B) Horizontal conflicts: Horizontal conflicts are the conflicts between the channel members at the same level, i.e. two or more retailers, two or more franchisees etc. These conflicts can offer some positive benefits to the consumers. Competition or a price war between two dealers or retailers can be in favor of the consumers. Reasons behind horizontal conflicts are:

- Extra service offered by one dealer / retailer can attract customers of others.
- Crossing the assigned territory and selling in other dealers / retailers / franchises area.
- Unethical practices or malpractices of one dealer or retailer can affect other and spoil the brand image.

C) Inter Type conflict: Inter type conflict occurs when, the Intermediaries dealing in a particular product starts trading outside their normal product range. For example, now the supermarkets such as Food world also sell vegetables and fruits and thus compete with small retailers selling these products. Large retailers often offer a large variety and thus they compete with small but specialized retailers. This concept is called as "Scrambled Merchandising" where the retailers keep the merchandise lines that are outside their normal product range.

D) **Multi-channel Conflict**: Multi-channel conflict occurs when the manufacturer uses a dual distribution strategy, i.e. the manufacturer uses two or more channel arrangements to reach to the same market. Manufacturers can sell directly through their exclusive showroom or outlets. This act can affect the business of other channels selling manufacturer's brands

Manufacturers can bypass the wholesalers and sell directly to the large retailers. Conflict becomes more intense in this case as the large retailers can enjoy more customers and so the profit due to offering more variety and still economical prices, which is possible due to a volume purchase.

14.5.2 Resolving Channel Conflicts

Conflict is a natural phenomenon, which cannot be eliminated. In channel management, it is an inevitable as many individuals, institutions are involved and they are interdependent. Certain conflicts are constructive too. The conflicts can be reduced and managed better to reduce the friction in the channel management. Various techniques can be used to resolve the conflicts. It is important to find out the root cause behind the conflict so that appropriate technique can be used to resolve the conflicts and lasting effect is possible. Some techniques are as follows:

A) **Channel leadership** – Many channel conflicts can be resolved through the effective channel leadership. Channel leader is able to reduce conflicts because he possesses the channel power. Channel power is the ability of one channel member to influence another member's marketing decisions and goal achievement. It enables the leader to influence overall channel performance. The channel leader controls resources on which other members depend. Channel power can increase conflict and reduce cooperation if one channel member uses coercion to influence others. Manufacturers, wholesalers or even retailers can become the channel leaders. For example, producers like IBM, Ford can act as channel leaders because of their economic power.

B) **Adoption of Super ordinate goals** – The channel members come to an agreement on the fundamental goal they are jointly seeking, whether it is survival, market share, high quality or customer satisfaction.

C) **Exchange of persons between two or more channel levels** – This helps in better understanding. It can reduce the misunderstanding and conflicts can be reduced substantially through this communication. Each will grow to appreciate the others point of view and carry more understanding when returning to their position.

D) **Co-Opt** – It is an effort by one organization to win the support of the leaders of another organization by including them in advisory councils, board of directors so that they feel that their opinions are being heard. Co-operation can reduce conflict provided both the parties compromise some or the other issues in order to win the support of the other side

E) **Joint membership in and between trade associations** – Such associations bring all participants under one roof for more exposure to the public and to improve relations with each other by understanding their problems.

F) **Diplomacy** – Diplomacy takes pace when each side sends a person or a group to meet with their counterpart from the other side to resolve the conflict. It makes sense to assign diplomats to work more or less continuously with each other to avoid the conflicts.

G) **Third-Party Mechanisms** – When conflict is chronic, and the above mentioned techniques are ineffective, both the parties may have to resort to third parties, which are not involved or not the part of the existing channel.

- **Arbitration** – In this method, the two parties agree to present their arguments to a third party and accept arbitration decisions.

H) **Mediation** – Mediation implies resorting to a neutral third party who brings skills in conciliating the interests of the two parties. Mediation is the process whereby a third party attempts to secure settlement of a dispute by persuading the parties either to continue their negotiations or to consider procedural recommendations that mediator may make. Mediator has a fresh view of the situation and may perceive opportunities that insiders cannot. Effective mediation succeeds in clarifying facts and issues. Mediators help the parties to set up their own decisions whereas in arbitration it can be compulsory.

14.6 Channel Information System

Channel Information System is the orderly flow of pertinent operational data both internally and between channel members, for use as a basis of decision making in specified responsibility areas of channel management. 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.

14.6.1 Functions of Channel Information System

CIS is of primary use of sales managers. Information technologies are a precondition for the development of information systems, and thus information systems in a supply chain, i.e. in distribution or marketing channels. Information technologies can play various roles within a supply chain Information technologies are a precondition for the development of information systems, and thus information systems in a supply chain, i.e. in distribution or marketing channels. Information technologies can play various roles within a supply chain. Therefore, it is necessary to underline its specific role in it

- the increase in market sensitivity,
- simplification of distribution systems,
- the increase in the number of channel types,
- the increase in the market size,
- wider use of e-commerce,
- internationalisation and easier access to global markets,
- change in distribution channels.

Information technologies are used in three broad areas, according to their areas of application and technological systems in their hierarchical structures, the most complex technological business systems, such as ERP systems (Enterprise Resource Planning), which were designed to cover and connect the whole company on the software level;

b) Targeted technological solutions (the lower level of technological solutions that facilitate optimising certain business functions or enhance visibility along channels), such as: warehouse management system – WMS, transport management system – TMS, or advanced

planning system – APS;

c) Technological tools for executive solutions: Electronic Data Interchange – EDI, the Internet or RFID (Radio Frequency Identification).

14.6.2 Elements of Information System

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 Quick Link information systems are some successful information systems. Precision Code, Data Designs, Archer's Retail Database Management System (ARDMS) and Product Information Management System by IBM are examples of database systems developed by companies.

Few of them are described below:

CIS facilitate the sharing of information among manufacturers, suppliers, wholesalers, retailers, improve inventory management, and 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 Quick Link.

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 stems that improve b to b - relationships among channel members.

Quick response (QR) system - It is widely used in the apparel industry to ensure that fabric makers, apparel designers and retailers can share-info iätiff5'ut 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.

Efficient consumer response (ECR) - It is a variation of the continuous replenishment program used in the apparel industry. ECR uses category management organizes product replenishment on product groups.

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 retails 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 the retailer and save costs by promoting products with consumer demand.

Transaction-based information system (TBIS) - 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.

TBIS also acts as information barmier 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 - The 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.

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

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.

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.

Shipping Container Marking Technology (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.

Electronic Shelf Labels (ESL) - Electronic shelf labeling 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 cost.

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. 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 o 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 order. 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 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.

14.6.4 Information System in Managing Channel Relationship

Use of Channel Information Systems (CIS) has 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.

14.8 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.

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.

Multichannel marketing is where a single firm uses two or more marketing channels to reach one or more market segments. This process is also known as 'dual distribution.' Although additional channels increase the market coverage of the firm, they also result in greater conflict between the channel members, especially if the members are vying for the same market segments. Conflicts arise between marketing channel members when one member of the marketing channel thinks that another member is preventing or impeding it from achieving its marketing goals. Channel conflicts can be of three types – vertical, horizontal, and multichannel conflicts. Conflicts may arise due to various reasons such as a difference in the aim of producer and channel members, lack of clearly defined roles and responsibilities and both manufacturer and channel members fighting for the same market. The various methods for solving and managing conflicts include negotiation, problem-solving strategies, persuasive mechanisms, legalistic strategies, and climate management. Obtaining the cooperation and coordination of the channel members helps firms leverage their limited resources to achieve organizational objectives through the combined efforts of the channel members.

14.9 Self Assessment Questions

1. Discuss the dynamic nature of Channel Power and Leadership.
2. Discuss the various types of Channel Conflict.
3. Managing Channel Conflict is an everyday affair. Comment and discuss the resolving Techniques.
4. Discuss and illustrate the economic justification for Measuring Channel Performance.
5. Discuss the financial tools for Measuring Channel Performance.
6. Discuss the Impact of Channel Information System on Channel Management.
7. Discuss the various B to B Information System Applications.

14.10 Reference Book

- Agrawal, D.K., 'Textbook of Logistics and Supply Chain Management', MacMillan India Limited, 2010, New Delhi.
- Raghuram G., and N. Rangaraj, 'Logistics and Supply Chain Management - Cases and Concepts', MacMillan India Ltd., 2005, New Delhi.
- Shah, J., 'Supply Chain Management: Text and Cases', Pearson Education, Inc., 1st edition, New Delhi.
- Stern, L., A. El-Ansary, and A. Coughlan, 'Marketing Channels', Prentice Hall of India Pvt. Ltd., 5th edition, 1996, New Delhi.

UNIT – 15: Physical Distribution

Structure of Unit

15.0 Objectives

After completing this unit, you would be able to:

- Understand the meaning and objectives of physical distribution;
- Know about various activities of physical distribution;
- Understand the transportation, distribution inventory, warehouse, materials handling, protective packaging and order processing;
- Learn the significance of Total Physical Distribution Cost;
- Appreciate the contribution of different activities in Total physical distribution cost;

15.1 Introduction

Liberalization, privatization and globalization are changing the landscape of business environment. It is now becoming a strategic imperative for organizations to address the management of the distribution function in general and in particular to device a channel strategy which provide them access, coverage, representation in the market place. Earlier, "physical distribution" term was used to describe the physical movement of products from the point of origin to the ultimate consumer. The American distinguished Professor Philip Kotler considered that physical distribution concept involves materials and products planning, implementation and physical control, from the origin point to the consuming points, as to satisfy consumer needs and getting profit for the organization. It means that physical distribution is a whole process that concern also materials and finished product, a physical movement of goods from the manufacturers to intermediaries and finally to the ultimate consumer. Distribution accomplishes this by providing time and place utility, in other words, availability and its goals are like any other marketing goals: consumer satisfaction and profit for the organizations.

15.2 What is Physical Distribution?

Physical distribution management is to administer economic activities that impact on the flow of finished goods between points of production and consumption. Physical distribution components occupy a unique role in the organization. Physical distribution forms a pivotal part of the marketing task. It is physical distribution that confers place-utility and time-utility to a product by making it available to the user at the right place and at the right time thereby it maximizes the chance to sell the product and strengthen the organization competitive position.

If any product made in any place could be consumed in entirely at the very place of production and at the very time of production, there would be no need for physical distribution of that product. But such products are very rare. In practice, almost every product gets consumed at places and times that are different from those of their manufacture.

When production locations and markets are distanced, physical distribution becomes more crucial. In some cases, production locations are totally dictated by considerations like proximity to sources of raw material. As a result, the points of production might be far away from the markets for the product. In some cases, huge production capacities get established at a given location on consideration of technology and economies of scale. In all such cases, the product has to be marketed over an extended territory; it has to be transported over long distances, stored for a considerable length of time and sold.

There are products, which are impacted by the seasonality factor- either production is continuous but demand is seasonal, or demand is continuous but production is seasonal. Here too, physical distribution becomes particularly crucial. It has to perform the balancing act between production and consumption. That is why physical distribution serves two basic utilities for any organization, which are highlighted as:

- ➢ **Helps Build Clientele:** It is physical distribution that determines the customer service level to a large extent. As a result, it serves as a vital tool in building clientele / market for the product. And conversely, ineffective physical distribution leads to loss of customers and markets.
- ➢ **A Promising Area for Cost Reduction:** Physical distribution is a fertile area for cost savings. Over the years, in most businesses, physical distribution costs have grown into a sizeable chunk of the total costs and now ranks second among all cost elements, next only to material costs. And surprisingly, it has remained one of the neglected areas of cost control.

Gaedeke and Tootelian defined physical distribution as - "…all activities involved in planning, implementing, and controlling the physical flow of raw materials, in-process inventory, and finished goods from point-of-origin to point-of-consumption. The main activities include customer service, inventory control, material handling, transportation, warehousing and storage."

Basically, physical distribution encompasses all the activities involved with the physical movement of products through distribution channels. Specifically, physical distribution includes all activities related to the storage, handling, and movement of goods to make these goods available when and where customers demand them. Today, physical distribution is used interchangeably with the term 'logistics management.' However, they are not synonymous. Logistics management is a broader concept that actually encompasses physical distribution. Indeed, logistics management can be broken down into two major components: Materials management and Physical distribution management.

- ✓ Materials management involves the movement of parts, materials, and other factors of production into the production process. Materials management, therefore, involves sourcing parts and materials, arranging for their transportation to the production facility, and receiving and placing these products into inventory.

- ✓ Physical distribution management is the movement of finished goods from their point of production into the hands of consumers. Physical distribution activities, as a result, focus on managing inventories of semi-finished and finished goods, warehousing these goods enroute to middlemen, handling these goods within the production and warehousing facilities, and arranging and managing their transportation through the channel.

15.2.1. Objective of Physical Distribution

The success of an efficient and effective physical distribution system relies on integration of effort. The overall physical distribution objectives are listed below:

- Attain customer satisfaction
- Profit maximization
- Getting the right product, at the right place, at the right time, in right quantity, at the right customer at the lower cost
- Proper co-ordination of distribution activities.

Customer service objectives must be defined up-front, based on the physical distribution needs of customers. Generally, customers' physical distribution needs consist of such things as:

- ✓ On-time delivery
- ✓ Willingness to meet customers' emergent requirements
- ✓ Careful handling of merchandise
- ✓ Willingness to take back defective merchandise and re-supply quickly
- ✓ Willingness to carry inventory for customers

These needs can be translated into specific customer services objectives or standards, such as:

- ✓ to deliver at least 95% of orders within 3-days of order receipt
- ✓ to fill orders with 100% accuracy
- ✓ to answer customers' questions about order status within 30 minutes
- ✓ to ensure damage to merchandise in-transit is not greater than 1%
- ✓ to turn around damaged merchandise within 24 hours

15.3 Physical Distribution Activities

Physical distribution of organization requires coordinating efforts of various activities so as to achieve the objectives of physical distribution. Physical Distribution Management (PDM) is concerned with the flow of goods from the receipt of an order until the goods are delivered to the customer. In addition to transportation, PDM involves close liaison with production planning, purchasing, order processing, material control and warehousing. All these areas must be managed so that they interact efficiently with each other to provide the level of service that the customer demands and at a cost that the company can afford. PDM is concerned with ensuring that the individual efforts that go to make up the distributive function are optimized so that a common objective is realized. This is called the 'systems approach' to distribution management and a major feature of

PDM is that these functions be integrated. Various activities of physical distribution are listed as:

15.3.1 Order Processing

Order processing is the first activity of physical distribution. The efficiency of order processing has a direct effect on lead times. Orders are received from the sales team through the sales department. Many organizations establish regular supply routes that remain relatively stable over a period of time providing that the supplier performs satisfactorily. Very often contracts are drawn up and repeat orders (forming part of the initial contract) are made at regular intervals during the contract period. Taken to its logical conclusion this effectively does away with ordering and leads to what is called 'partnership sourcing'. This is an agreement between the buyer and seller to supply a particular product or commodity as and when required without the necessity of negotiating a new contract every time an order is placed.

Order-processing systems should function quickly and accurately. Other departments in the organization need to know as quickly as possible that an order has been placed and the customer must have rapid confirmation of the order's receipt and the precise delivery time. Even before products are manufactured and sold the level of office efficiency is a major contributor to a company's image. When buyers review their suppliers, efficiency of order processing is an important factor in their evaluation. A good computer system for order processing allows stock levels and delivery schedules to be automatically updated so management can rapidly obtain an accurate view of the sales position. Accuracy is an important objective of order processing as are procedures that are designed to shorten the order processing cycle.

In fact, a customer order is the message that sets the physical distribution process in motion. As already mentioned, it starts with the receiving of customer order and ends with the final delivery of goods along with transfer of title. More specifically, order processing is the activities that take place in the period between the time an organization receives an order and the time a warehouse is notified to ship the goods to fill that order. In other words, order processing is a set of activities for receiving, recording, assembling of products for dispatch to fill the customer order. Order processing involves several activities, which consume time and known as order cycle.

According to Agrawal (2010) order processing system needs to have following characteristics such as:

- responsiveness or speed in order-handling and fulfillment;
- lowest possible delivered costs for products or service; and
- Minimal wastage in the system (such as inventory holding in various locations, which ties up scarce working capital).

Customer order processing involves several functions, which need to be performed by various partners of the supply chain at different point of time. The functions of organizations' order processing can also be elaborated more systematically in five crucial stages, namely order preparation, order receipt, order conduct, order execution and order release.

(a) Order Preparation: Order preparation is the first step in order processing of any organization as it is considered as ground work for delivering value to customers. It refers to all those activities, which are basically performed by the customers, in terms of gathering the information needed about the products and services desired and formally showing the purchase intention. It may involve determining an appropriate vendor, filling out an order form, determining stock availability, communicating order information by telephone to a sales clerk, or making selections from a Web site menu. In other words, it refers to designing an efficient order handling system, i.e. it determines how a customer order is received and by whom, what technique should be adopted. Orders are generally placed by customers to visiting sales people of the organization or by telephone, fax, mail order, e-mail, or EDI directly to the dispatching point/controlling office/head office. Nowadays, most of the big organizations prefer to have computer-to-computer order receiving and entry system to speed-up customer response. Technology is eliminating the need to manually fill out order forms.

(b) Order Receipt: After order preparation at customer's end, receipt of the order information at seller's end is the next sequentially logical activity of the order-processing cycle. It involves transferring the order request from its point of origin to the place where the order entry can be handled. Order receipt refers to a series of events that occur between the time a customer places an order or sends an order and the time the seller receives the order. Order receipt can be accomplished in two fundamental ways: manually and electronically. Manual receipt of orders can include the mailing of orders or the physical carrying of orders by the sales staff to the point of order entry.

(c) Order Conduct: Order conduct refers to several tasks that take place prior to the actual execution of an order. It includes following activities:

- Checking for completeness and accuracy of the order in terms of item description and number, quantity and price;
- Examining the customer's credit status;
- Checking the availability of the requested items
- Allocation of products by inventory department and advices it to pick the shipment and updates the firm's master inventory file;
- Preparing back-order or cancellation documentation if required
- Recording of transaction by the accounting department in terms of generation of bills / invoice etc.

These activities are necessary because order request information is not always in the form needed for further processing, it may not be represented accurately, or additional preparation work may be needed before the order can be executed.

(d) Order Execution: Order execution involves giving instruction to a specific warehouse to assemble a given order for a customer. In other words, it is a written document given to a warehouse and its employee indicating the items to be assembled as per the list of the customer order. More specifically, order execution includes following physical activities as:

- acquire the items through stock retrieval, production or purchasing;
- pack the items for shipment;
- schedule the shipment for delivery; and
- Prepare the shipping documentation.

A number of these activities may take place in parallel with those of order conduct so as to compress the order processing time.

(e) Order Release: Order release is final step of order-processing, which ensures that good customer service is provided by keeping the customer informed of any delays in order processing or release of the order. More categorically, it includes

- Tracing and tracking the order throughout the entire order cycle; and
- Communicating with the customer about where the order may be in the order cycle and when it may be delivered.

The order release time is the time from when a carrier picks the shipment until it is delivered to the customer's receiving dock, i.e. transit time. This transit time has a direct and major impact on sellers total order cycle time or customers' replenishment cycle time.

15.3.2. Inventory Management

Inventory constitutes one of the most important elements of any system dealing with the supply, manufacturing and distribution of goods and services. In fact, inventories are common to farms, manufacturers, traders, hospitals, temples, prisons, zoos, universities and even governments. Inventory management is a critical area of PDM because stock levels have a direct effect on levels of service and customer satisfaction. The optimum stock level is a function of the type of market in which the company operates. Few organizations can say that they never run out of stock, but if stock-outs happen regularly then market share will be lost to more efficient competitors. The key lies in ascertaining the re-order point. Carrying stock at levels below the re-order point might ultimately mean a stock-out, whereas too high stock levels are unnecessary and expensive to maintain. Stocks represent opportunity costs that occur because of constant competition for the company's limited resources. If the organization's marketing strategy requires that high stock levels be maintained, this should be justified by a profit contribution that will exceed the extra stock carrying costs. Sometimes an organization may be obliged to support high stock levels because the lead-times prevalent in a given market are particularly short. In such a case, the organization must seek to reduce costs in other areas of the PDM 'mix'.

Hereby, inventory management refers to the efficient control over the stock of goods stored in the warehouse for the purpose of meeting customer demands in time. In order to keep minimum inventory cost, an organization has to go for an optimum inventory which requires an accurate sales forecast. Number of techniques have been developed which help organizations in deciding the volume of inventory.

15.3.2.1 Types of Inventory: There are several ways in which inventories are classified, namely:

On the basis of nature of materials: The categorization is as under:

- **Production Inventories:** Raw materials, parts and components which are consumed in the production process of goods, come under the category of production material inventories.

- **MRO Inventories:** Maintenance, repair and operating (MRO) items which are used in the production process but do not become a part of the products, called MRO items, and their stocking is called MRO inventories.
- **In-Process Inventories:** These goods are partially completed or finished that are still in the production operation, i.e. semi-finished products found at various stages in the production process are called in-process inventories.
- **Finished-goods Inventories:** These inventory items are final products, available for sale and distribution, i.e. completed products ready for shipping. This type of inventory is major concern for the physical distribution system.

On the basis of uses of materials: This categorization is more useful for the physical distribution management, which is listed as:

- **Transaction Inventory:** This type of inventory items is basically needed for transaction, e.g., transaction of finished saleable products or raw materials.
- **Speculative Inventory:** The stocking of materials as a measure of speculation so as to get greater price for the goods in future.
- **Precautionary Inventory:** The stocking of certain materials or items to prevent the breakdown of the production process and/or to meet any unexpected demand.

Another way to explain the purposes inventory services is by introducing functional classifications of inventory. Based on its utility, all inventories can be placed in one or more of the following categories

- **Working Stock:** Working stock is also known as cycle or lot size stock. In general, it is an average amount of inventory in stock that results from lot sizes to get the benefits of minimum ordering and holding costs, quantity discounts and/or favorable freight rates.
- **Safety Stock:** The safety stock or buffer stock function of an inventory is to meet short-range variations in either demand or replenishment, i.e. safety stock inventory is held in stock to protect against the uncertainties of demand and supply.
- **Anticipation Stock:** The anticipation or seasonal or stabilization stock refers to holding a high level of inventory to meet the peak seasonal demand, erratic requirements, or inconsistency in the production capacity, e.g. production and holding of woolen garments in advance to meet the demand during winter.
- **Pipeline Stock:** The pipeline stock is also known as transit stock or work-in-process inventory. Generally, a geographical gap exists in the point of production and point of consumption of goods. Hence, goods in transit from manufacturer to be delivered to a customer are called pipeline stock. Furthermore, raw materials and components being processed, waiting to be processed, or being moved to become finished goods also come under the functions of pipeline inventory function.
- **Decoupling Stock:** Decoupling stock is inventory accumulated between the various departments' activities (manufacturer, wholesalers, retailers,

etc.) or stages to reduce the requirement for completely synchronized operations. In other words, inventory brings about a smooth interface between material, production and distribution system of an organization.

- **Psychic Stock:** Psychic stock refers to window display of an inventory in order to stimulate demand and act as a salesman. This function of inventory generates an impulse-buying tendency, fulfilling the need of promotion function.

15.3.2.2. Functions of Inventory in Physical Distribution Management: Inventories usually exist throughout the network in various forms and for various reasons. At any manufacturing point, inventories may exist in the form of raw materials, work-in-process, and finished goods. They also exist at the gathering and distribution warehouses; and in transit, or the pipeline. Inventories, on each of the path, link the fixed facilities.

It is very difficult to have a perfect trade-off between demand and supply, which results into an inventory. There are certain reasons behind a gap between demand and supply, namely; time, discontinuity, uncertainty and economy.

The time factor refers to the time required in the production and distribution of goods for the final use by the consumers. The discontinuity factor deals with different degrees of risks associated with various departments' operation in an independent and economical manner. For instance, the quantum of inventory risk is highest in the case of manufacturers as the inventory, materials and components and finished goods, including work-in-process. The wholesalers'/ distributors' inventory risk is higher as they stock goods in bulk quantities and then sell them in small quantities to retailers. The inventory risk of retailers can be viewed as wide but not deep as fundamentally, for them, it is a matter of buying and selling.

The uncertainty factor behind an inventory is normally due to unforeseen events such as equipment breakdown, strikes, act of God, or error in demand forecasting. To overcome such situations, organizations need to have some preventive stock of goods. On the other hand, the economic factor behind the inventory allows an organization to take advantage of cost-reducing alternatives such as quantity discounts.

Some of the objectives of inventory management are listed as:

- ✓ To ensure continuous supply of material
- ✓ To avoid both over-stocking and under-stocking of inventory
- ✓ To maintain investment in inventory at optimum level
- ✓ To keep materials cost under control
- ✓ To eliminate duplication in ordering or replenishing stocks
- ✓ To minimize losses through deterioration, pilferage, wastages and damages
- ✓ To design proper organization for inventory management
- ✓ To ensure perpetual inventory control so that materials shown in stock ledger should be actually lying in the store.
- ✓ To ensure right quality goods at suitable price.

15.3.2.3. Inventory Control Techniques: The ultimate objective of the inventory control program is to provide maximum customer service at minimum cost. Traditionally, inventory management involved two fundamental questions:

how much to reorder vendor and/or their plants and when to reorder. Now-a-days, questions regarding where inventory should be held and what specific items should be available at specific location make the inventory management a big challenge. Sople (2010) classified inventory control techniques into two groups:

Selective Inventory Control Techniques: In these methods the degree of control varies with the importance of the item. Some of the commonly used techniques in industry are:

- **ABC Inventory Control Technique:** It relates to the annual usage cost of a particular item. The items are classified as per the usage value. Items in class A are less in number (approx. 10 percent of total inventory) but cost approximately 60-70 percent of the total cost of inventory. Items under class B cost 20-30 percent of total inventory cost as well as 20-30 percent in numbers and finally item C constitutes 60-70 percent of volume but less than 10 percent of inventory cost. It means activities that are considered high on priority are classified as A, those with lesser priorities are grouped under B and the group C items are having least priority.
- **VED Inventory Control Technique:** It relates to Vital, Essential and Desirable status of the inventory items. As the term implies, certain items are considered to be vital for meeting operational requirements and this aspect is taken into consideration for making any inventory related decisions.
- **SAP Inventory Control Technique:** Scarce, Available and Plenty status of inventory item is used for planning and forecasting inventory requirements. The ordered quantity is governed by the scarcity factor.
- **FSN Inventory Control Technique:** Fast, Slow and Normal determines the consumption pattern of the items.

In all these control techniques, the degree of control varies with the importance of items. For example, for the A class, Vital, Scarce and Fast moving items perpetual reviews are recommended, while for B class, Essential and Medium moving items periodic reviews will be OK. In the case of C class, Desirable and Slow moving items the periodicity of review will be longer.

Inventory Control through Inventory Planning: Over the years experts have suggested various models for controlling inventory. Various approaches to inventory control can be categorized into the traditional and modern approach. Traditional approaches are based on assumptions, which are suitable for dynamic market conditions.

- **Economic Order Quantity (EOQ):** Ford Harris and R.H. Wilson devised square root formula for EOQ. The assumption for the model are listed as:
  - Demand is known, constant and spread over a period of time.
  - There is no lead time for re-supply of material.
  - The cost of ordering per unit is the same irrespective of the lot size.

  The calculation of the economic order quantity involves only simple mathematics. The following nomenclature may be used:
  Let

O = the cost of placing a order
Q = quantity ordered
N = number of times that quantity is ordered,
S = Q × N (i.e. the total number of units demanded)
C = cost per unit per annum
Order processing costs = O × N
Average carrying costs = C × Q/2
Total costs = (O × N) + C × Q/2
Since NQ = S then N = S/Q
Total costs = OS/Q + CQ/2
Therefore EOQ = $\sqrt{}$OS/C

It will quickly be realized that the EOQ model, as just described, is an over-simplification of the real world. It does not incorporate such realities as the variation in sales volumes over time, variable lead times between order placement and delivery, discounts for purchasing in larger quantities and the need for safety stocks.

The modern approaches for controlling the inventory are based on four primary factors, i.e., flow, flexibility, balancing and integration.

- **Materials Requirement Planning (MRP):** The materials requirement planning system (MRP) most commonly found in modern manufacturing or processing concerns is based on the Japanese Kanban system. MRP is a computerized inventory control system intended to minimize the investment in manufacturing/processing materials and components, consistent with matching production levels to current demand. MRP is typically applied to mange inbound material movement in the organization and is based on production requirements and scheduling.
- **Manufacturing Resource Planning (MRP –II):** MRP II represented a move towards an integrated approach to the entire manufacturing process. It is defined as a method for the effective planning of all resources of a manufacturing organization. MRP and MRP-II systems draw on Master Production Schedule (MPS).
- **Distribution Requirement Planning (DRP):** Distribution Requirement Planning (DRP) applies the techniques of MRP II to warehousing and transportation activities. It is guided by customer demand and allocates inventory from the mother warehouse to the various distribution centers based on various factors such as: demand patterns, safety stock provisions, order quantity, reorder point, average performance cycle length etc. DRP also coordinates finished goods requirements across the distribution network.
- **Just-in-Time (JIT):** The purpose of JIT is to eliminate all production activities which do not directly add value to the product. The just-in-time (JIT) concept was developed with manufacturing in mind but it has implications for distribution. Whilst the organizations that have implemented this system tend to be large enterprises, the system also has implications for the smaller and middle-sized firms who may be their competitors, suppliers or customers. JIT has four specific objectives:
    - ✓ the production of goods that the customer wants

- ✓ the production of goods when the customer wants them
- ✓ the production of perfect quality of goods and
- ✓ the elimination of waste (in labor, inventory movement, space, etc.).

- **Vendor Managed Inventory (VMI):** It is made popular by Bose Incorporation. In VMI, the supplier takes charge of inventory management of products and manages the replenishment process based on the consumption pattern of the customer. For VMI to be successful, three things are essential, i.e., right partners, the right set of products and mutual trust.

Case: Inventory Reduction at Asian Paints : Color dispensing machines, both computerized and manual have transformed the business, particularly manufacturing and distribution side of the Asian Paints. Earlier paint companies were required to manufacture all shades in all the pack sizes. The demand pattern was difficult to predict even with support of historical data as consumer preferences were changing very fast. The machine altered the production pattern from shades to producing bases thus providing economies of scale, reduced inventory levels and eliminated redundancy of stocks. This has helped expand the range of shades for each product category, offering a choice of shades to consumers. For the retailers, dispensing machines eliminated the sales loss for want of desired shades by the customer.

15.3.3. Warehousing

A warehouse is a place. Here, surplus goods can be kept safely for future use. Modern warehouses are equipped with latest equipments and facilities for the safety of goods from theft, sun, moisture, rats etc. Warehousing has removed the obstacle of time in the smooth flow of trade. It helps in storage of goods until they are demanded for further use or sale. It has proved to be a boon to the manufacturers and trades by helping them to store and accumulate goods. Traditionally, a warehouse was viewed as a storage facility necessary to accomplish basic marketing processes. That is, the warehouse served as a static unit in the material and product pipeline, necessary to match products in a timing sense with consumers.

Changing requirements of the retail environment where they became business partners against mere traders have further broadened the concept and function of a warehouse. From this perspective, a warehouse is expected to provide superior logistical customer service in terms of regular availability of products, zero defect delivery, information sharing, and consistency and reliability of services.

15.3.3.1. Types of Warehouses: There are two broad bases on which we can divide warehouses, namely:

On the Basis of Ownership: It can be categorized into two broad categories as:

- **Private Warehouses:** Private warehouse comprises of warehousing facilities operated by and owned or leased by a firm handling its own goods. They are used by firms whose warehousing needs are stable enough, such as retail chain stores firms or multi-brand, multi-product FMCG firms, to make long-term commitments about fixed facilities. Generally, private warehouses assure greater design flexibility with respect to storage and material handling needs, greater and efficient control of warehouses, operational functionality, rapid information flow and lower costs. The major benefits of private warehousing include control, flexibility, cost, and other intangible benefits.

- **Public Warehouses:** Public warehouses are those warehouses which are owned and operated by organizations like government, cooperatives, or a Third Party Logistics Service Provider (3PL) in the private sector. The space of public warehouses can be used by any firm, organization or individual public on certain terms and conditions of payment. Despite having higher operating costs, the major benefit of public warehouses to organizations using space, are flexibility in terms of ease in changing the location, size and number of facilities, no fixed costs, economies of scale, and value-added service.

A comparison of private and public warehouses is clearly discussed in Table 15.1:

Table 15.1: **Public vs. Private Warehouses**

Operating Costs Factor	Public Warehouses	Private Warehouses
Operating costs factor	Higher due to inclusion of profit selling, and advertising costs,	10 to 25 per cent lower, if in sufficient volume.
Initial investment	None	Large facility, startup, equipment, rained personnel.
Control	Good due to incentive to perform on short-term contract	Direct responsibility over personnel and procedures.
Risk	Minimal	Risk of obsolescence due to change in technology or demand.
Tax advantages	Free-port states, tax-less real estate, no property advantage.	Depreciation allowance
Economies of scale	Possible due to serving many customers.	Dependent on company's volume.
Consolidation of shipments	Can consolidate to a warehouse and from the warehouse to the customer.	None
Storage and handling costs	Know exact charges for decision-making.	Generally only estimated

On the Basis of Services: It can be categorized into following:

- **Bonded Warehouses:** It is licensed and authorized by the custom authorities for storing goods till import duty due on it is paid or owned either by the government or private parties.
- **Field Warehouses:** These warehouses are managed by a public warehousing agency in the premises of a factory of the organization which needs the facility for borrowing money from a bank against the certification of goods in storage or in process by an independent professional warehouseman.
- **Cold Storage:** It is another type of warehouse which provides facility to preserve the perishability of goods against payment of a storage charge for the space utilized by different parties.

- **Distribution Warehouses:** These warehouses are generally located nearer to the market owned or leased by the manufacturers to stock their final products for immediate supply to the market. These distribution warehouses are also called distribution centers.
- **Buffer Storage Warehouses:** These warehouses are built at strategic locations with adequate transport and communication facilities and the goods are stored in bulk quantities and further transmitted to distribution warehouses.
- **Export and Import Warehouses:** These warehouses are located near the ports from where international trade is undertaken. They provide transit storage facilities for goods awaiting onward movements.

15.3.3.2. Functions of Warehouses: The functions of warehouses are to provide cost-effective storage, in suitable conditions, for the organization's products and materials. The existence of a warehouse is justified by the extent to which it contributes to the efficiency and effectiveness of physical distribution functions. The contribution of warehousing in the achievement of physical distribution objectives can be assessed in two heads, namely;

- **Economic Functions:** This category of functions is directly related to the physical distribution costs, i.e. tradeoff between various elements of distribution costs. For instance, generally, the addition of one more distribution warehouse results into an increase in the warehousing and inventory costs but there may be a decrease in the overall cost due to reduction in the transportation costs and increase in the customer service level, resulting into an increase in the volume of sales. In such cases, such a step will be justifiable. The economic functions of warehousing are as follow:
  - **Consolidation:** In this function, a warehouse receives and consolidates materials or goods from different production plants and then dispatches the same to a particular customer on a single transportation shipment.
  - **Break-Bulk:** This function refers to the transshipment of goods from the production plant in bulk quantity by low rate volume shipment to the distribution warehouse and then reshipment in small quantities to different customers.
  - **Stockpiling:** The next economic function of warehousing is the seasonal storage of goods to select businesses. For instance, agricultural products are produced at a specific time but consumed throughout the year or woolen garments are manufactured in summer and stocked to meet the demand of winter**.**
  - **Value-Added Services:** Certain value-added services are also provided by the warehouses, such as packaging and labeling. In some cases, basic products are produced and shipped to warehouses and finally distributed to different customers in different packages and labels.
- **Operational Functions:** Operational functions include:
  - Receiving of goods.
  - Up-to-date recording of goods showing stock position

- Storing of goods at an appropriate place and in the minimum area.
- Protecting and preserving the physical attributes of the products.
- Proper handling of goods, especially loading and unloading.
- Order receiving, processing, and filing.
- Dispatching of goods.
- Preparation of documents pertaining to transactions, records, and advices.
- Other legal functions related to trade

Warehouse operates as an integral element of physical distribution management. Key decisions for setting up such facilities must be determined by the overall physical distribution strategies for service and cost. In any such strategic system design, a warehouse would fit if it can render either service or cost advantages. The appropriate number and geographic sites of warehouses are determined by the number of customers, manufacturing locations, and product requirements. Warehouses represent one part of a firm's overall effort to gain time and place utility. From a policy viewpoint, a warehouse should be established in a physical distribution system only when the sales and marketing impact increased or the total cost is reduced.

Warehouse managers have a number of important challenges including:

- ✓ determining the most appropriate unit load(s)
- ✓ optimizing space utilization
- ✓ reducing the movement of labor, equipment and products/materials to a minimum
- ✓ establish a safe, secure warehouse environment and
- ✓ keeping costs to a minimum.

15.3.4. Materials Handling

Material handling system has experienced the major changes and improvement during past few years. It represents all those activities which are responsible for the efficient movement of products within the factory, warehouses and transportation company terminals. In the past the activity was mainly associated with man power but at present, it is a mechanized activity for which improved conveyor systems and forklift equipments are used. The concept of containerization is equally responsible for the improvement in the physical distribution system. The improvement in the process of physical distribution has also resulted in the reduction of material handling costs and time, and effectiveness of transportation and storage. At the same time, it contributes to customer service standards by expending the process of order cycle and its shipment.

In any distribution system within the supply chain framework, materials handling would inevitably manual or mechanical) take inputs in the form of products from vendors (internal or external) and move diem for conversion into outputs tailored to the needs of the customer (internal/external). Thus, material handling is a very basic and internal component of any physical distribution system for the movement of goods. Generally, finished goods are often packed in consumer sized boxes, bottles or cans, which are handled either manually or by some small mechanical handling devices. Whereas, raw materials or industrial products are often moved in bulk quantities and are loosely packed or unpacked, and handled by more advanced and big mechanical devices, such as pumps, conveyer belts, cranes, etc.

15.3.4.1 Objectives of Materials Handling: The major objectives of materials handling are:

- ✓ Reduction in wastage of machine and order picking times;
- ✓ Reduction in overall replenishment cycle time by quick marshalling and movement of goods;
- ✓ Uninterrupted production and distribution schedules for avoidance of movement bottlenecks, such as loading and unloading problems;
- ✓ Protection of goods from breakages or damages during movements;
- ✓ Offering safety to workers and provide safer working conditions;
- ✓ Ensure better customer service and satisfaction; and
- ✓ Enhance productivity and efficiency by reducing handling cost.

15.3.4.2. Principles of Material Handling: In order to achieve the above-stated objectives, material handling system follows certain principles. Materials handling is a branch of engineering and deals with the movement of the material between two or more different points. Most material handling systems are designed and tested through rigorous engineering analysis. The College Industry Council on Materials Handling Education has developed and refined a list of twenty-four materials handling principles (MHED, 1993-94), which are listed below:

- ➢ The **orientation principle** requires that one should look at the entire system first, to learn how and why it operates. One should also look at the relationships with other systems and also to physical limitations.
- ➢ What the system is expected to do? The **requirement principle** focuses on answering this question.
- ➢ All storage and handling operations must be coordinated, and that is known as the **integrated system principle**.
- ➢ The **standardization principle** stands for what the name suggests. It is important in the selection of packaging that is to be used. Other things being equal, it is advantageous to standardize as small a number of packages or wraps as possible.
- ➢ The **just-in-time principle** holds that products are not moved until needed.
- ➢ The **unit-load principle** conflicts with the just-in-time principle in that it emphasizes the importance of handling materials in large blocks, such as the unit loads mentioned earlier in the chapter.
- ➢ Systems should be set up so that loads move for the shortest distances; this is the **minimum travel principle**.
- ➢ The **space utilization principle** requires one to make good use of space. Some materials handling equipment is designed to fit into otherwise underutilized space. Ergonomics involves an understanding of how the human body functions as it performs physical tasks.
- ➢ The **ergonomic principle** is used to justify manufacturing and materials handling systems that protect workers from performing difficult and repetitive functions that ultimately result in injuries or disability.
- ➢ The **energy principle** aims at reducing energy consumption by the materials handling activities.

- The **ecology principle** calls on devising systems that are environmentally friendly, with an example being the choice of materials to use in packaging.
- Using machines, where it is justified to replace human effort is called the **mechanization principle.**
- The **automation principle** involves the development of equipment that is pre-programmed, or self- controlled.
- The **flexibility principle** is important for those systems where there are changes from time to time in the tasks that the system is expected to perform.
- The **simplification principle** means what it says: Avoid overly complicated systems.
- The **gravity principle** is easy to understand; one should rely on gravity to move materials wherever possible.
- The **safety principle** emphasizes the importance of having equipment that is safe to operate and to be heard.
- The **computerization principle** recognizes the widespread use of computers to operate both individual pieces of equipment and massive supply chains spread across several continents.
- The **systems flow principle** calls for an orderly and logical flow of materials.
- The **layout principle** requires that the system be laid out in a manner that takes all these listed principles into account.
- The **cost principle** recognizes that all material handling alternatives have associated costs and that these costs must be carefully considered as the system is devised.
- Once in operation, a system must be maintained. This is recognized by the **maintenance principle**, which includes taking various maintenance alternatives into account.
- The **obsolescence principle** recognizes that this equipment must be phased out, taking into account its usefulness, as well as tax and accounting considerations.
- The **team solution principle** means that material handling challenges are sufficiently large and complex and teams of people are often required to devise the best system.

A wide variety of materials handling equipments are used by different industrial sectors, depending on their needs and requirements.

15.3.5. Protective Packaging

Packaging refers to a container in which the product reaches the consumers. It is part of augmented product. Packaging has two components namely:

- The technical aspect of packaging is concerned with protection of the product from moisture, heat, scratches, and mechanical shocks and so on.
- The promotional aspect of packaging is concerned with creating sales appeal through packaging.

Packaging of any product needs to follow two basic principles as –

- There should be no compromise on the protective capacity of the packaging and
- It is good to save on packaging costs but it should not result in any possible loss of sale, profit and goodwill due to rejection by the buyer.

15.3.5.1. Functions of Packaging: The various functions of packaging are as follows:

- It holds the product for the total duration of the transport and distribution chain.
- It protects the product from getting broken or being otherwise spoilt.
- It makes the transport and handling of the product as easy as possible.
- It informs various peoples in the transport and distribution chain about the identity, destination of the product and how it should be handled, stored, recycled or disposed off.
- It is also required in packaging that it needs to take into consideration the economic factors.

It should be understood that primary packaging of the product performs the function of the silent sales man.

There are various types of materials available for packaging of the goods. These materials are paper, plastic, wood, cardboard etc. the selection of packaging materials would depend upon the following factors:

- Product characteristics
- Transportation and storage methods
- Climate and culture
- Standards and environmental considerations.

There is growing awareness among the consumers in the developed markets of the world to protect their environment from the ill effects of the pollution. Appreciating this concern of the consumers regarding environment, even the manufacturers have begun to find ways and means to satisfy them. For example, the manufacturers in Germany have set up a Dual system under which the manufacturers contribute towards the funding of a system for recycling of the packaging waste materials. Thus, the manufacturers who contribute to this system permit their customers to return the packaging material to them for recycling.

15.3.6. Transportation

Transportation refers to the movement of goods from one location to another. In other words, raw materials can be transported from suppliers to the production facilities and finished goods from there to the consumers. Transportation plays a significant role in physical distribution processes because products are rarely produced and consumed in the same location. The very mission of physical distribution management is to make available the right quantity of the right quality goods at the right time and place at least costs. This can be achieved by proper planning of movement of goods and appropriate use of transportation resources. Transportation usually represents the greatest distribution cost. It is usually easy to calculate because it can be related directly to weight or numbers of units. Costs must be carefully controlled through the mode of transport selected amongst alternatives, and these must be constantly reviewed. The patterns of retailing that have developed, and the pressure caused by low stock holding and short lead times, have made road transport indispensable. When the volume of goods being transported reaches a certain level some organizations purchase their own vehicles, rather than use the services of haulage contractors. Hence, any effort to cut down the distribution costs needs efficient and effective utilization of transportation facilities and its trade-off with other physical distribution components. Being an integral part of total logistics and supply chain system in India, railways and roadways carry about entire domestic freight cargo, whereas seaways and airways for international freight cargo. In the corporate world, different movement functions have different transport needs.

A critical issue in the management of physical distribution activities is whether the organization should own transport facilities or hire them. There are three types of carriers which an organization might choose between when deciding how to ship its product; private carriers, common carriers and contract carriers. Where an organization owns and operates its own transport fleet it is termed a private carrier. This fleet is not usually available to any party other than the owner. Common carriers are available to any party wishing to transport goods. Common carriers charge standard rates which are published and freely available to anyone who is interested. A contract carrier serves individual shippers on a medium to long-term basis. The contract usually extends over a specified period with an option to renew the contract.

15.3.6.1. Modes of Transportation: Various modes of transport are used by organizations for specific purpose movement of various types of goods. The basic modes of transport are discussed below:

Airways: Air transportation is the most expensive mode of transportation and is therefore mostly used for goods of high unit value, perishable goods and emergency shipments to fill important orders that could not be filled out of inventory. This mode of transport is the newest and least preferred mode, especially for domestic purposes. One of the significant advantages of the air transportation lies in the speed. That is why it is a most preferred mode of transport for perishable goods like flowers or for emergency services like supply of a spare part during the breakdown of a machine. However, the freight of this mode is highest in comparison with other modes.

Waterways: Water transport has been broadly divided into two types. They are inland water transport and water transport. Water transport is very old. It is the cheapest mode of transportation. Rail and road transports require special tracks and surfaces before they can be used. A large amount of money is needed in their operation. But canals, rivers and oceans have their natural. So, Surface they are very cheap. Water transport has considerably developed internal and external trade of the country. Due to globalization of the world market, waterways have a large potential for foreign trade. Throughout the world, this mode has acquired a very high position due to its advantages like being the cheapest, having a larger capacity and flexibility. However, the greatest drawback of it lies in terms of slow speed.

Roadways: Road infrastructure is large consumers of space with the lowest level of physical constraints among transportation modes. However, physiographical constraints are significant in road construction with substantial additional costs to overcome features such as rivers or rugged terrain. Road transportation has an average operational flexibility as vehicles can serve several purposes but are rarely able to move outside roads. Most of the physical distribution operations of corporate enterprises largely depend on this mode of transport. It is mainly due to its moderate contribution in between two extremes of airways and seaways as far as speed and cost are concern. It ensures flexibility in service for better customer responsiveness. The reliability and economy of this mode is gradually increasing due to continuous improvement in the quality of motor vehicles and the condition of roads. These factors facilitate in the achievement of distribution objectives like lower transit time, lower total logistical costs and improved customer service.

Railways: They are the main carriers of goods. They are specially suited for handling heavy bulky items, over long distances at low costs. Grain, coal, wool, stones, sand, etc are transported by railroads at a relatively low cost. When lead-time is a less critical element of marketing effort, or when lowering transport costs is a major objective, this mode of transport becomes viable. Similarly, when goods are hazardous or bulky in relation to value, and produced in large volumes then rail transport is advantageous. Rail transport is also suitable for light goods that require speedy delivery (e.g. letter and parcel post).

Pipelines: This mode of transport is a very significant one but with a very restricted scope. Pipeline is used primarily for the shipment of liquid and gas like crude petroleum, and refined and natural gas. The basic nature of this mode of transport is unique in comparison to all other modes. It includes a significant initial fixed cost in setting up the pipeline and related infrastructure, lowest variable cost, 80 to 90 per cent optimization of pipeline capacity utilization, 24-hour operation, and not being labor intensive. However, pipelines are not flexible and this scope is limited with respect to commodities.

Multimodal Transportation: As we know, every mode of transport has its own strengths and limitations in absolute as well as relative terms. That is why, after realizing their limited strengths and emerging challenges, various modes of transport have started cooperating with each other to pool their resources and facilities so as to have a win-win situation to all while meeting the service expectation of their customers. Multi-modal transportation is defined as the carriage of goods by at least two different modes of transport. In multi-modal transport, one transport document, and one rate and through- liability are used. The ultimate aim of multi-models is to make the movement of goods from seller to buyer more efficient through faster transit at reduced costs. Some of the commonly known multi-mode transport options are:

- **Piggyback:** Piggyback is the best known and most widely used inter-modal transportation system, which is an outcome of the coordination between railways and roadways.
- **Fishyback:** The inter-modal transportation system is achieved by coordination of road and water modes of transport. In other words, in fishyback service, the goods containing boxes are loaded on the trailor which will be further loaded on a ship.
- **Trans-Ship:** Trans-ship refers to an inter-modal transportation system which is the combination of coordination efforts of railways and waterways for the "bulk movement of freight cargo.

- **Airtruck:** As the name itself says, this inter-modal transportation system is the outcome of the coordination between airways and roadways.

In nut shell, the chosen transportation mode should adequately protect goods from damage in transit (a factor just mentioned makes air freight popular over longer routes as less packaging is needed than for long sea voyages). Not only do damaged goods erode profits, but frequent claims increase insurance premiums and inconvenience customers, endangering future business.

15.3.6.2. Selection of Transportation Mode: For the selection of the appropriate transportation mode to move goods from one place to another, it is always necessary to have a comprehensive approach incorporating various factors. A distribution manager is required to take in consideration the following factors while selecting a transportation mode:

- ✓ The strengths and weaknesses of the organization in terms of marketing, financial and production resources.
- ✓ The prevailing market characteristics, including the competitive scenario, geographical and territorial structure.
- ✓ Braved equity of organization's products in the eyes of customers to bear with a stock-out situation.
- ✓ Product features and suitability to various modes of transportation such as weight, size, shape, etc.
- ✓ Quantity to be transported each time.
- ✓ Distance to be covered.
- ✓ Total transportation cost of various modes of transportation.
- ✓ Carrier performance in terms of speed, availability, flexibility, frequency, reliability, safety, versatability, claim settlement procedure, and logistical service capabilities

15.3.6.3. Transportation Networks: Movement of goods from the point of production to the point of consumption is done through various modes of transportation. Depending on transportation load, number of delivery points, existing distribution centers, product value, frequency of delivery, urgency and the cost economies, different types of networks are used, such as:

- **Point – to – point Network:** It is quite common for long distance hauls on the national highways. The point of origin and destination are fixed. Complete truck loading is assured for both ways.

- **Multiple Delivery Points:** It is used for round trip operations with multiple pickup and delivery points. For example, the delivery of filled bottles and pickup of empty bottles of soft drinks at multiple points on the fixed route is quite common.

- **Trans Shipment Point:** These are two local area networks having a common point where loading and unloading takes place for freight consolidation or break bulk. Most of the national transporters maintain two types of fleet that is vehicle dedicated for national long distance haulage and other ones for catering to local networks. The consignment from long distance fleet is trans-shipped to local vehicles for distribution across the local area.

- **Nodal Network:** These networks are used for multi-modal transportation system and include multi-stops and trans-shipment pickups and delivery stations. For example, a box container truck may have predetermined multi-point pickup stations for freight consolidation on its way to rail terminal from where the box container may be taken to port terminal for loading on the ships.

- **Hub and Spoke System:** This arrangement is like hub and spoke of the wheel. The hub acts like a central feeder point to the distribution centers, which are the strategic locations spread across the geographical area. The high volume and high speed shipment take place from hub to distribution centers through the predetermined short routes called spokes. The trans-shipment of the consignment is done at distribution centers for distribution across the local area.

Case: Transportation at Tata Steel : Tata steel has 28 stockyards across the country for stocking the steel products. Due to high distribution cost, they have decided to close down stockyards and introduce the hub and spoke distribution system in 2002. The hubs are located at five places at Jamshedpur, Sank rail, Vijayawada, Nagpur and Delhi. Theses hubs have direct rail connections to Jamshedpur plant. The location of hubs is planned to stock generic material to serve large number of customers. Tata steel provides 20-30 acres land and the material handling equipment for each of the hubs. However, day-to-day operations are left to private vendors.

15.4 Physical Distribution Cost

The level of customer service provided by an organization is part of the marketing mix. In some instances, an organization offers an exceptionally high level of customer service as the principal means of differentiating itself from competitors. There are aspects of customer service which have little to do with physical distribution, such as the after-sales service, warranties and the handling of customer complaints, but a large part of customer service is affected through the physical distribution function. A wide range of criteria may be used in evaluating the service level offered by an organization is listed as:

- ✓ timeliness of delivery
- ✓ order size and assortment constraints
- ✓ order cycle time, i.e. time interval between order placement and delivery
- ✓ percentage of items out of stock
- ✓ percentage of times an item cannot be supplied from stock (or within a prescribed number of days from order placement)
- ✓ percentage of orders filled accurately
- ✓ percentage of orders arriving in good condition,
- ✓ ease and flexibility of order placemen, and
- ✓ competitors' service levels.

Maintaining high levels of customer service carries heavy costs and can only be justified when doing so results in marketing opportunities which otherwise would not be realized. At the same time, the distribution manager must monitor the effects of operating a given level of customer service on profitability. As the customer service level gets nearer to 100 percent, the costs of doing so rise sharply as reflected in Graph 1.

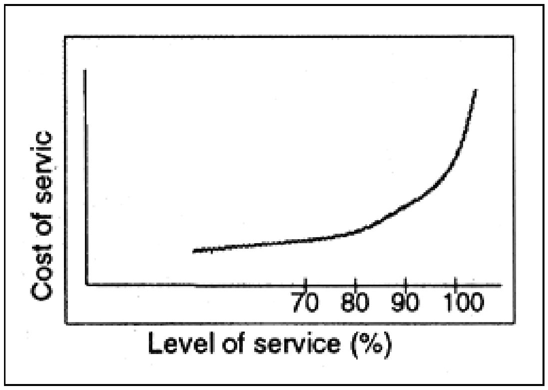


Figure 15.1: The relationship between customer service level and cost

The total distribution concept and the total cost approach are widely applied by managers of physical distribution. They are based on the notion that all elements of physical distribution are so interdependent that a decision made about one element will impact on some or all of the others. Thus, for example, the decision to reduce the number of depots operated by an organization may well reduce costs associated with staffing, wastage and inventory levels but will also increase transportation costs. The real question is whether the savings in one area match, exceed or fall short of the increased costs in another.

Since, in general, physical distribution managers appreciate that their challenge is to minimize the total costs of the distribution system, rather than the costs of a particular element, they tend to employ the total cost concept. To this end, management must calculate the trade-offs between three categories of cost: transportation costs, order processing costs and stockholding costs. Graph 2 shows the general relationship between these different categories of cost.

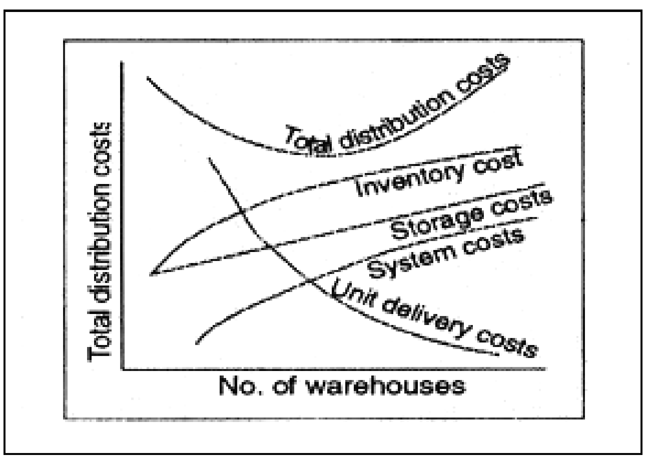


Figure 15. 2: The components of the total costs attached to physical distribution

- **Storage costs:** Because of economies of scale a large warehouse can be operated at a lower cost than can several smaller warehouses. These economies include the fact that larger warehouses are often better able to achieve better utilization of space and equipment, overheads incurred in a large warehouse can be spread over a higher throughput of stock items and the amount of money tied up in stock tends to be less for a large depot than for several smaller warehouses. In addition, each separate site will require its own management team and this increases distribution costs further. At some point, however, diseconomies of scale set in and the single central warehouse becomes less attractive in financial terms. This happens, for instance, when depots reach a size where they are difficult to manage and the distances between the warehouse and many of the organization's customers is so great that transport costs rise to unacceptable levels and the level of service to the customer is adversely affected.

- **Transportation costs:** The increase in storage costs may be offset, either in whole or in part, by savings made in transportation costs. As the number of warehouses increases, unit transport costs decline due to lower mileages being traveled by delivery vehicles. Distribution is usually a sizeable component of total distribution costs. Moreover, the costs of procuring and operating transportation are generally high, sometimes prohibitive as this is often a very scarce resource. It follows that if transport facilities can be managed efficiently this can have a dramatic effect upon total distribution costs. In turn, the efficiency and effectiveness achieved with the transport operations of an organization are greatly influenced by the routing and scheduling of the vehicles available. Figure 1 depicts the composition of total transport costs.

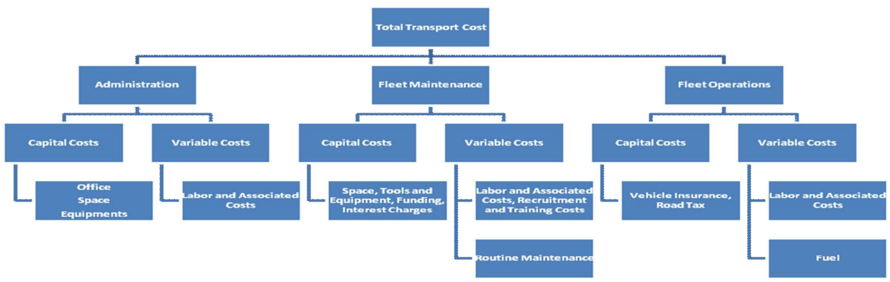


Figure 15.3: The Composition of Total Transport Cost

- **Inventory carrying costs**: The cost of maintaining sufficient stocks to meet any level of demand is usually prohibitive. Instead, the organization seeks to reach a balance between inventory carrying costs and an acceptable level of customer service. Among the chief determinants of inventory carrying costs are:
  - the greater the number of locations at which stock is held, the greater the level of stocks and carrying costs.
  - longer order cycles result in higher stocks, and vice versa and
  - as the product portfolio increases so does the amount invested in stocks With respect to the effect of increasing the number of warehouses located in various areas, this would be, as was said earlier, to increase stock holding costs.
- **System Costs:** The last category of the costs is those termed system costs. These include costs attached to order processing activities, the maintenance of information systems and communications between sites.

15.5 Summary

Discussion of physical distribution management usually takes place from the viewpoint of the supplier. Understanding of physical distribution is, however, just as important to the purchaser. In addition to understanding the distribution tasks that face the supplier, the purchasing department must also appreciate logistical techniques for inventory control and the order cycle. There is consequently a close link between physical distribution management and purchasing. Work study-techniques and operations management can also be linked with physical distribution management because management is concerned with efficiency and accuracy throughout the distributive function. As a function of the marketing mix, physical distribution is linked to all other marketing sub-functions and is an important element that plays a large part in achieving the goal of customer satisfaction. Total distribution costs are very much influenced by procurement costs, inventory carrying costs, and transportation costs. Similarly, inventories are a major cost element in the management of physical distribution and as such must be carefully controlled. Organizations are required to find the economic balance between order processing costs and stockholding costs. At the same time, they need to consider order cycles, fluctuations in demand and the size of the safety stock required. In transport management the key issues relate to the efficient and effective scheduling and routing of vehicles. Each of these is aimed at reducing the time and cost of delivery and the improvement of customer service levels.

Organization needs to understand the interrelationships between these categories of cost and to develop an understanding of the trade-offs that must be made between them. There are a number of current developments in the field of distribution management which are likely to have a major impact on the way in which this function is managed in the future. These developments include: the drive by retailers to account for direct product profitability, the move towards just-in-time materials and product supply and the evolving methodology of materials requirement planning.

15.6 Self Assessment Questions

1. Discuss the utility of physical distribution from marketing as well as operational prospective.
2. Describe the various warehousing options available, with their merits and demerits.
3. Elucidate the importance of material handling guidelines with proper examples.
4. Discuss the role of inventory in the physical distribution management.
5. Critically examine the various techniques of inventory control.
6. What are the different modes of transportation? Discuss their pros and cons.
7. How transport cost get affected by different activities of physical distribution? Explain with proper examples.
8. What do you understand by total cost of distribution? How organizations can manage the same to achieve the objectives of physical distribution?

15.7 Reference Books

- Agrawal D.K., 'Supply Chain Management', Macmillan India Ltd., 2010, New Delhi.
- Ballou H. R., and S.K. Srivastava, 'Business Logistics / Supply Chain Management', Pearson Education, 5th edition, 2009, New Delhi.
- Bowersox, D.J., E.W. Smykap, and B.J. La Londe, 'Physical Distribution Management', The MacMillan Company. 1968, pp. 27–28.
- Coyle J. J., C. J. Langley, B.J. Gibson, R.A. Novack, and E.J. Bardi, 'A Logistical Approach to Supply Chain Management', Cengage Learning India Private Limited, 2009, New Delhi.
- Gaedeke, R.M., 'Marketing Principles and Applications', West Publishing Company, 1983, Minnesota.
- Raghuram G. and N. Rangaraj, 'Logisticas and Supply Chain Management', Macmillan India Ltd., 2005, New Delhi.
- Sople V.V., 'Logistics Management', Pearson Education Ltd., 2nd Edition, 2010, New Delhi.

UNIT – 16: Order Processing

Structure of Unit

16.0 Objectives

After completing this unit, you would be able to:

- Understand the meaning of order processing;
- Realize the importance and utility of order processing function in an organization;
- Know about various activities under order processing;
- Comprehend about various cost elements of order processing;
- Appreciate the significance of various ICT tools and techniques in order processing;
- Know the mechanism of order processing under e-commerce.

16.1 Introduction

A very famous saying that now-a-days, organization cannot win market by their product's price and quality; the winning formula for organization is to serve market with speed and ensure availability. That is why; efficient and rapid order fulfillment allows an organization not only to substantially cut down its total logistical costs but also to distinguish itself among its competitors. It is a key to customer service and satisfaction capability of the firm. Elements such as fixed and small order cycle time, meeting promised delivery dates, accuracy in filling orders, advance notice of shipping delays and schedules, quick action on complaints and wrong assortments, all are rated as more important than product quality, product features, or price factors. Furthermore, a late or inaccurate product delivery can cost a customer more than the actual product cost.

In the era of information technology, firms are investing heavily in new communication technologies such as electronic data interchange (EDI), bar coding, radio frequency, internet, intranet and extranet, etc., for proper and speedier order handling and processing systems to save the customers' time, money and inconvenience in getting orders processed. These new technologies enable customers to hook up their computer to the supplier's computer to exchange ordering, invoicing and other information.

16.2 What is Order Processing?

Order processing is the term used to identify the collective tasks associated with fulfilling an order for goods or services placed by a customer. The processing procedure begins with the acceptance of the order from the customer and considered complete when the customer has received the products and determined that order has been delivered accurately and completely. Organization often invest a great deal of time and effort in designing an efficient order processing strategy, thus increasing the possibility of establishing a long-term working relationship with its customers.

The actual approach to order processing will vary, depending on the complexity of the order and the type of products that are being ordered. In some cases, order processing can be almost instantaneous. For example, if a buyer places an order for a software download or an e-book, the order processing usually involves nothing more than the buyer rendering payment for the product, the seller registering the sale and accepting the payment and the immediate delivery of the e-book or software by means of a download. When physical goods are involved in order processing, a more complex approach is commonly employed. Customers may place orders by submitting a written request, by phone, or by using online order forms that are routed directly to the seller. Each order is then routed through a distribution center, where the type and quantity of items requested by the customer are collected and prepared for shipping. In order to facilitate this process, big organizations often operate multiple distribution centers that are strategically located, allowing for the shipment to be delivered to the customer as soon as possible.

In fact, a customer order is the message that sets the supply chain process in motion. As already mentioned, it starts with the receiving of customer order and ends with the final delivery of goods along with transfer of title. Johnson and Wood defined order processing as means how a firm handles incoming orders. More specifically, order processing is the activities that take place in the period between the time a firm receives an order and the time a warehouse is notified to ship the goods to fill that order.

In other words, order processing is a set of activities for receiving, recording, assembling of products for dispatch to fill the customer order. Order processing involves several activities, which consume time and known as order cycle. Order cycle is a related term having several meanings, depending upon one's perspective. Time consumed during the receipt of customer order and delivery as per the requirement to customer is considered as order cycle from seller’s point of view. As concern to buyer’s perspective, order cycle is time lapsed during the order sent and goods received. Hence, an order cycle time is the total time consumed in order preparation and its transmittal, order receipt, order entry, order processing, warehouse picking and packing, preparation of invoices and shipping documents, transportation and finally delivery and unloading of goods at the customer's end. If consider the perspective of logistics and supply chain customer's order cycle is determined not only by the speed of the physical movement of goods but also by the speed and efficiency of information and money flows along with their processing in the supply chain.

In a very simplified manner, the order processing is depicted in figure 16.1. It starts with the preparation of sales order by the buyer, which actually is customer's request for product and service. This sales order is transferred at seller's point through various possible mechanisms. Seller enters the buyer's order in formal and accurate manner while checking the position of stock, backorders, credit positions and billing details. In next step of order processing, order is executed by the buyer by filling the order through execution of several activities such as – product arrangement through production or purchase, packing of product for transportation, scheduling the delivery and preparation of shipping documents. After the dispatch of the ordered product, the last step of order processing is order status reporting through tracing and tracking the order for effective delivery to customer and having feedback from customers to know the status the order execution.

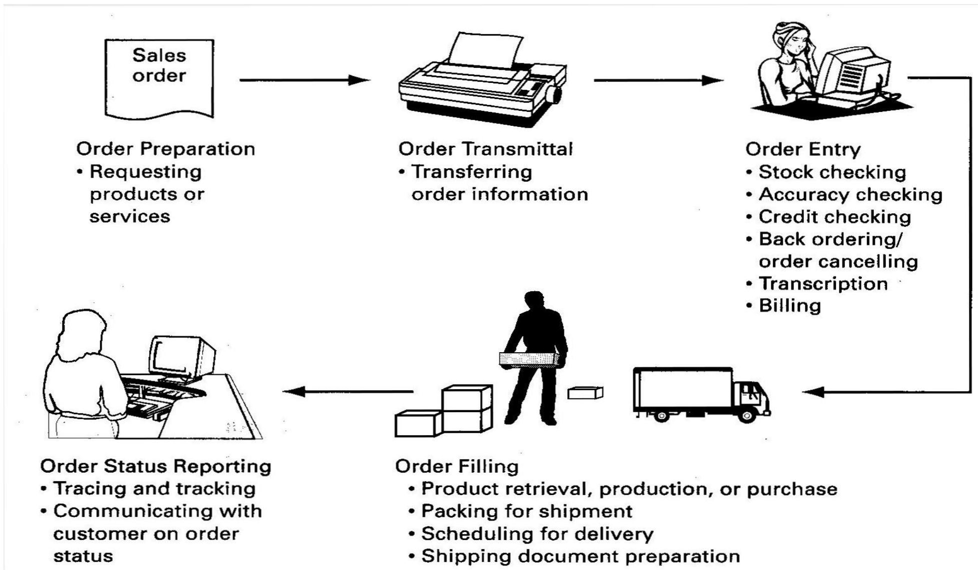


Figure 16.1: Order Processing in Simplified Manner

16.2.1 Characteristics of Order Processing

Goods are constantly transported from one place to another throughout the world. And it takes a well-established process to do this with consistent reliability. Customer satisfaction is hugely affected by the organization's capability in order processing. No amount of customer relation can replace poor order fulfillment and unmet customer expectations. That is why; order processing is the key to the customer service and satisfaction. According to Agrawal (2010) order processing system needs to have following characteristics such as:

- responsiveness or speed in order-handling and fulfillment;
- lowest possible delivered costs for products or service; and
- Minimal wastage in the system (such as inventory holding in various locations, which ties up scarce working capital).

Further, order processing system desired characteristics routinely targeted for:

- continuous improvement of the system (to handle demand under a variety of conditions);
- proficiency (to guarantee right-the-first-time shipping or invoicing); and
- Efficiency related to minimizing the handling of paperwork or products.

Efficient and accurate order processing is essential to the success of any type of organization. A truly efficient order processing system will require that orders must be verified with customers to ensure there are no questions about what the customer wants. Once the order is verified, the items needed to fill the order accurately must be collected in a timely fashion. After collecting the necessary products, they must be packaged securely and delivered to the customer within the time frame promised. Failure to efficiently manage any of these tasks increases the chances of disappointing the customer, and thus losing any possibility of repeat business. Once the order is received, the customer completes the order processing by inspecting the items that are delivered. If the items are in fact what the customer ordered, and are not damaged in any way, then the order processing cycle is considered complete. If the received items be incorrect, or are damaged in any way, then the processing is not considered complete until the issues are resolved by the seller.

16.2.2 Importance of order processing

Now-a-days, organizations recognize that they must deliver outstanding customer service in order to acquire new customers and retain existing ones. The ability to process and ship orders accurately and on time and to provide quick feedback to customer about the status of their order, is considered as the core of any organization's strategy. The fierce competition at market place is forcing organizations to adopt those managerial tools and techniques that will be able to bring maximum customer value and satisfaction so that their happiness and loyalty can be preserved for the long-run at minimum cost. Researches shows that in the eyes of customers, product quality and features, and price factors are less important than elements like meeting committed delivery date, intact delivery, correct documentation, accuracy in filling orders, information regarding order status, advance notice of shipping delays, etc. Furthermore, a late or inaccurate product delivery can cost a customer more than the actual product cost. That is why; service quality defect costs often exceed product quality defect costs. Almost all of the above customer expectations from organizations are basically coming under the facet of order processing functions. The importance of order processing can be understood in terms of following parameters such as:

- Achievement of Desired Customer Service Level - the objective of organization under order processing is to render the best possible customer service in a cost-efficient manner by making available the product in desired quantity, quality and time. Hence, to achieve the required level of customer service standard, it is essential to have a proper and well-defined order processing system. This order processing system is by and large guided by the front-end partners of the supply chain such as retailers, wholesalers etc. Over the period of time, there has been a clear shift of power away from manufacturers to the resellers.
- Legal Importance - From the legal point-of-view, when finished products move from the production plant to customers, it is essential that there should be transfer of title from seller to buyer. This particular activity is performed by the order processing function of the firm by raising invoice or bill in the name of the customer, which transfers the title to the customer. In addition to raising the invoice, there are other legal documents, which are required to be prepared, such as shipping advices, road permits, challans, packing slips, documents related to payment of taxes and duties. Hence, order management

has a very significant role in fulfilling the legal requirements in the process of transaction between the organization and the customer.

- Reduction of Order Cycle Time - Supply chain management enable firms to ensure a smoother and faster flow of material and related information from the point of inception to the point of consumption. It also advocates that fixed, shorter and reliable order cycle time or replenishment cycle time will ensure better working capital management and customer service management. Any reduction in order cycle time reflect on the organization’s capability to streamline the total system and elimination of unnecessary administrative procedures in the total order processing system.
- Point-to-Point Information - One of the major importance of order management in recent times is sharing of point-to-point information, which is considered as crucial market intelligence. Today, a firm's ability to provide accurate and timely information to customers regarding the status of order, availability of inventory, tentative shipping and dispatch schedules, back-order status, etc., are more significant. With the development of ICT tools and techniques, customers’ expectations are ever increasing and they are becoming more and more aggressive for fulfillment of their desired service level for order processing. Hence, order management enables organizations to have point-to-point information sharing with their customers.

16.3 Functions of Order Processing

Customer order processing involves several functions, which need to be performed by various partners of the supply chain at different point of time. Agrawal (2010) highlighted the major functions of order processing as entry and maintenance of customer order, inventory allocation and delivery schedule, along with processing of pending back orders. It also includes transfer of title of ordered goods by means of preparation of invoices and shipping documents. Various functions of order processing are further listed as:

- ✓ Order entry;
- ✓ Credit checking;
- ✓ Inventory availability check;
- ✓ Order acknowledgement;
- ✓ Order editing and modification;
- ✓ Order status inquiry;
- ✓ Price and discount extension;
- ✓ Back order processing;
- ✓ Raise invoice;
- ✓ Prepare transportation and shipping advices;
- ✓ Shipping scheduling;
- ✓ Reserve inventory/safety stock and their release;
- ✓ Reassign order source;
- ✓ Verify shipment; and finally
- ✓ Return processing in case of defective delivery.

The functions of organizations’ order processing can also be elaborated more systematically in five crucial stages, namely order preparation, order receipt, order conduct, order execution and order release.

16.3.1 Order Preparation

Order preparation is the first step in order processing of any organization as it is considered as ground work for delivering value to customers. It refers to all those activities, which are basically performed by the customers, in terms of gathering the information needed about the products and services desired and formally showing the purchase intention. It may involve determining an appropriate vendor, filling out an order form, determining stock availability, communicating order information by telephone to a sales clerk, or making selections from a Web site menu. In other words, it refers to designing an efficient order handling system, i.e. it determines how a customer order is received and by whom, what technique should be adopted. Orders are generally placed by customers to visiting sales people of the organization or by telephone, fax, mail order, e-mail, or EDI directly to the dispatching point/controlling office/head office. Nowadays, most of the big organizations prefer to have computer-to-computer order receiving and entry system to speed-up customer response. Technology is eliminating the need to manually fill out order forms. Voice-actuated computers and wireless encoding of product information, called radio frequency and identification system (RFID), are new technologies that will further reduce the time for the order preparation phase of the customer's order cycle. In terms of, possible learning for organization so as to make the first stage of order processing more and more fruitful lies in following dimensions:

- Make sure to provide necessary and accurate information to customers through all possible touch points of customers to organization.
- Design the order processing system in such a manner that it allows easy entry through any of the possible channels to prospective customers.
- Provide all possible facilitation for solving the customers' doubts and queries.
- If possible, organization can also provide the facility of customization to gain competitive advantages, for example, Dell Inc. did the same throughout the world to gain leader's position at the marketplace.

16.3.2 Order Receipt

After order preparation at customer's end, receipt of the order information at seller's end is the next sequentially logical activity of the order-processing cycle. It involves transferring the order request from its point of origin to the place where the order entry can be handled. Order receipt refers to a series of events that occur between the time a customer places an order or sends an order and the time the seller receives the order. In the fierce competitive scenario, the real-time customer responsiveness is fast catching the attention of most of the organizations due to two possible reasons as:

- ✓ unreasonably long order transmittal time serves as crucial bottleneck in the organization's capability to provide better customer service and
- ✓ Flexible and smaller replenishment cycle time becomes the essential requirement for best customer service levels.

Order receipt can be accomplished in two fundamental ways: manually and electronically. Manual receipt of orders can include the mailing of orders or the physical carrying of orders by the sales staff to the point of order entry.

Electronic receipt of orders is now very popular with the wide use of toll- free telephone numbers, data phones, Web sites on the Internet, EDI, facsimile and satellite communications. These new ICT tools and techniques are making it possible to receive the order information almost instantaneously with high degree of reliability and accuracy, increasing security and ever decreasing cost.

The time required to move order information in the order processing system can vary significantly, depending on the methods chosen. Sales personnel collection and drop-off of orders and mail transmission are perhaps the slowest methods. Electronic information transfer in its various forms, such as telephoning, electronic data interchange, and satellite communication, is the fastest. Organizations need to be very careful while evaluating the various options available for order receipt where they need to have trade off among various factors such as speed, reliability and accuracy as performance characteristics against the cost of any equipment and its operation. Some critical factors require attention of the organization at this stage as:

- Receipt of the order needs to be accurate in line with the customer order entry
- Timeliness needs to be maximum between order preparation and order entry
- Order transmission channel needs to be secure to minimize the information distortion.
- Validation of order receipt by the customer is also required to serve the customer in best possible manner.

That is why; organizations are making huge investments in information and communication technologies for speedier transmission of information. Fax, e-mails and even EDI are today, commonly used by organizations. Organizations like Mahindra & Mahindra, etc., allow their dealers to place orders through EDI software system via the internet.

16.3.3 Order Conduct

Order conduct refers to several tasks that take place prior to the actual execution of an order. It includes following activities:

- Checking for completeness and accuracy of the order in terms of item description and number, quantity and price;
- Examining the customer's credit status;
- Checking the availability of the requested items
- Allocation of products by inventory department and advices it to pick the shipment and updates the firm's master inventory file;
- Preparing back-order or cancellation documentation if required
- Recording of transaction by the accounting department in terms of generation of bills / invoice etc.

These activities are necessary because order request information is not always in the form needed for further processing, it may not be represented accurately, or additional preparation work may be needed before the order can be executed.

Order can be conducted manually through completing aforesaid activities or the steps may be fully automated. Order conduct has benefited greatly from ICT tools and techniques. Bar codes, optical scanners and computers have substantially increased the productivity of these activities. Bar coding and scanning are especially important for entering order information accurately, quickly and at low cost. That is why, bar coding is getting popular throughout retailing, manufacturing and service industries.

The method of order collection, restrictions on order size and the timing of order entry affect order cycle time. Order design must be closely coordinated with sales order taking. For example, an order conduct procedure might have sales personnel collecting orders while they check the trade. Order conduct rules may require that the equivalent of a full truckload of order volume be collected by a salesperson before the order is forwarded to an order-processing point. Alternately, the procedures might be adjusted where the customer fills out a standard order form that is required to be mailed by a certain date in order to guarantee that the order will be delivered by a specified date. Further, a restriction might be imposed that only minimum order sizes will be accepted, which would ensure that very high transportation costs would not occur, especially if the supplying firm pays the freight.

Furthermore, working within the supply chain concept, buyers often specify when they want the goods (time span within which an order must arrive). In such situations, the seller must put in his best efforts to meet the customer requirement and know when to place the order into the queue of orders being handled so that it leaves at the needed time. Some critical factors need attention by the organization as:

- ✓ Proper checking of the order for validity before serving the items. Details such as Order Date, Payment Terms, Item, Order Quantity, Unit Price, etc., need to be checked. Checking also includes stock checking, accuracy checking, credit checking, back ordering, order cancelling, transcription and billing.
- ✓ The accounts receivable system is a reference for order conduct since customer credit or payment status is required to clear the order to be served.
- ✓ Customer feedback is also important especially when the order cannot be served as expected by the customer, for whatever reason: product not available, delivery date not feasible, credit or payment impediments, etc. so as to take corrective actions earliest.

16.3.4 Order Execution

Order execution involves giving instruction to a specific warehouse to assemble a given order for a customer. In other words, it is a written document given to a warehouse and its employee indicating the items to be assembled as per the list of the customer order. More specifically, order execution includes following physical activities as:

- ➢ acquire the items through stock retrieval, production or purchasing;
- ➢ pack the items for shipment;
- ➢ schedule the shipment for delivery; and
- ➢ Prepare the shipping documentation.

A number of these activities may take place in parallel with those of order conduct so as to compress the order processing time. Setting order-filling priorities and the associated procedures affect the total order cycle time for individual orders. Too often, firms have not established any formalized rules by which orders are to be entered and dealt with during the initial stages of order capture. Priorities for processing orders may affect the speed with which all orders are processed or the speed with which the more important orders are handled. Some alternative priority rules might be the following:

- First-received, first-processed
- Shortest processing time
- Specified priority number
- Smaller, less-complicated orders first
- Earliest promised delivery date
- Orders having the least time before promised delivery date

Selection of a particular rule depends on such criteria as fairness to all customers, the differentiated importance among orders and the overall speed of processing that can be achieved. The process of order execution, either from available stock or from production, adds to the order cycle time in direct proportion to the time required for order picking, packing, or production. At times the order cycle time is extended by split-order processing or freight consolidation. Split deliveries and a large portion of any additional order information handling time can be avoided by simply holding the order until replenishment stocks for the out-of-stock items are available. This may adversely affect customer service to the point of being unacceptable. Therefore, the decision-making problem is one of trading off the added costs of the increased order information handling and the transportation costs with the benefits of maintaining the desired service level.

The decision to hold orders rather than execute them immediately, for consolidating the order weight into larger but lower per-unit transport cost loads, does require more elaborate order-processing procedures. Increased complexity is a consequence since these procedures must be tied into delivery scheduling to achieve an overall improvement in order processing and delivery efficiency. In this stage organizations need to be critical on following points:

- ✓ Carefully choosing the priority rule for order execution;
- ✓ Conducting trade-off between customer responsiveness and order execution cost;
- ✓ Order aggregation needs careful scrutiny.

16.3.5 Order Release

Order release is final step of order-processing, which ensures that good customer service is provided by keeping the customer informed of any delays in order processing or release of the order. More categorically, it includes

- Tracing and tracking the order throughout the entire order cycle; and
- Communicating with the customer about where the order may be in the order cycle and when it may be delivered.

The order release time is the time from when a carrier picks the shipment until it is delivered to the customer's receiving dock, i.e. transit time. This transit time has a direct and major impact on sellers total order cycle time or customers' replenishment cycle time.

Order Processing in Practice : Dell Computer uses and extends the technology to receive and track an order for a computer from the time of order entry until it is received by the customer. Typical progress stages are order verification and credit checking, time waiting for components, manufacturing, staging for carrier pickup, and routing steps through the delivery process. Customers, knowing their order numbers, can check the order progress throughout the entire order cycle from the organization's Web site, or call a customer service center via a toll-free telephone number.

16.4 Elements of Order Processing Cost

Basically, order processing is an administrative function whose costs are generally incorporated in the office expenditures. For the purpose of calculation of total logistics costs and its trade-off with customer service level, it is essential to locate various elements of order processing costs. It includes employee’s remuneration and benefits who are involved in this function, postage and stamps, stationary, rent, electricity, taxes, office equipments for speedier flow of information and their storage and repairs, etc.

Nevertheless, the costs to fulfill customer orders include order taking and customer service, storing and maintaining inventory, shipping and product tracking to ensure delivery. So, organization needs to understand how it manages and processes orders and the cost involved in the process. It allows organization to create budgets, monitor employees and determine where cuts can be made to simplify the process to save time and money. Some of the prominent heads of order processing cost are discussed below:

- **Customer Service:** Regardless of whether an order is filled by mail, phone or online, customer service representatives play an important role in order fulfillment. Customer service employees verify the order to ensure that all necessary information, such as names, addresses, product numbers and description codes, appears on the order form. Customer service representatives contact customers to verify or obtain missing information. Representatives are also on hand to answer questions customers may have once they receive the products.
- **Warehouse/Inventory:** After receiving an order, the shipping department must locate the item within current inventory. Most manufacturers store inventory in large warehouse spaces. Employees find the item and bring it the shipping area. The cost to maintain warehouse space varies based on size and location. The number of employees needed to manage a warehouse depends on inventory size and order fulfillment demands. Employees may include inventory pickers, packers, managers, quality assurance, maintenance and janitorial staff.
- **Shipping:** Shipping a product involves verifying the order, packing the product to keep it safe during shipping and transporting the product using organization vehicles or by hiring third-party package delivery services. Most products ship securely in various kind of packaging. The cost to ship a product depends on its weight and volume.
- **Product Tracking:** To make tracking a product through the order fulfillment process easier, many organizations rely on product tracking software. Each order receives an individual number used to track it through the customer service, warehouse and shipping processes. Employees use product scanners to input information by scanning bar codes on the product and the order form. Products may be scanned during each process to determine the location of the

product. Some organizations allow customers to track their orders by allowing them to view the process from their own computers.

Furthermore, it has already been said that currently, most of the organizations prefer to have computer-to-computer order receiving and their processing with two objectives:

- ✓ to speed-up customer responsiveness by preventing unnecessary delay in order transmittal; and
- ✓ To cut-down day-to-day order processing cost due to delay transmittal as well as administrative bottleneck.

In this case, major costs come in the development of communication infrastructure. So far as operating cost is concern, it is quite negligible in comparison to development costs.

16.5 Order Processing Systems

Various activities involved in order processing have been identified in generic manner till now in the chapter, but it is essential to understand how order processing works in different kind of organizational systems. An overview of these order processing systems is mentioned in following paragraphs.

16.5.1 Industrial Order Processing through Manual System

A manual order-processing system is one that has a high component of human activity throughout the system. Some aspects of order processing may be automated or handled electronically, but manual activity will represent the largest portion of the order-processing cycle. Consider how a hypothetic manufacturer selling to industrial customers designed its order-processing system.

Suppose organization X produces a full line of custom hose couplings and valves. The organization processes 80 orders per day on the average with order cycle time is 15 to 25 days, which is long enough due to customization. The primary steps in the order-processing cycle, excluding the order execution activity, are the following:

- ✓ Customer requests are entered into the order-processing system in two ways. First, salespeople collect orders from the field and mail or telephone them to organization headquarters. Second, customers take the initiative to mail or telephone their orders directly to headquarters.
- ✓ Upon receipt of telephone orders, a customer service receptionist transcribes the order to an abbreviated order form. Along with the mailed-in orders, the orders accumulated for a given day are passed along to the senior customer service representative, who then tallies the information for the sales manager.
- ✓ The sales manager reviews the order information to keep abreast of the sales activity. He also occasionally writes special notes of instruction on an order about the needs of a particular customer.
- ✓ Next, the orders are sent to the order-preparation clerks, who transcribe the order information, along with special instructions, onto standard organization order form.

- ✓ At this point, the orders are sent to the accounting department for credit checks. They are then forwarded to the sales department for price verification.
- ✓ Next, the data processing department keys the order information into the computer to be used for transmission to the plant, for more convenient handling and for easy tracing of the order once in process.
- ✓ Finally, the senior customer service representative checks the order in its final form and transmits it via electronic transmission to the appropriate plant. In the same process, an order acknowledgment is prepared for the customer and e-mailed as order verification.

16.5.2 Order Processing under E-commerce

The Web can be used effectively to plan order flows through a supply channel. If the Internet is integrated into the overall planning process, channel members can easily communicate with each other, share relevant information in real time and respond quickly and often efficiently to shifts in demand, material shortages, transport delays and order-filling inaccuracies. Order status is transparent, since all channel members can share a common database, which facilitates tracking and expediting. Low-cost access to the Internet encourages communication among channel partners, which further encourages coordination within the channel, leading to lower ordering costs and improved customer service.

The order processing under e-commerce starts when an order is received and after verification that it is a real order. Several activities take place, some of which can be done simultaneously; others must be done in sequence. These activities include the following steps:

- ✓ Making sure the customer will pay as per the order requirement: Depending on the payment method and prior arrangements, the validity of each payment must be determined. In B2B, the organization's finance department or financial institution (i.e., a bank or a credit card issuer, such as Visa) may do this. Any holdup may cause a shipment to be delayed, resulting in a loss of goodwill or a customer. In B2C, the customers usually prepay, frequently by credit card or debit card. One more payment mechanism is getting popular in B2C segment is Payment on Delivery (PoD).
- ✓ Checking for in-stock availability: Regardless of whether the seller is a manufacturer or a retailer, as soon as an order is received an inquiry needs to be made regarding stock availability. Several scenarios are possible here that may involve the material management and production departments, as well as outside suppliers and warehouse facilities. In this step, the order information needs to be connected to the information about in-stock inventory availability.
- ✓ Arranging shipments: If the product is available, it can be shipped to the customer right away. If the product is readily available, packaging and shipment arrangements need to be made. It may involve both the packaging and shipping department and internal shippers or outside transporters.
- ✓ Insurance: Sometimes the contents of a shipment need to be insured. This could involve both the finance department and an insurance agency. Again, information needs to flow, not only inside the organization, but also to and from the customer and insurance agent.

- ✓ Replenishment: Customized orders will always trigger a need for some manufacturing or assembly operation. Similarly, if standard items are out of stock, they need to be produced or procured. Production can be done in-house or by contractors.
- ✓ Contacts with customers: Sales representatives need to keep in constant contact with customers, especially in B2B, starting with notification of orders received and ending with notification of a shipment or a change in delivery date. These contacts are usually done via e-mail and are frequently generated automatically.
- ✓ Returns: In some cases, customers want to exchange or return items. Such returns can be a major problem. The movement of returns from customers back to vendors is called reverse logistics.

Order fulfillment processes may vary, depending on the product and the vendor. The order fulfillment process also differs between B2B and B2C activities, between the delivery of goods and of services, and between small and large products. Furthermore, certain circumstances, such as in the case of perishable materials or foods, require additional steps.

16.5.3 Retail Order Processing

Organizations, such as retailers, that operate intermediate to vendors and customers frequently design their order-processing systems with at least a moderate degree of automation. Very quick order response time is usually not necessary, since there are inventories available for final consumers. However, replenishment order cycle times that help to maintain a fixed replenishment schedule are important.

Modern information systems have had the benefit of replacing many of the assets previously needed to run a business. Using the Internet, organizations have been able to reduce warehouse space, lower inventory levels, reduce handling time and better track order progress. A hypothetical warehouse-free-distribution, direct-to-customer delivery system's order processing through Electronic Data Interchange (EDI) is explained as:

- ✓ The customers tell the distributor how much of which products are wanted and where via EDI.
- ✓ The distributor tells the suppliers how much of which products must be shipped via EDI.
- ✓ The distributor tells the logistics provider where to pick up product and how much via EDI.
- ✓ The distributor tells the logistics provider how much of which products is to be delivered where and when via EDI.
- ✓ The suppliers prepare the product for shipment.
- ✓ The logistics provider picks up the product, and sorts and segregates the product to the distributor's specifications.
- ✓ The logistics provider delivers the products to the customers.

16.6 Utility of ICT in Order Processing

The order triggers all activity within a logistics system. It is a key information system and the quality and speed of the information flow will determine both the effectiveness and the efficiency of logistics performance. The more quickly an order is transmitted, entered and processed, the more time (lead time) management has for planning transportation and inventory activities while meeting the required customer service levels. For example, if order preparation, order transmittal, order entry and order processing requires three days within an eight day order cycle which customers find to be acceptable, then reducing the time required for the successful completion of these activities will release time for management planning. Implementing an advanced order processing system could eliminate most of the first three days. By using this time for planning transportation consolidations, production and inventory levels, management can reduce the cost of transportation, holding inventory and warehousing. Warehousing costs will be lower because consolidated shipments can be made directly from plant locations to customers, thereby avoiding handling at field warehouses. Also, the planning time will result in more efficient scheduling of warehousing resources. In addition, variability in the order cycle will be reduced enabling customers to reduce their inventories.

That is why; business performance depends on how well an organization manages its internal processes. Organizations with effective business process management in place are able to analyze key performance indicators to monitor efficiency of day-to-day activities and employees against operational targets. Many organizations have implemented Enterprise Resource Planning (ERP) applications to standardize enterprise operations and support business process management strategies. ERP solutions empower organizations to automate many business processes formerly done by hand. But to achieve full return on investment in ERP solutions, businesses need to automate the documents that drive business processes. Some organizations have also implemented technologies to automate document exchange, but often only to a limited degree.

When organizations examine ways to gain efficiencies and competitive advantages in a constantly evolving business world, order processing within the order-to-cash cycle emerges as an area offering significant potential for improvement. If there's a single characteristic that distinguishes high-performing organizations, it is efficiency in the processing of customer orders. Beyond cost savings, organizations converting to an automated order processing system can realize efficiencies throughout the order-to-cash cycle. Along with reducing operational costs, freeing staff to spend more time on customer service activities and improving accuracy, automation of sales order processing gives organizations more control and insight into what is happening on a daily basis. These factors help organizations better manage customer and supplier relationships, manage inventory and production, comply with regulatory requirements, control finances and sales forecasting, bring visibility to business processes and improve overall profitability.

Using manual processes to orchestrate order-to-cash operations creates heavy administrative burdens along with the potential for incorrect shipments and cash collection delays. Manual processing of sales orders is inherently labor intensive, time-consuming and error-prone, requiring valuable resources to manage each part of the process. Using conventional methods, it can take hours to prepare, enter and store a sales order. Further, one wrong keystroke during data entry, such as inputting 100 units instead of 10 units, could become a nightmare for the organization and its customers. All activities down the line, including invoicing, will be affected — and cash collection can be delayed. Inevitably, human errors cost organizations both time and money. Within the order-to-cash cycle, organization needs to deal with following bottlenecks in manual order processing activities:

- **Sales Order Entry Bottlenecks:** Sales order entry needs specific attention as it represents potential bottlenecks that can cause huge inefficiencies and significant costs directly affecting the bottom line. Integrity of the sales order is crucial to achieving and maintaining high efficiency throughout the order-to-cash cycle. If organization begins with inaccurate or ambiguous information, performance will suffer. All activities are affected by the information that is pulled from the sales order. When organizations receive customer purchase orders, the nature of the processes they use to create sales orders in the ERP system and handle workflow can determine how much efficiency they are capable of achieving. Once the information is entered into the ERP system, there are issues of how to handle exceptions and how to keep track of order status. And when customers call to find out if their orders have gone through or to check the status of their orders, it means tracking down whether the order is still pending with the sales force or already entered into the system, etc.
- **Sales Order Archiving Bottlenecks:** Organizations also spend a significant amount of time retrieving orders and order data for internal or external audits and to satisfy the requirements of regulatory frameworks imposed by different governments in different countries. Receiving orders automatically can enable organizations to archive orders electronically, whereas in the past orders may have arrived via fax with the risk of getting lost at the fax machine and thereby delayed. Automated archiving offers major benefits in helping organizations support regulatory compliance and avoid the hassles of filing and retrieving order documents.
- **Manual Touch Point Jumbles:** In many organizations, sales order processing travels through a labyrinth of departments and manual touch points for order preparation, data entry and archiving. Upon the arrival of a sales order, staff collects orders from a shared fax machine or printer, collate them, keep the paper copies and store them along with associated documents for later retrieval as needed. Manual data entry is required for sold-to number, quantities, part numbers and other key fields. Sales representatives and administrators can only hope that none of these manual touch points cause misplaced orders, delays in fulfillment and payment, or errors and returns of incorrect shipments that end up in the customer's hands, resulting in customer dissatisfaction and loss of business. The ideal solution automates every phase of the process to eliminate as many manual touch points as possible.
- **Order Prioritization Bottlenecks:** Many organizations process orders on a first-in/first-out basis, which fails to account for priority of sales orders according to customer or product line. Certain customers and products may take priority over others, but all orders go through the same process. Orders might lie in files until they are collected by an employee once an hour and

then hand-delivered. In addition to helping organizations share resources to process orders faster, automation can help them recognize when orders come from key customers, or for key products. This capability can result in competitive advantages if organizations can respond to top customers faster, ship orders sooner and be more proactive.

If organization continues with the manual order processing system, it may lead towards inefficient business processing. Some of the negative outcomes of manual order processing system are listed as:

- ✓ Delayed cash collection
- ✓ Expensive execution
- ✓ Slow fulfillment
- ✓ High vulnerability to errors
- ✓ Low customer satisfaction

After understanding the bottlenecks in manual order processing system, it becomes essential to grab the details of automated order processing.

To optimize customers order processing, four essential areas of operations must be automated in any organization:

- ✓ Inbound document capture to eliminate handling of paper
- ✓ Optical Character Recognition to remove manual data entry
- ✓ Workflow to coordinate all processes that must occur along the path
- ✓ Access to documents and information about the process

The automation of order processing related with not only to automate document capture but also auditing of the entire order process. Sales orders arriving in various formats (paper, fax, email, electronic file) are automatically captured, approved and transferred to an archiving system. Order data such as customer name, part number, quantity and prices can be automatically made available in the ERP system, replacing manual data entry. The order object is linked to the stored document, allowing the user to retrieve the original document easily when necessary — within the ERP application interface. The process flows through the following steps:

- ➢ **Receiving and Routing:** When a sales order arrives, it is automatically handled by automated sales order processing system. The document is recognized and and sales order data is extracted. Immediate confirmation can be sent to let customers know that their orders have been received. Based on your specific criteria, system can capture and route sales order documents to the corresponding customer service representatives for processing, regardless of whether the orders are received by fax, email, mail, or electronic document. New orders are distributed according to criteria such as customer ID, telephone number dialed etc. on the received purchase order. Orders can be routed and prioritized so that top-priority customer orders get immediate attention while others hold in the queue.

- ➢ **Document Capture:** System needs to be designed for flexibility in capturing relevant sales order data such as the name of the customer that placed the order, the shipping address and instructions, the order number and requested date as well as line-item information — no matter how the data is displayed or where it is located on the incoming sales order. Customer service employees can view corresponding data straight form master tables as well as item numbers and description information.

- **Process Workflow and Exception Handling:** Now-a-days, the web-based user interface in order processing system is required so as to enable validation and approval of sales orders, allowing users to double-check correct recognition of the data. Whenever it is necessary to draw the user's attention to identified or potential issues, the interface displays warning and error messages next to the captured fields. For automated exception handling, system needs to allow users to validate against master data, add any missing information and simulate order entry in the ERP system to manage exceptions and order blocks. When a customer service representative is ready to approve a sales order, the captured information from the purchase order is validated against master data to check for duplicate orders, price variations or invalid part numbers. After all exceptions are cleared, the order is created in the ERP system. Users can view the newly created sales order, containing the fields captured and validated in the previous steps, from the ERP application interface. Within the ERP application, the order is linked to the original, stored image document for easy retrieval. This makes it possible for everyone involved in order processing and fulfillment to see the order, along with any associated documents, from their ERP applications — rather than having to request copies of orders from customer service reps or data entry staff.
- **Order Process Audit and Reporting:** Automated sales order processing system needs to continuously track and report on sales order processing from end to end, creating a detailed audit report from the time it receives the document until an order is created in the ERP system. One can gain visibility into the entire process — with the ability to identify and remove bottlenecks for improved order-to-cash performance. Reports can easily be created to give a view of performance indicators such as the number of orders that have been entered each day, the number that have been received but not processed, how long orders wait to be processed, the amount of time it takes each rep to enter an order, which customers are using correct product details (such as pricing and part numbers) and which are not.

Benefits of Automating the Order Processing System: Incoming sales order documents launch the order-to-cash cycle. Fast response to orders helps businesses increase customer satisfaction and ensure on-time delivery as well as timely customer payment. Incoming customer orders need to be entered and confirmed quickly to allow for efficient delivery. Up-to-date information on the status of customer orders is crucial for effective customer service as well as sales management and forecasting. Key financial management benefits of automating all of these areas include real-time budget control, sales monitoring and forecasting. This level of automation also enables organizations to:

- ✓ Increase speed and responsiveness — make the entire process quicker and more efficient
- ✓ Reduce operational costs — remove manual administration by adding business rules to corporate forms
- ✓ Reduce per-transaction costs — streamline throughput and save money while improving service
- ✓ Gain a clear view into the process — use and share the information for more effective management

- ✓ Realize rapid return on investment — reduce costs and improving controls boosts the bottom line
- ✓ Ensure high-quality presentation — apply consistent rules to all your online and offline processes

Automation minimizes the amount of manual labor and the number of keystrokes required to complete order processing. These capabilities can yield lots of monetary savings by reducing the number of touch points at each step of the process and by providing the ability to identify and resolve bottlenecks within the process. Organizations can improve the customer experience by increasing speed and responsiveness. Orders received by a certain time can be entered the same day for more on-time shipments.

Further, the automated order processing system provides information necessary for the management of the interfaces between logistics and the other functional areas of the firm as well as within logistics. For example, the primary input to the sales forecast is historical sales data captured from the order processing system. The quality and timeliness of the information will impact:

- ➢ The reliability of the forecast and therefore the accuracy of the operating plan becomes necessity for any organization. The operating plan is the set of activities that the firm will engage in during the coming year. It determines production schedules, procurement requirements sales promotion, sales force requirements, advertising levels, inventory levels, transportation requirements, warehousing needs and the cash budget. The plan must be modified as actual sales lead to re-evaluations of the forecast and new forecasts.
- ➢ The organization's marketing effectiveness also gets enhanced. The order processing system provides the sales history that drives the forecast and the communications information network relays the information to the necessary levels of management. Also, the information system drives day-to-day operations such as warehouse order picking, transportation scheduling and inventory management.
- ➢ The organization's future profitability can grow significantly. The information system can be used to monitor costs and customer service performance. This is required if least cost logistics is to be successfully implemented.

Order Processing in e-tailing : After opening the website, customer may select the items as per her requirements. One can purchase more than one items by putting the products into shopping carts. The order processing on some sites is done online, while many go in for batch processing at the end of the day. For the e-tailing organization order processing is of critical importance as it involves the setting up of system standards to meet customer expectations. Depending on the volume of the orders, the organization may process the order on an hourly or a daily basis. In e-tailing, the organization has to integrate online order capture with order processing, inventory and fulfillment system. In case an item is not in stock and is under process, late delivery will have to be confirmed to the client before the order is accepted. For stock items the replenishment instructions will be issued as soon as an item is removed from the shelves. Once an order is accepted for execution, order filling instructions are passed on to the inventory manager or directly to the vendor for case filling and packaging. It incorporates the consignee details, item details, quantity and packaging. The vendor or warehouse manager instructs the courier or 3PL partner to pick up the consignment for delivery to the client. All this is done electronically. The delivery details will be immediately conveyed to the customer along with the invoice copy for him/her to be ready with the balance payment against delivery by the courier or logistics firm.

After placement of an order, the client always wants to know the order status or whereabouts of the products during transit. The bar coding system with satellite communication will help track the consignment Most e-tailers provide the consignment tracking facility to the client as a value-added service on their websites.

Payments for a B2C transaction are accepted through credit or debit cards. In B2B transactions, the system needs credit management support to decide on the credit terms to clients, based on their payment history and the volume of business received. The system needs to generate online invoices, deliver notes, payment outstanding reports, payment reminders, and so forth, using EDI. The e-tailing organization has to carefully evolve its policies for order cancellation, postponement and offering substitutes in the event an inventory is not available. In the event the customer does not like the product, or it has been damaged during transit, or the product performance is below expectation, the e-tailer needs to evolve a product-return policy for issuing guidelines to customers and the operating people of the organization.

16.7 Summary

The order processing is one of the most crucial activities of any organization. Order cycle starts with preparation of order by customer and ends with the delivery of product or service to the customer as per the specifications entered into the order. The five key elements of order processing are Order Preparation, Order Receipt, Order Conduct, Order Execution and Order Release. Order processing system differs on the basis of order type for example a traditional retailer has altogether different order processing system in comparison to e-tailer, where the former one may have the dominance of manual processes whereas the later one may be fully automated system. Various ICT tools and techniques are well supporting and improving the experience of the entire order processing system, in which organizations are not only enhancing the level of customer service but also realizing significant savings in their operations through elimination of errors in order receipt and execution, transmission of information on real time basis, providing tracing and tracking of orders, handling exceptional conditions through prioritization and many more to count for.

16.8 Self Assessment Questions

1. Define order processing in an organization. Why is it important for any organization to carefully design the order processing system?
2. Discuss the characteristic of order processing in a retail organization.
3. What are the different stages of order processing? Discuss the same with examples.
4. Elaborate your experience of order processing by e-tailer, while highlighting the areas of improvements in the order processing system.
5. Discuss the role and significance of various ICT tools and techniques in handling the orders.

16.9 Reference Books

- Ballou H. R., and S.K. Srivastava, 'Business Logistics / Supply Chain Management', Pearson Education, 5th edition, 2009, New Delhi.
- Coyle J. J., C. J. Langley, B.J. Gibson, R.A. Novack, and E.J. Bardi, 'A Logistical Approach to Supply Chain Management', Cengage Learning India Private Limited, 2009, New Delhi.
- Raghuram G. and N. Rangaraj, 'Logisticas and Supply Chain Management', Macmillan India Ltd., 2005, New Delhi.
- Sople V.V., 'Logistics Management', Pearson Education Ltd., 2nd Edition, 2010, New Delhi.

Unit – 17: Inventory Control

Structure of Unit

17.0 Objectives

After completing this unit, you would be able to:

- Understand the nature and purpose of Inventory;
- Classify the inventory and costs and understand the Inventory functionality;
- Learn how to plan the Inventory Resources during Certainty and Uncertainty;
- Understanding the EOQ and other Inventory Management tools;
- Know about the various Review Systems and Inventory Management Policies;
- Understanding the basics of Material Resource Planning Tools.

17.1 Introduction

Inventory is the stock of any item or resource used in a company. It includes: 1) Raw Materials, 2) Finished Products, 3) Work-in-Process. The unit includes: Inventory system and its management, determining what levels should be maintained, when should the stock be replenished, and what should be the order size. The unit reviewed the inventory Management alternatives such as Inventory Control, Reactive Methods, Planning Methods, Adaptive Logic.

17.2 Inventory: Meaning

It has been established Inventory is the stock of any item or resource and the role of inventory management is to ensure that stock is available to meet the needs of the beneficiaries as and when required. A very high inventory ratio is vital for the healthiness of an organization. Inventory represents a large cost to the supply chain. This is made up of the cost of transporting the goods, cost of the inventory itself, Plus cost of managing the goods, and keeping the goods in warehouses. The inventory manager's job is to make inventory available at the lowest possible cost.

Types of Inventory - Inventory includes:

- Raw Material Inventory
- Work-In-Process Inventory
- Finished Goods Inventory
- Maintenance, repairs and operating (MRO) Inventories.

The purposes of Inventories - The purpose of inventories are:

- To meet variation in product demand
- To maintain independence of operations
- To provide a safeguard for variation in raw material delivery time
- To take advantage of economic purchase order size
- To allow flexibility in production scheduling.

Functions of Inventory - The important functions perform by inventory are:

- **Economies of scale:** Inventory allows companies to get volume discounts from a supplier. Inventories in warehouses may also result in lowering the cost of individual items by enabling larger production batches.
- **Protection against uncertainties**: The safety stock or buffer stock protect from short range variation in either demand or replenishment cycle uncertainties, At times when demand from customers or from a company's own production operation is not always known or when delivery from suppliers or from production is not always reliable or goods inventories protect from stock outs.
- **Seasonal fluctuations:** to ensure continuous availability of goods inventories in distribution or production warehouses are required. In the case of seasonal consumer goods demand, keeping the inventories in distribution and production warehouses enable the continuous production at full capacity despite swings in seasonal demand. Clothes and Agricultural goods etc have a seasonal supply as well.
- **Geographical Specialization:** Geographical separation also requires manufactured goods from various locations to be collected at a stage warehouse. These are then shipped together as a mixed product shipment and sent to the required destination
- **Decoupling**: Decoupling processes permit each product to be manufactured and distributed in economic lot sizes that are greater than market demands. The production of the lot was carried out keeping in mind the future demand as well as the economies of production. A large shipment with FTL that is full-load capacity of trucks allows to achieve minimum freight cost.

There are several disadvantage of carrying inventory, these are:

• Maintaining large inventory is difficult to control

• Large inventory levels conceal other problems

• Product life cycles are becoming shorter ultimately increasing the likelihood of product obsolescence

• The high costs of inventory storage.

Three basic inventory management costs are - Holding, Ordering and Shortage Costs

a. **Holding** or **carrying costs**: This includes cost incurred due to Loss of Interest on saving, Insurance, Taxes, Depreciation, Obsolescence, Deterioration, Spoilage, Pilferage, Breakage, Warehousing Costs (heat, light, rent, security and Opportunity Costs associated with having funds which could be used elsewhere tied up in inventory. Holding costs are stated in either of two ways: as a percentage of unit price or as a dollar amount per unit.

b. **Ordering costs**: The costs of ordering and receiving inventory. They are the costs that changes with the actual placement of an order. These include 1) cost per quantity order, 2) cost incurred in preparing invoices, 3) shipping costs, 4) inspecting goods upon arrival for quality and quantity, and moving the goods to temporary storage. Ordering costs are expressed as a fixed amount per order, irrespective of order size.

c. **Shortage costs** occur when demand exceeds the supply of inventory on hand. These costs can include A) the opportunity cost of not making a sale, b) loss of customer good will, etc. c) late charges. Furthermore, if the shortage occurs in an item, the cost of lost production is considered as shortage cost.

Inventory Classification System

There are various inventory classification systems like ABC analysis, VED analysis etc.

The ABC classification process is an analysis of a range of objects, such as finished products, items lying in inventory or customers into three categories. It's a system of classification, similar to Pareto analysis, and the method classify inventory into three classes with each class having a different way of management and control associated :

A - Outstandingly important; B - of average importance; C - relatively unimportant as a basis for a control scheme. The process of managing in a different way, with more attention being devoted to category A, then B, and then to C Commonly known as the "80/20" rule ABC concept is applied to inventory management as a rule-of-thumb. It says that about 80% of the money value, consumption wise, of an inventory remains in about 20% of the items. The greatest benefits, in terms of cost reduction as well as maintaining a smooth availability of stock, are attained. The ABC concept is derived from the Pareto's 80/20 rule curve. Here, money value of each individual inventory item is calculated on annual consumption basis.

Thus, applied in the context of inventory, it's a estimation of the relative ratios between the number of items and the money value of the items purchased / consumed on a repetitive basis :

- 10-20% of the items (**'A' class**) account for 70-80% of the consumption
- the second ,15-25% (**'B' class**) account for 10-20% of the consumption and
- the last 65-75% (**'C' class**) account for 5-10% of the consumption

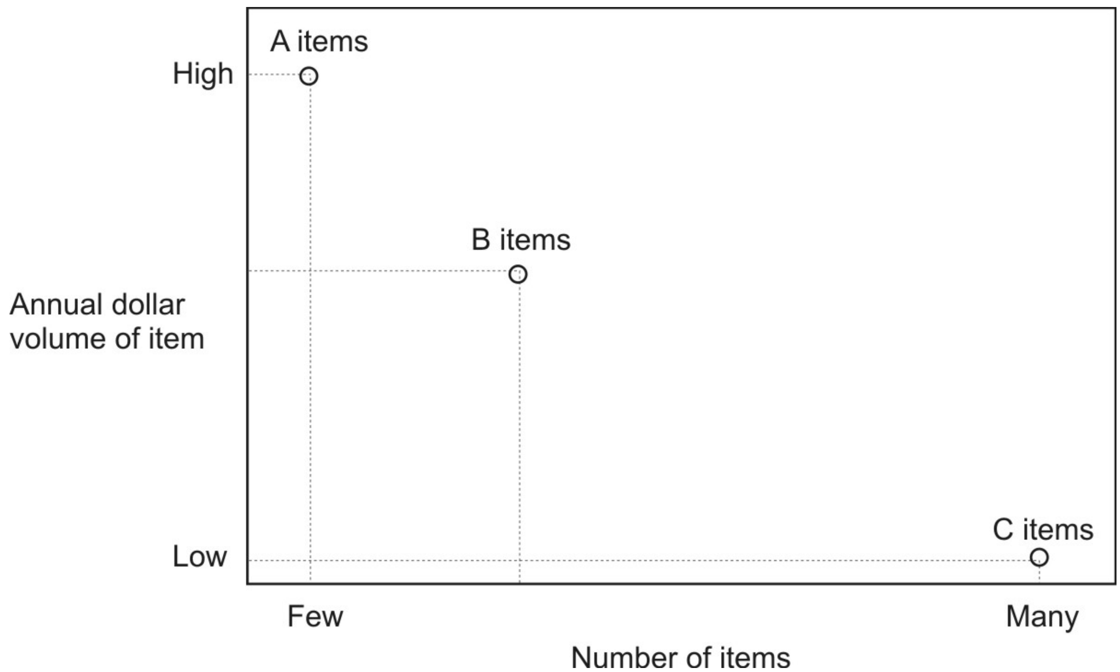


Figure: 17.1 ABC Classification System

17.4 Planning the Inventory

The section describes the key parameters and procedure for planning inventory. It focus on –When to order (Reorder Point) and how much to order (EOQ Point).

17.4.1 Reorder Point

Determining when to order (order points): reorder points determine when a resupply shipment should be initiated. Reorder points can be determined in terms of units or days of supply. Reorder Point during Certainty: The certainty conditions imply that future demand and performance cycle are known,

R= D * T

R= Reorder points in units

D= Average Daily Demand

T = Average Performance Cycle Length

Illustration: Assume that demand is 10 unit /day and a 20 day performance cycle, than

R = D* T

= 10 units /day * 20 day = 200 units

During Uncertainty: Uncertainty is a position of uncertainty either with the demand or with the performance cycle length. An inventory buffer is necessary to compensate for the uncertainty. This buffer is known as safety stock, handles customer demands during uncertainty of either performance cycle or demand. In such a case reorder point is

R= D * T + SS

R= Reorder points in units

D= Average Daily Demand

T = Average Performance Cycle Length

SS = Safety or buffer stocks in units

17.4.2 Economic Order Quantity (EOQ): Determining the Order Size

EOQ is simple to understand and use but it has several disadvantages in practice. Even with these drawbacks. EOQ is a good place to start to understand inventory systems.

EOQ assumes:

1. Demand rate is recurring, known, constant and uniform.
2. Lead time is constant and known.
3. Price per unit of product is constant; no discounts are given for large orders.
4. Inventory holding cost is based on average inventory.
5. Ordering or setup costs are constant.
6. All demands will be satisfied; no stock outs are allowed.

Economic Order Quantity (EOQ) model

Let Q units be the quantity order, which are taken at a uniform rate over time. When the quantity on hand is just sufficient to satisfy demand during lead time, an order for Q units is placed. Bit is assumed that both the usage rate and the lead time do not changed, the order will be received, the moment the inventory on hand reaches to zero. Thus, orders are place to avoid both excess stock and stock outs.

Annual carrying cost is calculated by multiplying the average amount of inventory on hand by the cost to carry one unit for one year, The average inventory is equal to half of the order quantity: the amount on hand decreases from Q units to 0, for an average of (Q+0)/2, or Q/2. The symbol H represent the average annual carrying cost per unit and the total annual carrying cost is given by

$$\text{annual carrying cost} = \frac{Q}{2}H$$

Where

Q=order quantity in units

H = holding (carrying) cost per unit

On the other hand as order size increases, annual ordering cost decrease, because for a given annual demand, the larger the order size, the fewer the number of orders required. In general, the number of orders per year re given by

No of orders per years = D/Q, where D = annual demand and Q = order size.

Unlike carrying costs, ordering costs is independent of order size;

Regardless of the amount of an order, certain amount of activities must be done such as:

- Determining how much is needed periodically
- Evaluating sources of supply, and preparing the invoice.
- Inspection of the shipment to verify quality and quantity characteristics since large shipments are sampled rather than completely inspected

Hence, there is a fixed ordering cost. *Annual ordering cost* is a function of the number of orders per year and the ordering cost per order:

$$\text{annual ordering cost} = \frac{D}{Q}S$$

Where

D = demand, usually in units per year

S = ordering cost

T he total annual cost associated with carrying and ordering inventory when Q units are ordered each time is

$$TC = \begin{matrix}\text{annual}\\ \text{carrying}\\ \text{cost}\end{matrix} + \begin{matrix}\text{annual}\\ \text{ordering}\\ \text{cost}\end{matrix} = \frac{Q}{2}H + \frac{D}{Q}S$$

Note that D and H must be in the same units, e.g., months, years.

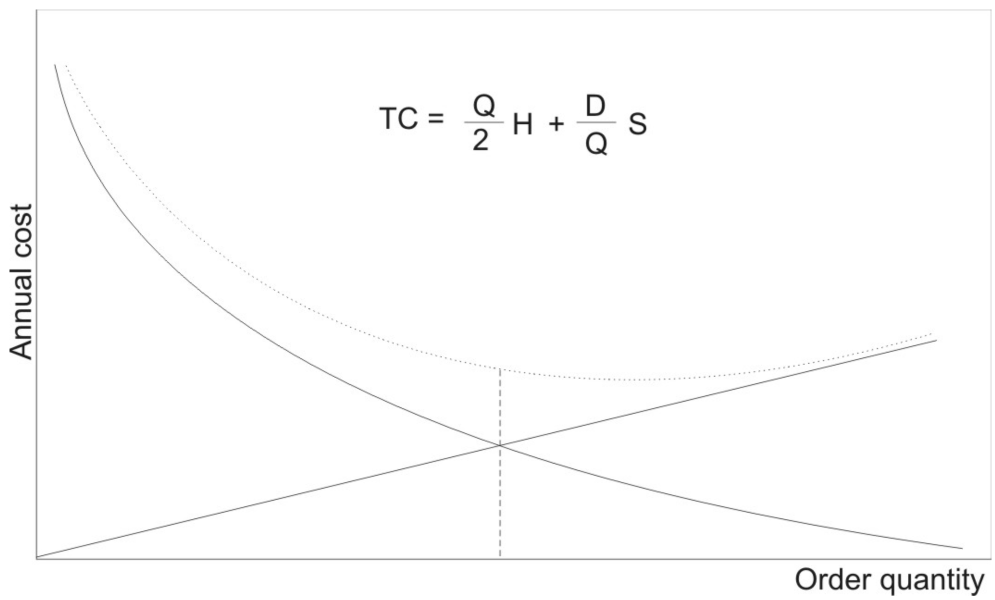


Figure 17.2: Total Cost and Economic Order Quantity

n expression for the optimal order quantity, Q_0, can be obtained using differentiation function. The resultant formula is

$$Q_0 = \sqrt{\frac{2DS}{H}}$$

Thus, given annual demand, the ordering cost per order, and the annual carrying cost per unit, one can compute the optimal (economic) order quantity. The minimum total cost is then found by substituting Q_0 for Q in the total cost formula above.

The length of an order cycle (i.e., the time between orders) is

$$\text{length of order cycle} = \frac{Q_0}{D}$$

Example: A local distributor for a national tire company expects to sell approximately 9,600 steel belted radial tires of a certain size and tread design next year. Annual carrying cost is \$16 per tire, and ordering cost is \$75. The distributor operates 288 days a year.

a. What is the EOQ?
b. How many times per year does the store reorder?
c. What is the length of an order cycle?
d. What is the total annual cost if the EOQ quantity is ordered?

Solution:

D = 9,600 tires per year

H = $16 per unit per year

S = $75

a. $Q_0 = \sqrt{\frac{2DS}{H}} = \sqrt{\frac{2(9{,}600)75}{16}} = 300 \text{ tires}$

b. $\text{Number of orders per year}: \frac{D}{Q_0} = \frac{9{,}600 \text{ tires}}{300 \text{ tires}} = 32$

c. $\text{Length of order cycle}: \frac{Q_0}{D} = \frac{300 \text{ tires}}{9{,}600 \text{ tires}} = \frac{1}{32} \text{ of a year} \Rightarrow \frac{1}{32} \times 288 = 9 \text{ workdays}$

d.
$$\begin{aligned} TC &= \text{carrying cost} + \text{ordering cost} \\ &= \frac{Q_0}{2}H + \frac{D}{Q_0}S \\ &= \frac{300}{2}\$16 + \frac{9{,}600}{300}\$75 \\ &= \$2{,}400 + \$2{,}400 \\ &= \$4{,}800 \end{aligned}$$

17.4.3 EOQ extension: Quantity Discount Model

Quantity discounts are discounts offer for large orders offered to customers to include them to buy in large quantities. When quantity discounts are offered, the buyer must weight the potential benefits of reduced purchase price and fewer orders that will result from buying in large quantities against the increase in carrying costs caused by higher average inventories. The buyer's objective is to offer quantity discounts is to select the order quantity that will minimize total cost, where total cost is the sum of carrying cost, ordering cost, and purchasing cost:

$$\begin{aligned} TC &= \text{carrying cost} + \text{ordering cost} + \text{purchasing cost} \\ &= \frac{Q}{2}H + \frac{D}{Q}S + PD \end{aligned}$$

Where P = unit price.

In the basic EOQ model, determination of order size does not includes the purchasing cost. This is based on the assumption for not including unit price is that the assumption of no quantity discounts, price per unit is the same for all order sizes that is when the demand, D, is known and constant . Therefore in the total cost computation, adding unit price is that case would merely increase the total cost by the amount PD, P times D.

Procedure for determining the overall EOQ differs slightly, depending on which of these two cases is relevant. For carrying costs that are constant, the procedure is as follows:

1. Compute the common minimum point.
2. Only one of the unit prices will have the minimum point in its range since the ranges do not overlap. Identify that range.
    a. If the feasible minimum point is on the lowest price range, that is the optimal order quantity.
    b. If the feasible minimum point is in any other range, compute the total cost for the minimum point and for the price breaks of all lower unit costs. Compare the total costs; the quantity (minimum point or price break) that yields the lowest total cost is the optimal order quantity.

In short we can say that by allowing quantity discounts vendor

- Provides a reduced price when item is purchased in larger quantities.
- Must balance the trade-off between Lower item price resulting from the discount
  and Increased cost of holding more inventory.

Example: One department of a large hospital uses about 816 cases of liquid cleanser annually. Ordering costs are $12, carrying costs are $4 per case per year, and the new price schedule indicates that orders of less than 50 cases will cost $20 per case, 50 to 79 cases will cost $18 per case, 80 to 99 cases will cost $17 per case, and larger orders will cost $16 per case. Determine the optimal order quantity and the total cost.

Solution: D = 816 cases per year, S = $12, H = $4 per case per year.

Range	Price
1 to 49	$20
50 to 79	18
80 to 99	17
100 or more	16

1. Compute the common EOQ: $\sqrt{\frac{2DS}{H}} = \sqrt{\frac{2(816)12}{4}} = 70 \text{ cases}$
2. The 70 cases can be bought at $18 per case because 70 fall in the range of 50 to 79 cases. The total cost to purchase 816 cases a year, at the rate of 70 cases per order, will be

$$TC_{70} = \text{carrying cost} + \text{ordering cost} + \text{purchase cost}$$

$$= \frac{Q}{2}H + \frac{D}{Q_0}S + PD$$

$$= \frac{70}{2}4 + \frac{816}{70}12 + 18(816) = \$14{,}968$$

Because lower cost ranges exist, each must be checked against the minimum cost generated by 70 cases at $18 each. In order to buy at $17 per case, at least 80 cases must be purchased. (Because the TC curve is rising, 80 cases will have the lowest TC for that curve's feasible region.) The total cost at 80 cases will be

$$TC_{80} = (80/2)4 + (816/80)12 + 17(816) = \$14{,}154$$

To obtain a cost of $16 per case, at least 100 cases per order are required, and the total cost will be

$$TC_{100} = (100/2)4 + (816/100)12 + 16(816) = \$13{,}354$$

Therefore, because 100 cases per order yields the lowest total cost, 100 cases is the overall optimal order quantity.

17.4.4 Managing Uncertain Demand:

In the presence of uncertain demand, the objective is to minimize the expected cost or to maximize the expected profit

- Two types of inventory control models
- Fixed time period - Periodic review
- Fixed order quantity - Continuous review

a) Fixed order quantity policies - The order quantity is always the same but the time between the orders will vary depending on demand and the current inventory levels. Inventory levels are continuously monitored and an order is placed whenever the inventory level drops below a prespecified reorder point.

b) Continuous review policy- Fixed order quantity policies - The order quantity is always the same but the time between the orders will vary depending on demand and the current inventory levels. Inventory levels are continuously monitored and an order is placed whenever the inventory level drops below a pre specified reorder point.

17.5 Inventory Control

Implementation of the following procedures and desired inventory management policies and control procedures must be taken into the consideration. Inventory levels are finally reviewed and compared against different parameters of inventory which includes when and how much to order. Hence it gives us the feedback for all the alternatives and the outlines to be used.

17.5.1 Perpetual Review

Replenishment needs are reviewed by the inventory status on the daily basis which is called perpetual inventory control process. Accurate accountability is needed to keep records of the stock units. For efficient working computer assistance is needed.

This perpetual inventory control process is reviewed using a reorder point and order quantity as shown below,

	ROP	=	D x T + SS
Where	ROP	=	reorder point in units
	D	=	average daily demand in units
	T	=	average performance cycle length in days
	SS	=	safety or buffer stock in units

This review compares the sum of on-hand and on-order inventory to the reorder point. Quantity which particularly resides in the distribution facility is represented by on-hand inventory. The order taken from suppliers is represented by the on-order inventory. If the sum of on-hand and on-inventory is less than the recognized reorder point than the control process will take another replenishment order. The formula is;

If $I + Q_0 \leq ROP$ then order Q

Where I = inventory on hand

Q_0 = inventory on order from suppliers

ROP = reorder point units

Q = order quantity units

17.5.2 Periodic Review

The inventory status at regular time intervals such as weekly or monthly is reviewed through periodic inventory. Adjustment of basic reorder point must be done at regular intervals for the periodic review. Mathematically it is stated below;

$$ROP = D (T + P/2) + SS$$

Where, ROP = reorder point

D = average daily demand

T = average performance-cycle length

P = review period in days

SS = safety stock

This inventory count has to be completed in the specified time and any item can fall under the desired reorder point prior to review period. One-half of the review times shall fall below the ideal reorder status prior to periodic count. Review period can be assumed of 7 days and similar conditions can be used to those of perpetual example, the ROP in now;

$$ROP = D (T + P/2) + SS$$
$$= 20(10 + 7/2) + 0 = 20(10 + 3.5) = 270 \text{ units}$$

The average inventory formula for periodic review is

$$I = Q/2 + (P \times D)/2 + SS$$

Where, I = average inventory in units -

Q = order quantity units

P = review period in days

D = average daily demand

SS = safety stock

For the preceding example, the average inventory is calculated as

$$I = Q/2 + (P \times D)/2 + SS$$
$$= 200/2 + (7 \times 20)/2 + 0 = 100 + 70 = 170 \text{ units}$$

Larger inventories are required when the time intervals introduced by periodic review, periodic control system are less than perpetual systems.

17.5.3 Modified Control Systems

Various variations and combinations of basic periodic and perpetual control systems are developed to accommodate specific situations. The replenishment system and the optional replenishment system are the most common ones. A range of modified systems are available for control processes.

Fixed-order interval system that provides short-interval periodic review is called target level replenishment. With complete status on inventory similar to the perpetual concept, the system establishes an upper limit or replenishment level for reordering. The review period is added to the lead time, and the target replenishment level (TOT) is defined as;

$TGT = SS + D (T + P)$

Where, TGT = replenishment level

SS = Safety Stock

D = Average Daily Demand

T = average performance-cycle length

P = review period in days

The general reordering rules become

$Q = TGT — I — Q_0$

Where, Q_0 = order quantity

TGT = replenishment level

I = inventory status at review time

Q_0 = quantity on order

Assuming a review period of 5 days, average expected sales of 20 units/day, zero safety stock, and a replenishment cycle of 10 days,

$TGT = D (T+P) + SS$

$= 20(10 + 5) + 0 = 300$ units

Since the replenishment cycle is longer than the review period, it is necessary to consider outstanding orders. Assume them is one outstanding order for 100 units at the time of the review and the current inventory is 50 units. Then

$Q = TGT — I — Q_0$

$= 300—50— 100 = 150$ units

Under the target replenishment system, the size of order is determined without reference to lot sizing. Emphasis is placed on maintaining inventory levels below a maximum, which is the target or order-up-to level. The maximum is protected as an upper level since inventory will never exceed the replenishment level and can reach the replenishment level only if no unit sales are experienced between the replenishment initiation order and the following review period. Under these conditions the average inventory is

$I = (DP)/2 + SS$

Where, I = average inventory

V = average daily demand

P = review period in days

SS = safety stock

A variation of the target replenishment system is the optional replenishment system, which is sometimes referred to as the (s, S) or mm-max system. Similar to the target level replenishment system, the optional system substitutes a variable order quantity for a specific lot size. However, the optional replenishment system introduces a modification to limit the lower size of the variable order quantity. As a result, the inventory level is perpetually maintained between an upper and lower bound. The upper bound exists to establish a maximum inventory level, and the lower bound guarantees that replenishment orders will at least be equal to the difference between the maximum (S) and the minimum (s) level. The basic replenishment rule is

If, $I + Q < S$ then $Q = S - 1 - Q_0$

Where, I = inventory status at review time

Q_0 = quantity on order

s = minimum stock level

Q = order quantity

S = maximum stock level

The minimum or (s) level is determined similarly to ROP. When there is no uncertainty,

s = D x T

Where, s = minimum stock level

D = average daily demand

T = average performance-cycle length

When demand and performance-cycle uncertainty exist, the minimum stock level (s) must be incremented by an allowance for safely stock.

The mm-max system can be implemented in terms of absolute units of product, days' supply, or a combination of both. In the case of absolute units, both the minimum and the maximum are defined in terms of a specific number of units. For example, suppose the minimum and maximum are defined lobe 100 and 400 units, respectively. The resulting replenishment rule is

If $I + Q_0 < 100$ then $Q = 400 - I - Q_0$

Where, the terms are the same as defined above. If the inventory and quantity currently on order arc 75 and 0, respectively, the resulting quantity to order is 325 (Q = 400 — 75). The mm-max policy can also be implemented using "days' supply'' parameters. For example, the minimum can be defined as 10 days' supply. For each replenishment review, the days' supply is converted to a specific number of units by multiplying it by the current forecast. The days' supply approach has the advantage of being dependent on the forecast, so it responds to changes in demand.

17.5.4 Reactive Method

The reactive inventory system, as the name implies, responds to a channel member's inventory needs by drawing the product through the distribution channel. Replenishment shipments are initiated when available warehouse stock levels fall below a predetermined minimum or order point. The amount ordered is usually based on some lot sizing formulation, although it may be some variable quantity that is a function of current stock levels and a predetermined maximum level. In summary, a reactive inventory system waits for customer demand to pull the product through the system. For example, each retailer independently makes a choice regarding when and how much to order from the wholesaler or distribution center. In turn, each wholesaler or distribution center orders independently from its suppliers. The series of independent actions results in uncertainty at each reorder point throughout the distribution channel. Multiple levels of uncertainty require significant safety stock to provide adequate performance.

17.5.5 Planning Method

Inventory planning methods use a common information base to coordinate inventory requirement across multiple locations or stages in the value-added chain. Planning activities may occur at the plant warehouse level to coordinate inventory allocation and delivery to multiple distribution centers. Planning may also occur to coordinate inventory requirements across multiple channel partners such as manufacturers and retailers.

Two inventory planning methods are fair share allocation and distribution requirements planning (DRP). Each is described and illustrated.

Fair Share Allocation. Fair share allocation is a simplified inventory management planning method' that provides each distribution facility with an equitable or 'fai1 hare' of available inventory from a common source such as a plant ware-house. Figure 9-2 illustrates the network structure, current inventory level, and daily requirements for three distribution centers served by a common plant ware- house.

Using fair share allocation files, the inventory planner determines the amount of inventory that can be allocated to each distribution center from the available inventory at the plant warehouse.

Distribution Requirements Planning (DRP) DRP is a more sophisticated p1anning approach that considers multiple distribution stages and the characteristics of each stage. DRP is the logical extension of manufacturing requirements planning (MRP). Although there is one fundamental difference between the two techniques, MRP is determined by a production schedule that is defined and controlled by the enterprise. On the other hand, DRP is guided by customer demand, which is not controllable by the enterprise. So, while MRP generally operates in a dependent demand situation, DRP operates in an independent environment where uncertain customer demand determines inventory requirements.

17.6 Material Requirement Planning

Materials Requirement Planning (MRP) can be used both for production planning and as an inventory control technique. MRP includes a series of steps which in the beginning starts from determining the finished products that are needed to meet the demand by the schedules period of time and which are to be completed with the statement of finished products required at each assembly level for the given time period.

Conventional Inventory Systems are based on following models:

1. ABC Classification
2. Reorder Models
3. Safety Stock
4. EOQ

In the given project situation and production for batch the demand is not always consistent but isolated. The time period and the demand are clearly stated, which also has known as Time-Phased Requirements Planning.

The concepts included in MRP are:

1. Independent versus Dependent demand
2. Lumpy demand
3. Lead times
4. Common use items

Computerized use of MRP has helped it gaining the popularity among the market as it has reduced the number of calculations for the explosion of the product which are handled with the direct accessibility into the disc systems. The online capabilities of computer have also generated interest in MRP.

Where to use MRP:

MRP is considered as the most efficient scheduling technique for many of the industries which are engaged in fabrication and assembling of products like automobiles, trailer-tractor equipments etc. MRP can be used in the situations which have the following conditions:

- The finalized product is composite in nature and which should be made up of many assemblies.
- The finalized product is costly.
- The leaded time for the raw materials and components is long.
- The cycle for the manufacturing process is lengthy.
- Requirements of products can be merged according to the economic sizes applicable.

Objectives of MRP can be achieved in the given manner:

- Specify the availability of raw materials, products and other resources for the planned production and delivering of products to the customers.
- Lowes level of inventory should be maintained.
- Manufacturing activities, schedules for delivery and purchasing activities should be planned.

Dependent demand items are more appropriate for MRP systems. Demand for the higher level items which is directly related or to its result is called dependent demand. Hence, when the demand for product is continuous and independent, the demand for its lower level and related items is granted to be consolidate and dependent. Forecast of dependent demand is not needed but these can be calculated by the Master Schedule of MRP systems.

MRP has the following key features including the time phasing requirements, generation of lower-level requirements, planned order releases and rescheduling capability. A specific planned order indicates that when orders should be placed by purchasing and manufacturing activity. MRP system is explained in the flow diagram given below.

17.7 Summary

Inventories are necessary for a firm to operate efficiently. In any business, big or small, we must understand that taking good care of our inventory is very important. Inventory is usually a business's largest asset. The instant inventory levels are established, they become strategic input to the system. Inventory decisions involve a delicate balance between three classes of costs: ordering costs, holding costs, and shortage costs. The basic element of planning were reviewed the concept of Economic Order Quantity was developed, with special adjustments such as quantity discounts and transportation discounts. A critical aspect in formulating inventory policy is the identification of the inventory management goal of customer service, Profitable inventory allocation prediction and control of inventory requirements and total cost Integration.

17.8 Self Assessment Questions

1. 'Inventory management is important for a successful supply chain response'. Defend
   this statement.
2. Explain general classification system of inventory?
3. Explain the concept of Economic Order Quantity
4. Discuss the relationship between Service Level, Uncertainty, Safety Stock and Order Quantity. How can a trade off between these elements are made.
5. Compare and contrast the difference between Periodic and Perpetual Review System
6. What advantage does DRP have over Fair Share Method?
7. Explain Reactive Inventory Logics and Inventory Planning Logics.

17.9 Reference Books

- Ailawadi, S.C., and R. Singh, 'Logistics Management', Prentice Hall of India Pvt. Ltd., 2005, New Delhi.
- Agrawal D.K., 'Supply Chain Management', Macmillan India Ltd., 2010, New Delhi.
- Coyle J. J., C. J. Langley, B.J. Gibson, R.A. Novack, and E.J. Bardi, 'A Logistical Approach to Supply Chain Management', Cengage Learning India Private Limited, 2009, New Delhi.
- Bowersox, D.J., 'Logistical Management- The Integrated Supply Chain Process', Tata McGraw Hill, 2000, New Delhi.