Retail vs. Wholesale

By Dan Jensen, Compensation Plan Specialist

In the world of direct selling, there is frequent debate over the pros and cons of working with your sales force on a retail basis or a wholesale basis. There are two basic issues to decide:

1. Do we charge our consultants the retail price and then “rebate” back to them their retail profit or commission? Or do we have them purchase from us at a discount off the retail price and keep their retail profit as a personal commission at the time of sale?
2. Do we pay our consultants their team or downline commission on the retail price, the wholesale price, or some other lower commissionable value?

In this article, I will identify key points to consider as you determine which approaches will work best for your business.

What price do we charge our consultants when they place an order?

We have two choices:

1. Charge them the retail price and later pay them their personal commission or profit on the sale
2. Give them a discount off the retail price at the time of purchase. They keep the personal commission or profit because they pay a discounted wholesale price when they place their order with the company.

When we charge retail price to everybody (customers and sellers), we need to pay the sellers their retail profit at a later time. Some companies pay this weekly while others simply include it in their monthly commission check.

Charge Retail Price to Everybody	
Advantages	**Disadvantages**
Seller receives a commission check from the company weekly or monthly of their personal selling commissions (retail profit). Some companies report that the sellers feel they are making more money and see that what they earn is worth their time because it comes to them in a single larger installment. If they pocket their profits at the time of each sale, many will spend it on their way home on groceries, gas, etc.	Income tax: When you pay a retail profit or personal commission to the seller you must report that profit as income on form 1099 (US) or T4A (Canada). But what if they did not sell the product at retail? Or they used the product personally and made no profit? You have no way to know when their retail profit happens or does not happen, so you must assume ALL potential retail profit is actually taxable income to them. They will thereby have to pay income tax on their own personal purchases. If much of your sales are for personal use by your sales force, this could be a major disadvantage to you.
Sellers are often pressured by friends and relatives to give them a discount off the retail price. If the seller is paying retail and receiving their profit later from you, this pressure is reduced or removed entirely because the customer has no other price options. Your sellers might earn more profits this way. You control the selling price assuring your sellers that they will earn their full retail profit.	The lag time to receive their retail profits is problematic for many sellers. Some feel they are better motivated by instant gratification. Many sellers will work more and harder when they can earn their profits instantly. Any time you delay a reward, the power of the reward to influence behavior is diminished.
Your cash flow is improved by collecting the higher retail price and later paying out the retail profit to the seller. This can also work against you where your sellers have less cash flow and thereby may buy less product.	Many sellers prefer to keep their earnings private – unknown to their spouse – so they can spend their earnings as they wish. Receiving a check makes this hard to do.

When we charge wholesale price to the sellers, they buy at wholesale (often a discount of 25% to 50%) and sell at retail or whatever price they choose. For credit card customer purchases, you charge the full retail price to the customer and pay the retail profit to the seller with their monthly or weekly commissions (the same as if you charged retail to everybody).

Charge Wholesale Price to Sellers	
Advantages	**Disadvantages**
Seller collects the retail price from customers and pays the company a wholesale price – usually a 25% or higher discount off retail. They keep their retail profits providing instant cash in their pocket. This instant gratification often motivates them more when they feel a financial need or crisis. Some feel they work harder and sell more as a result. Instant gratification is a more powerful motivator.	Some sellers don't know how much they really earn through selling because they mix their cash profits with other money and spend it. Some thereby feel they earn less than they actually earn. Some will spend their earnings at the grocery store on the way home from their party or meeting and have little to show for their time.
Income tax: You do NOT report their estimated retail profits as income on form 1099 (US) or T4A (Canada) because you have no idea if they sold the product to somebody at a profit or used it personally. It is the seller's responsibility to keep track of their retail profit income and report it annually.	Friends and relatives will be more likely to pressure the seller to give them a discount or even sell it to them at their cost. The seller might earn little or no profit selling to some friends. Sellers must feel that it is okay to earn a profit selling to friends. In some cultures this is a psychological hurdle that must be taught and overcome.
	Your sellers buy products at wholesale and may come to feel that the retail price might be too high in some cases. The value perception can be "calibrated" in their minds to the price they pay if they receive any amount of price resistance from customers. Your sellers often think more like consumers than business people.
	You have no control of the selling price at the time of sale.
	Your sellers are often challenged with keeping track of their retail profits to report their earnings to the IRS at the end of the year. Some might not report their earnings at all thereby exposing themselves to the risk of tax penalties and audits.

Do we pay our downline overrides on retail or wholesale?

Your sales force earns a personal commission on the products they sell. But they also earn additional commission overrides on the sales of the people they recruit, and their recruits, and so forth. These downline overrides are the meat and potatoes of our industry. Their earnings from building teams are the lifeblood of our growth and success.

Some companies choose to pay these downline overrides on the retail price while others choose to pay it on the wholesale price after deducting the standard personal retail commission. In a 1997 DSA Quick Poll, 68% of 56 responding companies reported that they pay on the wholesale price while 32% paid on the retail price. Unfortunately, more recent data is not available. My observations suggest that these numbers are approximately the same today, perhaps even more weighted toward the wholesale price.

Paying Team Overrides on Retail Price

Advantages	Disadvantages
Paying on the retail price is simpler to understand because the team builders need to see only one number – retail sales volume. It is the basis for every aspect of the compensation plan. Many plans, even those that pay on the wholesale, qualify people on the retail sales value for Personal Volume, Group Volume, etc.	The percentages of your compensation plan look smaller when compared to other compensation plans that pay on wholesale. For example, a plan that pays 8% four levels deep on the wholesale would be the same as another plan that pays 6% four levels deep on the retail. When prospective recruits compare your compensation plan to others they might incorrectly feel they would earn less because your percentages are smaller.
	If you have products that are much less profitable than most others, it is difficult to reduce the basis on which commissions are paid if you pay on the retail price. Some companies pay their overrides on a reduced Commissionable Value for less profitable products in order to protect their profit margins on those products. If you pay on retail, this option is more difficult.

Most companies pay their team or downline overrides on the wholesale price. Some go a step further and pay on a reduced value below the distributor wholesale price on some or all products.

Paying Team Overrides on the Wholesale Price

Advantages	Disadvantages

The percentages of your compensation plan are higher than other plans that pay on retail giving you a slight competitive advantage when prospects compare your plan to others. They usually do not realize that one plan pays on wholesale while the other plan pays on retail.	Most plans that pay on wholesale will use the retail value to qualify people for their Personal Volume, Group Volume, and other requirements. Paying on wholesale while qualifying on retail introduces an additional level of complexity to the plan.
You can choose to pay commissions on a reduced Commissionable Value on products whose margins are less than desired thus protecting your profit margins better.	Not understanding the plan, some will expect their commissions to be paid on the same volumes on which they and their team members qualify. If you qualify on retail and pay on wholesale, some will be confused.

Conclusion

There you have it. There is no perfect solution to the question of Retail vs. Wholesale. You will need to decide which approach best suits your sales culture and business model.

About the Author

Dan Jensen has earned an enviable track record helping new and existing companies develop winning compensation plan strategies that build sales and recruiting. In 1978, Dan founded Jenkon, an industry leading software provider for the direct selling industry. Working with hundreds of new start-up companies as well as many direct selling giants in the last 30+ years, Dan has acquired a broad and unique perspective on what makes successful companies succeed, and what makes too many of them fail. He has published numerous articles on sales force compensation and other industry issues and has consulted for many industry leading companies on their compensation and incentives programs. Given to only one person each year, Dan was honored in 1997 to receive the DSA Partnership Award for his work at Jenkon. In 2007, we was once again honored to receive the award for the increased success his clients have found with their field compensation strategies.