Case Study Name: Pro-Audio Sales Agent Program

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***The case problem that I analyzed and addressed in this study is in page number 7.*

1. **Major Facts:**

- The flagship PSX-360 which retails for $12,000 from Pro-Audio accounts for 70% of the firm's revenue.
- Los Angeles and New York are the two large dealers where the sales became concentrated representing 70% of sales which was fueled by aggressive discounts.
- Smaller regional dealers complaining about losing sales due to customers only using them for information and then purchasing from somewhere else at lower prices.
- Aggressive discounting damaged the margins, reduced local service support, and also risked devaluing the premium image that the PSX-360 had set.
- Sales Agent Program was implemented in June 1998 by Pro-Audio with the following rules:
  - Stocking dealers converted into retail agents with demo-only models.
  - Routed all the transactions with a fixed price of $12,000 through the factory.
  - Guaranteed commission of $4,000 per unit to retail agents.
  - Cash or bank check in advance required for payment
  - Trade-ins and discounts eliminated with no dealer-level price flexibility.
- After 18 months:
  - Sales remained flat despite all the controls in price.
  - Inefficiencies created due to the administrative burden for agents and customers.

2. **Major Problems:**

- The program showed lack of growth where it failed to increase unit sales or revenue.
- Delays and rigid processes led to low dealer motivation which further led to reduced customer satisfaction.
- Buyers while in the market for professional audio expect different type of credit terms, discounts and trade-ins which was not aligned perfectly with the expectations.
- The pricing was fixed because of the attempt to control discounting.

3. **Possible Solutions:**

A. Strengthen current sales agent program with relevant cost adjustments:

The company could create a rule where everyone is paying the same price where no store will be able to undercut another store. The company can add some value by not being completely rigid where they can offer financing plans, provide training services, support services, and by making the process to order easier for dealers. Doing all this shifts the focus from fighting price and enable higher profit by selling smarter and by managing costs in a better way.

B. Adopt a hybrid value-based model:

The company can use a mixed approach where they can let some stores carry the actual inventory again, considering the areas with high demand. Also, introduction of something like MAP (Minimum Advertised Price) stops dealers from advertising or selling the products below a certain price limit. This type of rules can give dealers flexibility without the loss of the premium image of the product. Proper tracking of costs and also utilizing breakeven analysis to check if the discounts are increasing sales or not.

4. **Possible Solutions:**

Advantage A:

- Increases brand image by avoiding damage and maintains price integrity.
- Nagle's point, 'pricing should represent perceived value, while costs present constraints' is matched here by using rational price setting aligned with value.
- Cost allocations are done properly by focusing on avoidable, variable and increasing costs rather than averaged totals.

Disadvantage A:

- Unmet customer expectations for flexibility. This damages long term contribution margin because of the rigid terms by decreasing volume.
- Channel relationships may worsen due to enforcement.

Advantage B:

- Dealers get more motivation to sell more with increased inventory control and autonomy.
- MAP pricing gives unique flexibility to give local level deals while maintaining the upward price pressure.
- This solution aligns with the industry practice of capturing the buyer perception of fairness while sustaining good margin with negotiated deals.
- Break-even analysis is used to test different metrics like whether there is higher volume of sales due to incremental discounts or not.

Disadvantage B:

- If this method is not monitored properly than there is a risk of renewed discounts.
- Will raise administrative costs initially to educate the dealer and for oversight.

5. **Choice and Rationale:**

In my view solution B, Hybrid MAP and stocking dealers focuses more on the customer and demand instead of just thinking about controlling costs. The recent program failed because it focused on only setting one set price which stopped big discounting, but this created a lot of frustration due to no flexibility. To give more motivation to the dealers they can add MAP and by letting dealers to give local level discounts by setting a rule of a minimum price from which they cannot go down allows customers the flexibility and protect the brand's premium image. Measuring profits is easier with this method and it also brings down the two major roadblocks to a minimum which are completely ignoring the real cost and missing on the long-term risk of upsetting the customers and dealers.

6. **Recommendations / Implementation:**

- Localized support and after sales service should be strengthened by establishing or re-establishing selective good stocking dealers in some major areas.
- While there is a set minimum price, give them room for negotiation on a small scale for trade-ins, bundled deals and services which are highly valued by buyers.
- Financial flexibility can be introduced by bringing installment plans and leasing options without undermining margin and increasing volume.

- Contribution Margin Analysis should be used for every sales scenario. Mostly looking at how much net profit increases with different discounts and strategies.
- All the activity of the dealers should be monitored so that proper penalties are in place if they break any rules.

References

Nagle, T. T., & Hogan, J. The Strategy and Tactics of Pricing: A Guide to Growing More Profitably (7th Edition).

Case:

PRO-AUDIO SALES AGENT PROGRAM*

After nearly 18 months of experimenting with the Pro-Audio Sales Agent Program, Steve Marsh was pondering the difficult assignment of re-evaluating the Pro Audio Sales Agent Program. The program had been extolled by some as "creative" and "pioneering," and an important effort to stem the tide of discounting that seemed to be harming the overall studio equipment industry. To others the program was seen as an administrative nightmare, that "basically caused the sun to come up in the West, instead of the East."

Pro-Audio is a manufacturer of electronic sound processing equipment. Its leading product was an advanced digital reverb unit called the PSX-360, which retails for about $12,000. The PSX-360 accounted for about 70% of Pro-Audio's total revenues. It was sold primarily to major recording studios and professional musicians throughout the country through an exclusive network of approximately 50 leading professional audio retailers.

In early spring 1998, Steve Marsh began to note some disturbing trends regarding selling activity in the PSX-360's retail channel. First, he noticed an increasing dependence on orders from two of PSX's largest dealers. One dealer was in Los Angeles and the other in New York, and by April, these two dealers accounted for 70% of the company's total sales of PSX products. More troubling was the growing number of complaints from other PSX dealers that they were losing sales to other dealers outside their territories, and often linked the lost sales to heavy discounting being offered by "major dealers in LA and New York." In fact, if a customer really wanted a PSX-360 unit, he simply went down to the local dealer to get information on the product, and then would call around to other dealers around the country, get the lowest quote and have the unit shipped UPS for arrival within 7-10 days.

This was troubling to Pro-Audio for a number of reasons: First, it meant that a majority of PSX dealers were spending time and money educating and selling potential customers, but then would lose the sale at the last minute to a small number of distant large dealers. Second, customers buying the unit from a remote dealer were not receiving any after-sale support, training or service, since the local dealer was not involved in the transaction. Third, and most important, was the concern that the strong product image of the PSX-360 would be damaged by the persistent discounting at retail. Clearly some type of decisive move was needed.

After months of discussion among Pro-Audio management, it was decided to implement the new Sales Agent Program. Its objectives were: (1) To eliminate discounting by controlling the retail price of the product; (2) To increase sales by canceling exclusivity agreements and opening up additional non-exclusive dealers in the same territory.

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* This case was prepared by Gerald Smith, Carroll School of Management, Boston College, Chestnut Hill, Massachusetts 02467.

The implementation of the plan was as follows:

(1) Effective June 1, 1998 all Pro-Audio dealers were terminated and encouraged to sign a new contract with the company, where they would now become "Retail Agents" instead of stocking dealers. This designation allowed Pro-Audio to get around any possible violation of the Robinson-Patman Act.

(2) Instead of stocking units in inventory for immediate sale and delivery to the customer, "retail agents" could now only keep a demonstrator model in their showroom. When a customer wanted a product, the order would have to be placed directly to the factory, through the "retail agent," and would have to be shipped to the customer directly.

(3) Since Pro-Audio was not equipped to handle open credit arrangements for the public at large, the stipulation was made that a customer would have to pay cash or bank check in advance before the order could be processed.

(4) Of course, since all sales were now transacted directly from the factory, Pro-Audio could now control price, and the price was fixed precisely at $12,000. This was positive to the retail agents, because they could now be assured of making a guaranteed margin of $4,000 per unit sold. It was theoretically impossible for another retail agent to undercut a competing retailer in price, because the price was fixed at the factory. As Steve Marsh put it in his press conference announcing the program: "Now, instead of competing on price, the new retail agents will compete on salesmanship; on how good they are at finding, prospecting, demonstrating, and closing a customer sale. And if a competing retail agent somehow manages to sell to a studio in your back yard -- then *shame on you; how could you let that happen?* "

(5) On the other hand, with the price fixed a customer could not negotiate with his local retail agent, which stifled the expectations of most studio purchasers. Because of the high cost of this type of equipment the standard purchase process in the industry was to negotiate a deal with the retailer -- perhaps a trade-in of old equipment, a discount for taking delivery by a particular date, or extended payment terms being available from the dealer to ease the purchase the decision. But, of course, now all of that was gone, since the transaction was handled only from the factory.

(6) Finally, since Pro-Audio now sold products to retail customers directly, the change to the Sales Agent Program required a change also in accounting. Instead of counting a unit sold as $8,000 in net sales (at wholesale prices), now the unit would be entered as $12,000 in retail sales (at full list price).

The Pro-Audio Sales Agent Program has been in operation now for 18 months, but new issues are emerging and new questions are being raised. First, sales have not grown significantly under the new plan. Second, despite the factory's control over pricing there are still persistent rumors that some retailers are finding ways to get around the fixed pricing clause. Should Pro-Audio enforce this particular provision and cancel the errant retail agents? Third, Pro-Audio is getting more and more feedback that the program is administratively cumbersome at the retail level, and deters the retailer's ability to sell and deliver the product.