# Path Dependence in Personal Selling: A Meso-Analysis of Vertical Integration

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*Abstract*

We examine an unusual form of path dependence, in which suppliers that take different decision paths end up in the same position: excessive vertical integration of the personal selling function. We argue that this is the case even though outsourcing is more seriously considered than ever, and economic arguments for outsourcing the sales function are compelling. We develop an institutional explanation at the meso level (a combination of individual, organization, and environmental forces, explicitly considering how these levels combine). This meso-analysis focuses on four forces driving firms toward being locked into employee sales forces. The first force rests on inherent characteristics of the sales function, which is low in inclusiveness and suffers from ambiguous standards of desirable performance. The second force rests on the interplay between one motivated individual, the director of sales, who has inordinate decision-making influence, and the rest of the organization, which is motivated to accept the sales director's recommendations without sufficient challenge. The third force is a set of three path-dependence mechanisms: legitimacy, need for a critical mass, and asymmetric switching costs between governance modes. The last force rests on characteristics of the institution of outsourcing sales. We enumerate and classify these mechanisms, illustrating them with a simple simulation of how outsourcing sales becomes rare. We close with testable propositions about which firms are most likely to break their dependence on a vertically integrated path.

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*"Where all think alike, no one thinks very much."*
--Walter Lippman

In a developed economy, competitive forces should drive out inefficient, ineffective managerial practices. We explain how the opposite can occur in a marketing setting. We focus on how suboptimal practices become institutionalized, quashing efforts to expunge them. We explain how this occurs even when managers are eager to improve their operating results and protective regulation does not constrain market selection mechanisms.

We consider a major strategic decision in marketing, whether to outsource the personal selling function or vertically integrate it. In spite of strong theoretical arguments in favor of outsourcing (e.g. Anderson 1985), selling is largely performed in house in the U.S. and Canada. Below, we argue that an outsourcing boom has swept North America, and has affected almost every function except personal selling. Why has this critical function been left behind? Why do so many firms, newly ready to outsource even such core functions as production, R&D, and personnel management, refuse to outsource their sales force?

To understand that, we adopt a multi-level (meso) process perspective, looking at the individual, organization, environment, and bridging mechanisms among these levels (House, Rousseau and Thomas-Hunt 1995). We examine how firms make then revise the integration decision in personal selling. We propose that vertical integration in selling is a robust phenomenon in which firms gravitate to direct sales forces more than would be suggested by arguments of maximizing economic fitness. This over usage of direct sales forces reflects an unusual form of path dependence. Most path-dependence explanations consider firms that

start in the same place, follow diverging paths, and eventually find themselves unable to duplicate other firm's behaviors (e.g. Becker and Gerhart 1996). Firms thus grow different in their capabilities because they are constrained by the path taken (Nelson 1995). In contrast, we propose that even firms that start in different places and take different paths can come to the same decision—to employ their own sales forces. Different paths to the same destination are usually explained by standards races, but we do not suggest such a mechanism.

Instead, we suggest that four institutional forces drive diverse firms to a common outcome—an implausibly high level of in-house selling. These forces are 1) characteristics of the personal selling *function*, 2) characteristics of the *institution* of outsourced sales forces, 3) the *interplay* between two levels of the company, the director of sales and other organization decision makers, and 4) mechanisms of *path dependence*. To illustrate the impact of such mechanisms, we simulate a variety of sales environments. We show that under a wide range of circumstances, industries converge to what we observe—very high levels of vertical integration of selling—in no more than five to ten years.

This paper answers a call by Grewal and Dharwadkar (2002) to incorporate both economic-fitness and social-fitness arguments and to explain when each will prevail. Having sketched how so many firms become trapped into operating their own sales forces, even if the firms themselves desire to outsource, we turn to how to change this situation. We predict which firms will innovate by outsourcing selling, breaking the tyranny of incrementalism for this issue. We conclude with propositions as to when firms will not merely survive but prosper by reconsidering their strategic use of outsourcing in personal selling.

## Defining the Rep

The sales force is to business markets what advertising is to consumer markets: an important means of differentiation, the principal means of communication with the buyer,

and a critical marketing tool. The personal selling function in business-to-business markets can be outsourced to an independent selling organization, a "manufacturers' representative," often shortened to "rep." This institution goes by different labels in different industries, e.g. "agents," "commission agents," or "agencies" (in insurance or electronic components), or "brokers" (in financial services). We label them "Reps," capitalizing to avoid confusing these professional sales firms with individuals.

Reps provide purely selling services on a contractual basis for makers of goods or originators of services (legally, the principals in a principal-agent relationship). Reps specialize in selling only; unlike distributors, they do not take title to what they sell, do not set their own prices, and do not handle merchandise. Rep organizations share risk with the principal: typically, they absorb all selling expenses and are paid by commission on sales realized (at the principal's prices). The principal, not the Rep, is responsible for order settlement and fulfilment. Unlike most distributors, Reps usually accord *category exclusivity* to each principal. Reps sell a "portfolio" of complementary product categories, one brand per category, based on their customers' needs and buying patterns. In short, Reps are a way to outsource *only* the selling function, as opposed to selling *and* the seven other flows of the distribution function (Coughlan et. al. 2001). Indeed, Reps sell *to* distributors (who are customers of a producer). Conversely, Reps may sell *for* some distributors.

## Vertical Integration of the Personal Selling Function

Thirty years ago, it was startling to suggest that any business function could conceivably be outsourced, and that many should be. Today, it is widely recognized that not all functions, even those fundamental to a business's existence, must be performed by employees of that business. Even such central functions as R&D, product development, production, sales, customer support, computing, and human resource management can (and often should) be

performed by employees of another business. Outsourcing of anything at all is a legitimate option considered worthy of debate by any company in any market (Lepak and Snell 1999).

Several scholars have investigated the different reasons explaining the heightened interest in outsourcing (e.g.: Poppo & Zenger 1998, Dragonetti, Dalsace & Cool 2002). One likely reason is the recognition that there are many ways to govern a relationship with another organization. Between the extremes of arm's-length contracting ("market") and vertical integration ("hierarchy") lies a wealth of arrangements offering the ability to design relationships of varying closeness, influence, risk, and resource commitment. These "relational contracts" include alliances, joint ventures, franchises, and other organizational forms which vary considerably in structure and function (Heide 1994, Gulati and Singh 1998). Firms have responded with such enthusiasm to these new possibilities that industry observers increasingly wonder what justifies vertically integrating almost any function (Auguste et al. 2002). In theory, this enthusiasm should extend to personal selling in B2B markets.

## Production Cost Advantages

In principle, outsourcing selling is appealing in terms of long-term economic efficiency (Anderson 1985, Williamson 1996). As a third-party specialist, the Rep enjoys economies of scale and scope by pooling the demands of many principals for representation, benefits that market pressures oblige the Rep to share with its principals. In selling, economies of scope are particularly important because for each sales call on each prospect, a salesperson must cover the marginal costs of the sale, such as travel, entertainment, samples, and return from foregone calls to other prospects. Because Reps sell many items that the customer buys (creating a broad assortment from multiple suppliers), they offer buyers "one-stop shopping."

The B2B buyer should be more willing to see a Rep, and even a small prospect should be worth a sales call because it may buy many items, albeit in small quantities.

In contrast, direct salespeople sell only their companies' products. Rarely can a direct salesperson match the Rep's breadth of line. The narrower the line, the larger a prospect must be to justify a sales call. Moreover, the narrower the line, the less likely buyers are to accept a call except for large orders. This is the "coverage" argument: covering a market thoroughly rapidly becomes prohibitively expensive unless the salesperson carries a broad line.

By representing multiple (non-competing) manufacturers, Reps pool their demands for selling services to create a large scale, pure selling organization within a coherent product categorization, exploiting benefits of specialization in running the sales force. In principle, Reps can gather more and better market intelligence by meeting the related needs of a broad range of customers, although, this advantage is limited by most Reps' regional nature.

## Transaction Cost Advantages

Outsourcing the selling function often reduces transaction costs. One reason is that the Rep is outside the principal's organizational politics and is motivated by powerful entrepreneurial incentives. Gimeno et al. (1997) demonstrate empirically how powerful these incentives are: entrepreneurs derive both monetary and psychic income such that they maintain businesses when their economic performance is unsatisfactory. This is pronounced when the business has a narrow scope or uses assets that are difficult to redeploy. Reps fit this description, as pure selling in one market is narrow and the assets (relationships and knowledge) are specialized to a customer base and a product category.

Being outside the politics of the producer generates benefits for a salesperson. Inside a manufacturer or service provider, selling is often viewed as peripheral and lower-status (Swenson et al. 1993). But selling is the Rep's only function; the successful salesperson is

accorded the organization's highest status. Thus, Reps can pay sales people without concern for whether their income surpasses the plant manager's. Reps also offer sales people the challenge of selling a varied product portfolio to a large customer base, Moreover, in North America direct salespeople are subject to frequent transfers. Rep agencies are a way for an individual who wants a career in sales to be valued and to succeed in an organization without uprooting geographically. In short, independence from a producing organization gives Reps the ability to recruit and retain salespeople with considerable success.

Transaction cost analysis posits that these factors should drive a firm to use Reps unless two circumstances prevail. First, selling jobs that result in high levels of idiosyncratic assets (knowledge, relationships, and producer-specific routines) should be filled by direct salespeople. Second, when the producer discerns results from the activities of a third party that do not index performance well, the producer faces internal uncertainty (aka behavioral uncertainty or performance ambiguity). Vertical integration is justified because it enables the principal to obtain other information from monitoring behavior to better index performance. Selling jobs are ambiguous when the task is complex and multi-faceted; making current sales is but only part of the picture. A study by Anderson (1985) in the electronic components industry finds that industry practices reflect the transaction-cost approach to personal selling. Further, there is evidence that following transaction-cost prescriptions improves selling efficiency, especially in turbulent environments (Anderson 1988).

## Bypassed by the Outsourcing Boom

On paper, then, outsourcing selling offers the producer lower production and transaction costs, at lower overhead, for jobs that are not highly idiosyncratic for which performance is not very difficult to evaluate. This suggests Reps should be common, but in practice, they are not. We contend that the outsourcing boom has bypassed the selling function.

Terminology clouds the classification of sales institutions.[1] According to U.S. census data, Reps (broadly construed) account for 11% of U.S. wholesale sales volume, the other 89% is carried out by resellers (both independent and in-house) (Fein 1999). About half of all producers in the U.S. use Reps (Dishman 1996). Thus, Reps appear common, but closer examination reveals many principals are merely nominal outsourcers. A producer recorded as using Reps may do business primarily through a "direct" sales force, while contracting with a Rep for only limited products, or only specialty markets (e.g. the military PX system) or less desirable geographies (e.g. a remote or sparsely populated state

Has the usage of Reps been growing along with the general increase of outsourcing? Aggregate census figures suggest that Reps gained ground in the 1970s and 1980s, but not since then. Many firms have moved from direct to Rep sales forces (usually quietly, as no firm seeks to publicize layoffs). However, these switches are offset by other firms that have done the reverse (Dishman 1996). In short, it appears that Reps are an institutional form that is well established and healthy. Yet the bulk of personal selling in the business-to-business domain is still performed by salespeople employed directly by the producer, and the outsourcing boom has not benefited Reps greatly.

What is the path by which company sales forces, rather than contract sales forces, become the dominant mode of organizing selling? Below, we sketch four forces (Figure 1) driving firms to company sales forces. Table 1 summarizes our arguments and organizes them by the Grewal and Dharwadkar (2002) taxonomy of institutional forces that are cognitive (why managers can't *see* what to do), normative (why managers *won't* do what should be done), or regulatory (why managers are *legally unable* to do what should be done).

## *Force 1: Characteristics of the Selling Function*

The selling function possesses two characteristics critical to understanding the rarity of outsourcing. First, the sales function in many producing organizations is low in inclusiveness, how much the activities of one unit involve those of another. Second, this function has ambiguous standards of desirable performance.

Low inclusiveness

Producer organizations frequently treat sales as a stand-alone function (often a separate division): products and services are handed off to the sales force, which is expected simply to sell them. The low inclusiveness of the selling function is enhanced because many producers consider it a bit mysterious and hold it apart from the rest of the company (Churchill et al. 2000). In a later section, we will argue that low inclusiveness impedes the firm's make-or-buy analyses.

Many producers fail to appreciate the challenges inherent in selling. Common fallacies are that good salespeople are born, not made (Churchill et. al. 1985), and that salespeople require little management. The reality is that selling skills must be carefully developed (Cron and Slocum 1986), and that sales management is a difficult and complex task (Anderson and Oliver 1987). Good sales management is not common: when practiced, it creates significant gains in both effectiveness and productivity (Mantrala, Sinha and Zoltners 1992). Yet, because they focus on production and not the selling function, many of a firm's managers do not appreciate the cost savings, nor the gain in total contribution, that a well-managed sales force will create. Thus, the organization will believe that it can do selling function well.

## Ambiguous Standards of Desirable Performance

Performance Uncertainty

The performance of any sales force (whether Rep or employee) is multi-faceted and difficult to reduce to one indicator. It also takes time to accrue: an industrial sale requires

multiple calls, and customer relationships build slowly (Churchill et al. 2000). The obvious measure is total sales volume, but the producer is interested in more than maximizing overall volume. Sales force objectives exist for each product, at desired prices (hence margins), to targeted customers, with target amounts of added services. Hence, performance will be evaluated on a composite of indicators, such as market share (by customer segment and by product), cost to serve, growth of new accounts, retention of existing accounts, and so forth. And these are only the measures of outputs. The firm may also evaluate performance in terms of activities (such as providing market intelligence). For employee salespeople, additional subjective indicators may be used that reflect the manager's discretion. Not surprisingly, the correlation between objective and subjective sales performance indicators averages a modest .4 (Rich et. al. 1999). Whatever the results are, they should be compared to the cost of maintaining the sales force (Anderson 1988). Here, producers using Reps have a clear picture. But for a direct sales force, many sales-related costs may be grouped with administrative overhead (SG&A) and very difficult to assess.

The greatest complication in evaluating performance is the baseline problem. Sales forces almost invariably generate sales: how large should that volume be before the producer can conclude its selling efforts are successful? The wrong governance decision (Rep or direct) generates lower sales, lower contribution margins, and higher selling costs. But lower or higher than what? The greatest difficulty is gauging results obtained relative to results that *would* have been obtained *had* the firm governed its sales force differently--which is unobservable (Masten 1993). This obliges the producer to infer the results it would have achieved from the road not taken (this Rep, a different Rep, or a direct sales force).

So far, we have assumed that the producer wants a high-performing sales force in terms of current economic results. Next we turn to alternative definitions of performance, ones that

are long term and uncertain. Market feedback mechanisms for such strategic goals are even weaker than for financial goals. Below, we consider three reasons why a firm may choose in-house selling, *knowingly compromising short-run efficiency,* in pursuit of a higher (strategic) goal.

## Strategic Goals

***Signaling***. A signal is an action or announcement that conveys credible information about the sender's intention and abilities. Hiring a sales force is an important investment both in terms of money and time, costly to reverse. Hiring a sales force therefore signals to all constituencies, especially to customers and competitors, that the firm is committed to the product line. The producing firm may believe that the signal will improve its market position, so that it will recoup at least partially its investment in a direct sales force.

***Strategic control***. keeping strategic control over the selling function may itself be a goal. Such a goal is less often announced, perhaps because its rationale is less clear. Why couldn't a producer maintain strategic control while using a Rep?

Agency theory provides theoretical support for why using Reps affords weaker control to the producer. An integrated sales force provides a short and direct link to the customer: the firm acts as a principal and hires multiple agents (its employees) to sell to its customers. The hierarchical link gives several advantages to the organization: through fiat, rules of conduct, legitimate authority, the right to monitor activity, and job design, companies can restrict their employees' actions in a way that not possible in a market context (Williamson 1996). Furthermore, facing individuals, the firm is *de facto* more powerful: employees have only one employer, creating a high dependence relationship. If all else fails, the threat of dismissal is powerful and credible. Thus, the firm can micro-manage employee's work.

In contrast, when a firm uses Reps, the chain of control has unfavorable characteristics, shown in Figure 2. First, the chain is longer. The principal contracts with the Rep. In turn, the Rep acts as a principal and hires sales representatives. The Rep has a *dual* role as both agent and principal. The firm-to-salesperson link is replaced by a firm-to-firm link. The supplier manages its relationship with the Rep, which blocks the supplier's efforts to micro-manage the Rep's employees (Liebeskind 1996). Further, the power balance in the principal-agent relationship has been altered; the Rep may be as or more powerful than the producer.

Further, the focal producer is usually not the only one with which the Rep has contractual ties. The Rep’s principals should be non-competing, although product lines should be related enough to justify calling on the same customers. But it is difficult to achieve zero overlap. Further, product lines change due to principals' competitive moves, such as product extensions, repositioning, or diversification. These can lead to some form of competition in some segments, and thus to bitter discussions and renegotiations.

Finally, all the Rep's principals do *de facto* compete among themselves, not for the customer's order but for the resources of the Rep. The Rep determines the customers to call on, the call patterns to follow, and the products on which to put selling efforts. These choices have important implications in terms of sales result for each principal.

***Coping with the future***. The producer may justify using employee salespeople as a generalized way to cope with (unspecified) future change. Under this perspective, one value of going direct is that it opens new perspectives to the firm. The analogy is of investing in an integrated sales force as a real option (Kogut and Kulatilaka 2001). Like an option, this investment gives the right, but not the obligation, to participate in future projects. Examples might include a launch of a new product line, which cannot be sold through the current Reps because it competes with the Reps’ other products, or a switch to “systems selling,” requiring

an in-depth involvement of the firm's skilled development engineers.  Another example is the possibility to carry other firms' products (a carrier-rider relationship) through one's integrated sales force.  These strategic moves may not be undertaken if the firm uses Reps.

As Bowman and Moskowitz (2001) underscore, options reasoning is not a blanket justification for investing in assets that may never be used.  Nevertheless, the intuitive analogy of "keeping options open," and the idea of proactively exploiting risks (Kogut and Kulatilaka 2001) may be powerful enough to motivate some managers to use employee salespeople, even in the absence of a current need or plan.

To this point, we have detailed how two characteristics of the sales function—low inclusiveness and ambiguous standards of desirable performance—work to limit outsourcing. These features of selling underlie our meso-analysis.  Following Figure 1, we now describe how interactions across different levels of aggregation further dampen outsourcing.

## *Force #2: A Meso Analysis of Organizational Decision Making*

### The Influence of the Director of Sales

The first step of meso analysis to identify key individuals and to examine the role they play and how they exert influence (House, Rousseau, and Thomas-Hunt 1995).  We argue that the director of sales has inordinate influence in the decision whether to outsource the selling function.  At first glance, this should not be true.  Outsourcing selling is a strategic decision, and since most strategic decisions are made by groups of top managers, the individual's influence is usually diluted.  However, in practice top management is unlikely to become more than nominally involved in a sales force structure decision (Hambrick, Cho, and Chen 1996).  Further, we have argued earlier that personal selling is low in inclusiveness: House et al (1995) argue that low inclusiveness gives rise to autonomous behavior.

As side effects of holding sales apart, albeit accountable, the sales director not only has considerable discretion over sales affairs, but also plays a large role in framing sales decisions for the rest of the organization. We focus on how the sales director will 1) frame the organization's *needs* vis-à-vis the selling function, 2) frame the organization's *alternatives*, and 3) factor in his/her individual career preferences and perceptual biases in exerting influence. That standards of desirable performance are ambiguous enlarges the sales director's ability to influence a major strategic decision.

## The Sales Director Frames the Organization's Needs

Transaction cost analysis argues that Reps should be used when assets needed to perform the selling function are not highly idiosyncratic, or when selling is not performed on a large enough scale to justify in-house overhead (Anderson 1985). However, the sales director is likely to question whether these conditions apply. The director is motivated to believe that his/her sales operation will be successful, thereby achieving large scale. And the director is likely to believe that his/her firm's selling function *is* idiosyncratic in a valuable way, in part because it is difficult to establish just how much this is so.

Most managers focus on their own firms and respond to uniqueness and novelty in their environment (Isenberg 1994). Unless they have changed jobs often or been consultants with a number of clients, they know best their own firm. Combined, the lack of familiarity with other firms, focus on their own firm, and attention to novelty may lead to over-emphasizing the uniqueness of their firm's products, selling process, salespeople, customers, and management style. This tendency is exacerbated; the selling function contains much tacit knowledge, which argues for internal control (Ghosh and John 1999, Hitt, et. al. 2001). Lepak and Snell (1999) underscore this phenomenon, noting that human capital often becomes idiosyncratic in a path dependent way, requires tacit skills and knowledge, and is

acquired by doing. Of course, to be an asset, the firm's selling routines should be both idiosyncratic and superior. If not, these routines are not an asset and may even be a liability.

How genuinely idiosyncratic *is* the firm's selling program? It may be less so than meets the eye. There is considerable commonality in how sales is carried out (Calvin 2001), even though the commonality may be less evident than in a tangible activity such as production. And the commercial value of sales relationships is easy to overstate: analyses of the productivity of sales time routinely demonstrate the salesperson's fallacy of believing that good relationships are the most profitable ones (Lodish 1980).

Nonetheless, the director is likely to believe that "our way" of selling is *both* idiosyncratic and valuable. A director of sales is motivated to do so as part of the role. Just as brand managers believe that their product is unique and offers superior value to their customers, sales managers believe that what they do is nonstandard and a better way to carry out the function. Although market research regularly contradicts the brand manager's beliefs (Moorman, Zaltman and Deshpandé 1992), there is no equivalent for the director of sales. The tacitness of sales makes it difficult to falsify the assumption that "our way" is unusual and valuable. Those who challenge the sales director on this issue will find that the low inclusiveness of the function makes their case difficult to argue.

## The Sales Director Frames the Organization's Alternatives

The egocentricity or positivity bias in attributions (Ross and Sicoli 1979) occurs because we understand best the environment from which we come, and often with this understanding comes a preference for the familiar. Since most sales are made by employee salespeople and managed by employee sales managers, the director of sales is likely to be familiar with the vertically integrated context and is unlikely to be well acquainted with the institution of Reps. Capability, as well as familiarity, plays a role. Anderson, Mehta, and Dubinsky (2003) point

out that the knowledge, skills, aptitudes, and other characteristics (KSAOs) of a sales manager are intra-organizational in nature, with the focus on attending to one's own salespeople. In contrast, dealing with another firm (such as a distributor or a Rep) requires KSAOs that are inter-organizational in nature—and relatively few sales managers acquire these skill sets in equal measure.

For several reasons the sales director will be in a position to frame the producer's alternatives. This framing carries great weight due to the low inclusiveness of the selling function.

***Personal Preferences***. Personal preferences are likely to influence the sales director's recommendation. One such preference is to manage one's own career and one's ability to influence the organization. An internal sales force is an organizationally formidable entity, and the manager of such an entity is likely to carry a significant level of power. On the other hand, a set of Reps, geographically distant and structurally disconnected from the organization, combined with the more minimal internal organization necessary to support the Reps, is not nearly as visible or formidable. Ironically, the low overhead and variable cost of outsourcing sales minimizes the power of the manager of this function. Thus, the sales director gains power through an internal sales force and can influence organizational and personal outcomes more (Lepak and Snell 1999).

***Perceptual Biases of the Sales Director***. Aside from personal preferences, a number of perceptual biases can affect the director's understanding of the possibilities of the decision.

The *availability bias* (Tversky and Kahneman 1973) suggests that more salient information in memory is more likely to be considered in a decision. The sales director interfaces with the Rep's managers (more than its salespeople), may make some key-account sales personally, and may manage a key-account sales force that sells direct. These hands-on

experiences raise the salience of the internal sales force, compared to the out-of-sight (possibly out-of-experience) Rep.

*Overconfidence* (Fischhoff, Slovic and Licthenstein 1977) means that, given a difficult problem, humans systematically overestimate their likelihood of solving it correctly. Achieving the organization's sales goals is challenging: sales managers may overestimate the internal sales force's ability to do so.

*Persistence of set* is the idea that humans persist in using decision strategies long after they have been shown not to work well (Luchins 1942). Repeated, successful use of a strategy inhibits learning better strategies. Sales managers may simply not see another solution (Reps), even if that solution is better than the current internal sales force.[2] Relatedly*, functional fixedness* is the tendency to think of an object as having only one function and to ignore less obvious ways to use it (Dunker 1945). Managers may see only the option to have salespeople (the object) as an internal sales force (the function), rather than access them through another employer (another function).

In short, sales managers' experience, skills, personal preferences, and biased perceptions suggest that they will lean easily towards the direct sales force. Once *a priori* superiority of company sales forces is perceived, the *motivated decision maker* bias (Kunda 1990) supports that tendency: once we categorize something as good or bad, we unconsciously code additional information to support that categorization. The *confirmation bias* (Einhorn and Hogarth 1978) exacerbates this; we are more likely to search for information confirming our beliefs vs. information disconfirming our beliefs. Thus, a prior tendency toward the direct sales force will be exacerbated due to these categorization and search biases.

***Stylized Break-Even Analysis.*** Another factor influencing the sales director's decision is how the Rep/direct analysis is done. The most common approach is a stylized breakeven

analysis (Dishman 1996), in which revenue is plotted against the cost of each type of sales force. This analysis, readily available in texts, trade books, and the business press, follows.

Reps are compensated by commission on sales with no reimbursement of their selling costs. The Rep's commission rate is low (average 5.3% across all industries[3]). Thus, at low sales levels, outsourcing is widely thought to be less costly than vertical integration. This conclusion is thought to reverse as sales grow. It is typically assumed that fixed costs don't rise, while the strictly variable cost of a Rep continues to mount in linear fashion. Hence, there is always a crossover point, a level of volume beyond which direct sales forces are more economical. This appealingly simple analysis points unequivocally to direct sales forces for all but small product lines.

It is unusual to see in print a discussion of the questionable assumptions behind this analysis: fixed costs don't rise as sales increase; Reps won't cut their commission rate for higher-volume items; a direct sales force can generate the same sales as the Rep, and can do so even when the direct force is of a fixed size and the Rep is of a variable size (Reps add personnel or shift selling time from one line to another as sales grow). Thus, popular stylized analysis leads sales directors to simplify the decision: product lines that succeed invariably grow into direct selling.

If the sales director persuades the producer to go direct, the market eventually generates feedback on the wisdom of the move. As noted earlier, this feedback is not unambiguous, particularly if the firm is interested in strategic goals (signaling commitment, driving markets, keeping strategic control, coping with the future) rather than economic goals (such as minimizing the cost/sales ratio given a volume objective). *Escalation of commitment* (Brockner 1992) is the tendency of managers to overweight previous investment in an alternative strategy and so to lobby the organization to invest further in that alternative, *even*

*in the face of poor performance*. We expect the decision maker to continue investment in the alternative in which s/he has already invested (likely the internal sales force), despite information suggesting better alternatives.

## The Organization's Reasons to Accept the Sales Director's Recommendation to Integrate

Below we argue that organizations, like their sales directors, are also motivated to favor integrating the selling function and capable of distorting information to favor such a move. We note that the mechanisms creating organizational biases and preferences are not the same as those that operate at the individual level, although the net result is the same: direct sales forces will be favored at the expense of Reps. First we consider six reasons why an organization would favor direct sales *a priori*: bundling, in-group trustworthiness, belief in loyalty, belief in stability, a perception that no good Reps are available, and failure to appreciate economies of scope. We then turn to five reasons why producers that use a Rep they might switch to direct selling: the curse of success, closing the legitimacy gap, ignorance of how to motivate Reps, scapegoating, and malleable switching cost estimates.

## Why Organizations Favor Vertical Integration *A Priori*

*Bundling sales efforts*. Williamson (1999) flags the problem of bounding a set of economic activities. Decision makers may treat transactions in clusters, introducing interaction effects among the decisions for each transaction. In the selling context, this occurs when the firm sells more than one product. If a direct sales force is appropriate for one product (for reasons of idiosyncracy), the producer may erect a sales force for that idiosyncratic product, then use that sales force to sell everything else to amortize fixed costs. Anderson (1985) finds evidence of such behavior in the Rep/direct context, while Anderson

and Coughlan (1987) find the same phenomenon in setting up the complete array of distribution flows to enter foreign markets. The consequence is that, by bundling sales of different products, the producer may creep into fielding a direct sales force to sell a product line that largely does not need it.

One can also bundle functions. Teece (1992) argues that it is essential to bundle many functions that are connected with innovations. This is because the producer of an innovation must generate and protect returns during the long, costly period in which the innovation diffuses. Often, institutional safeguards such as patents offer inadequate protection. The way to gain protection is to integrate into other stages of the value chain when these stages are both complementary with and specialized to the innovation. Such "co-specialized" assets are used in conjunction with the innovation, and are necessary to protect the rents accruing as the innovation diffuses. Teece (1992) refers to co-specialized assets as "bottleneck assets;" their owner could hold up the producer at some point in the diffusion process and thereby extract an excessive share of the innovation's rents. Prominent in the list of typical co-specialized assets is sales.

We now turn to factors that come into play once the firm has made the decision to outsource the selling function. We examine forces that make the producer reconsider.

*In-Group Trustworthiness.* Employee salespeople are believed more trustworthy than Reps, for reasons anchored in the stereotyping and inter-group categorization literatures. Social categorization is ubiquitous because it enables one to economize cognitive efforts (e.g. Kramer 1991; Brewer and Brown 1998). Fiske and Neuberg (1990) suggest that the more distant the object, the less effortful the processing. Non-sales members of the producing organization believe that the sales function is “different,” because selling involves boundary

spanning between firm and customers. Compared to employee salespeople, it is likely that Reps are seen as even more distant than the (already somewhat distant) integrated selling function. Therefore, motivation to form a more precise impression of Reps within the firm is generally low. Reps are seen as a breed of their own, different from the focal organization.

Further, employee salespeople and Reps compete to carry out the selling function. Williams (2001) proposes that competition between two groups has a negative impact on perceptions of benevolence and integrity, which are major components of trustworthiness (Mayer, Davis and Schoorman 1995). Because employee salespeople (an in-group) see Reps as a competing out-group, they will tend to believe that Reps are less trustworthy. They may transmit this belief, as employee salespeople and/or managers are what (meager) connectors Reps have with the rest of the organization.

*Building loyalty***.** A major issue in human resource management is how to induce employees, particularly those in autonomous jobs, to cooperate fully with their employers (Lepak and Snell 1999). Industrial selling is highly autonomous; therefore, it is critical to socialize salespeople. Yet many producers perceive they enjoy more loyalty on the part of their salespeople than is the case (Dubinsky et al. 1986).

Producers can forge strong relationships with Reps via such mechanisms as building relational norms (Heide and John 1992), creating expectations of future interaction (Heide and Miner 1992), and exchanging credible commitments (Anderson and Weitz 1992). However, the producer is often not fully informed of these possibilities, and suspicious of the risks and resources entailed by a relationship-building strategy. All else constant, the organization will overestimate the difficulty of forging a committed Rep relationship while underestimating the difficulty of building a socialized sales force.

*Perception of stability*. Human resource managers widely consider stability desirable (Lepak and Snell 1999). Sales forces usually are not stable; salesperson turnover is a major and expensive problem for firms (Tyagi and Wotruba 1993). For at least three reasons, the producer may perceive that the turnover problem is accentuated when using Reps. First, managers may frame the issue as losing an employee salesperson versus losing a Rep organization. The process by which a salesperson takes the actual step to quit the firm is largely individual (Chandrashekaran, et. al. 2000). The loss of a single salesperson is an isolated event that seldom has firm-wide repercussions. By contrast, when the firm faces the risk of contract termination by a Rep, a larger portion of its sales volume may be at stake. Second, non-compete clauses can be used to insure that the competition does not gain a salesperson's specific knowledge. These clauses are harder to write and enforce in a market relationship (Liebeskind, et. al. 1996). Third, when the firm is using Reps, customers' loyalty may reside with the Rep, not the firm. The relationship between customer and Rep may be only minimally affected by termination, as the Rep has complementary product lines to sell and can contract with another producer to offer a replacement brand. Further, the Rep can use the continuity of the relationship to disparage the producer's products once it has been terminated (Weiss and Anderson 1992). All of this is less likely to happen with employee salespeople, many of whom do not stay in contact with their former customers.

The perception that employee sales forces offer the producer more stability than do Reps may not be warranted (although the greater cost of replacing an entire Rep agency, versus a single salesperson, must be acknowledged). The issue may be one of visibility within the firm. The departure of individual salespeople is considered a routine, unavoidable, event linked to personal choices and preferences, part of business as usual. In contrast, termination

of a contract with a Rep is likely to be a visible, corporate-wide, out-of-the-ordinary event because it means losing a sales force, not just a salesperson**.**

*Perception of pre-emption of "good" Reps***.** A perennial problem in inter-organizational relations is that of discovering, then recruiting, suitable partner firms (Gulati 1995). Given that there may be hundreds of Reps in a product line/market, the producer is often at a loss as to how to find "the good ones." Producers know how to find and hire employees: this is a normal organizational routine, and the producer may reason that a salesperson is just another employee. But producers may not know how to locate and attract Rep agencies: this is not part of their routine. Routines condition producers' perceptions of their opportunities (Nelson 1995). They may perceive that there are no good Reps available. Part of the view that direct sales forces are more stable may thus be the result of an availability bias: traces of switching issues are available in memory in the Rep case and less so in the case of the salesperson.

*Ignoring economies of scope*. Organizational preferences for using employee salespeople may stem from the failure to appreciate the economies of scope achievable by using Reps. One reason is the lack of visibility of smaller customers' collective potential. Those customers large enough to warrant sales calls with a restricted product line are highly visible: focusing on these "big kills" is often regarded as the most efficient way to meet the sales target. Another reason may be an attribution error. The firm may overstate the benefits that a Rep agency derives from having the firm's product in the agency's portfolio and may underestimate the value of the other products to customers. The producer may thus think that its own product line benefits less than do the other products from economies of scope, and that the other products are free riders, benefiting excessively from the producer's lines. Part of the reason is sheer lack of information on customers' needs for these other products.

Alternatively, Reps share responsibility if they understate the importance of the other firms they represent to underscore efforts for the focal firm.

## Why Producers May Switch from Rep to Direct Sales Forces

We now turn to the case of producers that do use Reps. We argue that producers are often tempted to convert to direct selling, and consider five rationales.

*The Curse of Success*. If a producer uses Reps and the results are good, the firm is more likely to stay with its Rep (Weiss, Anderson, and MacInnis 1999). Surprisingly, even some manufacturers that *are* highly satisfied with their Rep's performance and *do* credit the Rep will replace it with a direct sales force. Paradoxically, positive market outcomes can have *negative* consequences for the Reps. The sales director may use this favorable market outcome to gain clout and credibility, then seize the opportunity to build up his/her own sales department (Pfeffer and Salancik 1978). Further, increased sales raise the likelihood that the break-even point of employee salespeople is reached. One textbook blandly phrases it thus:

> Another time the going gets rough, especially with manufacturers' representatives, is when the rep does a good selling job and develops a territorial market so that there is enough potential business to support the producer's own sales force. Then the producer wants to cancel its contract with the independent rep. While this is a normal evolution in dealing with manufacturers' reps, it is usually not a pleasant situation. (Stanton, Buskirk, and Spiro 1991, p. 80)

Hence, Reps cite the threat of being "too successful" as one of the three most common reasons they fear losing a line (Anonymous 2001).

*Closing the legitimacy gap*. If results under a Rep are disappointing, the producer may switch to another Rep, and often do. But many firms do not pursue this solution out of concern for legitimacy. Weiss, Anderson, and MacInnis (1999) demonstrate that firms decide to redress their dissatisfaction by going direct as a function of their "reputation gap." The producer holds a belief about how the customer base perceives the Rep and producer

(that is, each party's reputation). The producer may believe there is a reputation gap, such that customers have a higher opinion of the producer than of the Rep. This gap is worrisome (associating with the Rep may degrade the supplier), so producers seek to redress it. The less costly way to close the gap is usually to change to another Rep that the customer base holds in higher esteem. But producers instead take a more costly route—going direct—*if they believe that having a direct sales force is what the most legitimate producers in their industry do*. When managers believe an in-house sales force is a characteristic of legitimate producers, they copy the "legitimate" governance choice and do not consider another Rep.

*Ignorance of how to motivate Reps*. Why not change to more effective ways of influencing Reps? Anderson, Lodish, and Weitz (1987) inventory ways to do so. However, these are inter-firm influence methods, and many firms are not skilled in their use. Here, the sales director is called upon to change operating methods, an implicit admission that earlier methods were ineffective. At least some sales directors will be motivated to conclude the problem lies outside their responsibility.

*Scapegoating*. When producers are (rightly or wrongly) disappointed with the results of their Rep, the sales director needs to justify the poor results to his/her colleagues and top management. Research at the top management level in poorly performing organizations has shown that powerful CEOs are able to buffer themselves from direct responsibility by blaming the performance on subordinates and replacing them (Boeker 1992). These subordinate managers play the role of scapegoats (Gamson and Scotch 1964). The same situation may apply at a lower hierarchical level to sales directors and other sales managers.

Girard (1986) underlines three key elements of the scapegoating mechanism. Scapegoating requires a) a crisis, b) an accusation, and c) a victim, who is made to shoulder the blame. The accusation is usually brought against those who are observably different.

The crisis is the poor market results; the accusation is of responsibility for them. Reps are suitable victims: as stand-alone organizations, they do not belong to the firm's in-group. A basis for the accusation can easily be found. That Reps work concomitantly for several firms may serve as a basis; past critical incidents between the Rep and the producer may also be used. That Rep managers are not physically present inside the producer facilitates the work of the accuser, as the Rep cannot properly respond.

*Malleable Switching Cost Estimates*. We have sketched motives for producer management (particularly the sales director) to move to a direct sales force when a Rep is in place. However, a Rep-to-direct switch is not always feasible. Customers may have strong ties with their Reps (Heide and John 1988). Or principals may face high switching costs in other forms. Weiss and Anderson (1992) study the role of perceived *switching costs* among manufacturers currently using Reps. They model the producer's estimate of the cost of dismantling the Rep operation and erecting a direct operation (one-time switching costs). As expected, switching costs depress intentions to switch. However, Weiss and Anderson (1992) also discover a curious simultaneous phenomenon: *the producer appears to revise its estimate of switching cost to accord with its intention*. Producers intending to switch to direct downgrade their cost estimates, while those intending to stay with Reps upgrade their cost estimates. Such gymnastics of logic are easy to conceal because switching costs are difficult to estimate, thus necessarily subjective.

In short, our meso-analysis suggests that at the individual level, the sales director tilts the arguments in favor of a company sales force, while at a more aggregate level, the rest of the organization is motivated to accept this recommendation. The stage is ready to embark on a vertically integrated path. Below, we argue several mechanisms—legitimacy, critical mass, and asymmetric switching costs—play a dual role (Figure 1). These mechanisms raise

obstacles to leaving the vertically integrated path, once taken. The same lock-in mechanisms also feed meso-analytic arguments to vertically integrate in the first place.

## *Force #3: Path Dependency Mechanisms*

### Lack of Legitimacy of Reps

The institution of the manufacturers' representative is poorly understood. Reps are readily confused with distributors or with company salespeople on commission. It is not surprising that if the U.S. Census has difficulty identifying Reps, so do many businesspeople. And since Reps account for roughly a tenth of B2B sales in the U.S., there are fewer opportunities to correct misimpressions. Indeed, Reps try to project the image of each of their suppliers, and do not promote competing brands. Thus, their own identity and rationale as an institution is not always clear to personnel outside the purchasing function.[4] In short, Reps are relatively rare. We argue that rarity breeds more rarity.

An important factor is the producer's motive to seek legitimacy to improve social fitness, even at the expense of some economic fitness (Grewal and Dharwadkar 2002). A firm possesses legitimacy when its constituents see its actions as right and proper. When in doubt, the move considered legitimate is that which is common and taken for granted. Under uncertainty, firms imitate the actions of market leaders, thereby coming to resemble each other. This phenomenon of institutional isomorphism (DiMaggio and Powell 1983) suggests that direct sales force will propagate because they will be taken for granted as "normal," which confers legitimacy. Outsourcing the selling function may be seen as illegitimate merely because the Rep is seldom seen. Thus, many organizations aspire to having their own sales force when they become large enough to afford the overhead.

Institutional isomorphism reflects not only a desire for legitimacy but confusion about what is the profitable decision to make: firms imitate other firms when economic signals are unclear (Greve 1996). We argued earlier that standards of desirable performance are often unclear in personal selling. Specifying and measuring multiple, conflicting, long-term, and uncertain objectives opens the door to copying the vertical integration decisions of other firms in the selling domain.

## Need for a Critical Mass

Some markets are thin: they do not support many Reps. For example, a declining product category may become so small that few Reps are motivated to carry brands in it; or a market may be too small to support multiple Reps. Even a large market may undergo consolidation, such that few Reps are left. An example (Murphy 2001) is the U.S. fast moving consumer goods industry. Hundreds of regional "food brokers" have given way to three very large national brokers. Food brokers achieve overwhelming economies of scope and scale: their commissions range from 2 to 5 %, versus costs of up to 10% for direct sales forces. Suppliers that want to outsource need a critical mass of Reps: having only three market alternatives blocks a firm from leaving the path of direct selling. (In this example, lack of critical mass encourages a firm to leave the market altogether, unless it has other advantages to offset the high cost of direct selling. This underlies growing concern about excessive consolidation in the food industry.)

## Asymmetric Switching Costs

Argyres and Liebeskind (1999) argue that path dependence is a major reason why firms violate economic principles. In our context, path dependence arises when the decision taken to rely today on a direct sales force creates a lock-in effect tomorrow. We argue that

*switching costs in selling are asymmetric*, i.e. that it is costlier to change from direct back to Rep than it is to move from Rep to direct. Thus, the producer that has put a direct sales force in place is likely to become trapped in that choice—this is a corridor of no return.

A major reason is that firms that are failing with direct sales forces will not easily convert to Reps. Terminating a division is not easily done (Argyres and Liebeskind 1999). The firm's constituents (including customers and employees) may view it as an admission of failure. The sales director will escalate his/her commitment to direct selling, particularly if she or he originally urged going direct. Even in failure, the low inclusiveness of the selling function continues to insulate the sales manager's reasoning from some degree of challenge by other organization members.

The more likely path is that the producer, once it acknowledges the poor outcomes, will work with its employees to try to raise its results. Directing employees is a more familiar routine than influencing third parties. Thus, the firm is unlikely to turn to Reps until poor results have continued for some time. Only then will the organization be willing to "unlearn," that is, discard what it views as knowledge. Unlearning is difficult for any organization (Huber 1991).

A more insidious scenario is also common. Reliance on an integrated sales force has been internalized and therefore is not questioned anymore. Or managers simply may not realize that circumstances have changed and could warrant a switch to Reps (Johnson 1987). This situation can be described as the "tyranny of incrementalism." The dominant way of thinking is an incremental one, because it does not question the status quo. Under this pattern, the existing direct sales force may be thought as a "sunk cost," and new products are "naturally" sold through this integrated sales force.

In short, expensive as it is to switch from Rep to direct, a firm will see it as vastly more expensive to undo a direct organization: switching costs are asymmetric.

### ***Force #4: Characteristics of the Institution of Reps***

To this point we have focused on reasons for sales directors and organizations to favor vertical integration. We now turn to institutional and environmental barriers that can make it difficult to use a Rep *even if the producer wishes to do so.* Earlier, we argued that producers perceive more scarcity of "good" Reps than is the case. However, it is true that Rep availability is not unlimited, for structural reasons. The *institution* of the manufacturers' representative, as currently practiced in North America, has three features-- symmetric exclusivity, fear of dependence, and local market focus--that complicate the task of entering a relationship with a Rep, thereby reinforcing dependency on a vertically integrated path.

*Symmetric exclusivity*. It is an unquestioned feature of the Rep institution that each side grants exclusivity to the other. Principals appoint only one Rep in a product/market; Reps carry only that producer's line in its product category. This means the company speaks with only one voice in a market, while the Rep delivers only one message in each product category. This parallels what companies do with their internal sales forces: it is custom for employee salespeople to have exclusive territories, and for management to prevent employee salespeople from infringing on each other's assigned customers. This also means that a Rep is loyal not only to its customers but to its principals. Each side has made a credible commitment to the other (Fein and Anderson 1997).

Symmetric exclusivity retards the usage of Reps because it is a contractual commitment that constrains both sides. The producer may find that the Rep it would like to sign up already carries a competitor. The Rep might be induced to drop that principal to make room, but this does entail switching costs. Further, a Rep does not want to acquire a

reputation as a firm that drops principals readily: this is unsettling both to customers and to prospective principals. But even if the producer does find a suitable Rep, the growth paths of both sides are constrained. If the Rep wishes to grow geographically, it bumps up against the exclusivity the principal has granted to an adjacent Rep. If the producer wishes to grow its product line, it bumps up against the brand to which the Rep has already granted exclusivity.

*Fear of dependence.* Even within a product line and geography, growth can be hazardous. If the Rep grows large, the principal may fear that it is not important to the Rep and that it will be neglected. If the principal grows large, the Rep risks becoming dependent by deriving too much of its income from one source. Anderson, Lodish, and Weitz (1987) show that if a principal accounts for more than one third of a Rep's revenue, power becomes imbalanced, to the detriment of the Rep's profitability. It is not easy to keep a growing principal to one third of the portfolio: Reps are obliged either to resign the line or to invest to grow their entire business to retain balance in their product portfolio. Heide and John (1988) show that Reps need to manage their dependence on principals, and that failure to do so hurts the Rep's profitability.

*Local market focus.* An advantage of Reps is that they are dedicated to one market. This becomes a drawback when a producer serves very large customers that insist on being served in a uniform manner over all their locations. Global accounts, for example, may want one supplier-specific routine to be applied to every branch. As a Rep cannot serve every branch, the producer must coordinate multiple Reps to adhere to the routine. The inherent coordination challenges create transaction costs. Further, a Rep will be motivated to bend the routine to accommodate its branch, which is precisely what the head of purchasing of the global account does not want.

## Using Employee Salespeople Is a Robust Solution for Firms Over Time: A Simulation

Earlier, we proposed that going direct initiates a path that makes it difficult to return to the Rep system, because it is more costly to switch from direct to Reps than to convert from direct to Reps. To demonstrate the plausibility of this argument, we offer a small-scale simulation of how such a process would create a "robust solution" in which firms gravitate to direct sales forces more than is justified by considerations of idiosyncracy, performance ambiguity, or even strategic goals.

The switching process of the use of Rep versus direct sales forces over time can be modeled as a simple first-order Markov process with two states. The key inputs needed are the probability transition matrix and the proportion of firms in each condition at time $t_0$ (start of the simulation). Let $\pi_0$ be the probability for a firm to start with Reps, and $\pi_1$ the probability that the firm starts with employee salespeople instead, such that $\pi_0 = 1 - \pi_1$. Let p be the probability that the firm switches from Reps to employee salespeople during one period of time (say: one year), and q the probability that the firm switches from employee salespeople to Reps during the same period. The asymmetric switching cost argument indicates that q tends to be much smaller than p:

$$q \ll p \qquad (1)$$

It can be shown that the probability that the firm uses Reps at time n is (see e.g. Hoel, Port and Stone 1972):

$$[q/(p+q)] + (1-p-q)^n \; [\pi_0 - q/(p+q)]$$

Similarly, the probability that the firm uses employee salespeople at time n is:

$$[p/(p+q)] + (1-p-q)^n \; [\pi_1 - p/(p+q)]$$

As n goes to infinity[5], the probability that the firm uses Reps [respectively: employee salespeople] converges toward $q/(p+q)$ [respectively $p/(p+q)$].

Inequality (1) implies that:

$$q/(p+q) \ll p/(p+q)$$

This last inequality means that *over the years, there will be many more firms using employee salespeople than firms using Reps*. This simple stochastic formulation shows that going direct is a robust solution: over a wide range of values, it becomes the more common outcome, given enough time.

Figure 3 illustrates this result with different transition probabilities. In each case, the convergence occurs, with firms using Reps becoming a minority. *Surprisingly little time is necessary* for this to occur. Figure 3 illustrates the rapidity of the convergence process with a more limited number of years (n=5 and n=10). In almost all cases, the convergence is fast, as illustrated by the small difference between the 5- and the 10-year probability of using Reps. The driver of these outcomes is that switching costs are asymmetric: Rep-to-direct is less costly than direct-to-Rep. Hence, a producer that has vertically integrated is unlikely to reverse course, even if the path taken is recognized as mistaken. Tomorrow's choices are constrained by yesterday's path.

This simulation is a simple one that overlooks an important effect mentioned earlier, the need for a critical mass of Reps to begin with. Even in an all-Rep world (industry), a producer can readily create a direct sales force. But the reverse is not true. In an industry that is predominantly direct (such as chemicals or pharmaceuticals), it is difficult for a firm to switch to Reps, because virtually no Reps exist and it is difficult for a single supplier to start a Rep firm *ex nihilo*. Reps need multiple complementary lines; if "complementors" don't use

Reps, the Rep institution withers. A firm wishing to use Reps would have to start one *and* orchestrate complementors.

In short, if Rep usage drifts downward, the drift can become a spiral that is difficult to reverse. Add to this mimetic isomorphism: firms imitate what they see. If they don't see Reps in their industry, going direct becomes the unquestioned (and ultimately unquestionable) path to too many direct sales forces.

## *Breaking Path Dependence*

Grewal and Dharwadkar (2002) warn of the dangers of excessively mimicking unstable forces (for example, the Internet bubble). We show that personal selling is the reverse case: excessive mimicking of stable forces. Curiously, this occurs even though there are no regulatory forces in North America to constrain outsourcing the selling function. In contrast, restrictive termination laws provide a ready explanation for the scarcity of Reps in Europe.

If institutional, rather than economic, forces account for the over-usage of employee sales forces, there is considerable opportunity to achieve competitive advantage by being a contrarian. This raises the question of which producers will break their dependence on vertical integration. In industries where Reps have become rare, we develop propositions as to which firms will be contrarians (switch to Reps) and how well they will fare.

### Occurrence: Which Suppliers Will Switch to Reps

The most likely contrarians are firms that are keen to differentiate themselves and obliged to be highly conscious of competitive forces. This profile fits firms that must overcome the handicap of being a follower, suggesting:

*Proposition 1*: Market followers are more likely than market leaders to switch to Reps.

In a similar vein, entrants in an established industry not only need to differentiate themselves, but also have the advantage of starting from zero. Minus the baggage of the incumbents, entrants are more likely to break the mold.

*Proposition 2*: Market entrants will be more likely to use Reps than will incumbents.

Several propositions follow from the notion of "slack," or unused organizational capacity (Singh 1986). Firms hold slack as a buffer, enabling them to weather downturns. But slack can also cover inefficient decisions. It follows that firms with less slack will be more sensitive to economic arguments for outsourcing selling. Such firms are smaller, and are more focused, preventing them from using one activity to subsidize another. Further, all firms lose slack during industry downturns. Thus,

*Proposition 3*: Smaller firms are more likely to switch to Reps than larger firms.

*Proposition 4*: Focused firms are more likely to switch to Reps than firms with wider product lines.

*Proposition 5*: Switching to Reps is more likely to occur during an industry downturn.

As firms find their strategy is not working, they come under pressure from outside constituents to improve immediate results. Such firms, having little to lose, become risk seekers (Singh 1986). This reduces barriers to experimentation, such that:

*Proposition 6*: The worst the firm's performance, the more likely it will switch to Reps.

Meyer and Zucker (1989) note that many organizations are unable to make needed radical changes to rectify poor performance. They posit a major cause to be "dependent actors," constituents who derive psychic or financial benefits from the failing organization and cannot find an equivalent alternative to it. When such actors (e.g. specialized employees) form a coalition, they can block change. Meyer and Zucker (1989) suggest that one means of breaking the resistance of such a coalition is to spin off a division as a new

corporation. This isolates selected employees (e.g. the sales force and its director), making it difficult for them to ally with other employees to resist change effectively.

*Proposition 7*: Switching to Reps is more likely when a division has been spun off from a parent corporation.

Sales forces operating under behavior control develop firm-specific routines and strong organizational loyalties (Anderson and Oliver 1987). They are more likely become dependent on a (failing) firm and to organize a coalition of dependent actors to resist change.

*Proposition 8*: The less a firm uses behavior control to manage its sales force, the more likely it will switch to Reps.

Organizational memory suggests two more propositions. Hirshleifer and Welch (2002) note that some firms readily forget the rationale for their past decisions, either because they lose personnel familiar with a prior decision or because they promote to decision making roles personnel who were not previously involved. This is particularly true for large firms, in which decision-making is sufficiently complex that a rationale is inherently difficult to create, let alone recreate. Such firms are most likely to forget why they vertically integrated selling in the first place, opening the door to experimentation.

*Proposition 9*: Large firms with high personnel turnover, a pattern of early retirement, and promotion from outside are more likely to switch to Reps.

Forgetting is also pronounced in volatile environments, because firms need to remember their rationale and the circumstances surrounding it in great detail. This is necessary to discern whether, given environmental changes, the rationale can be extended to new circumstances (Hirshleifer and Welch 2002). Hence,

*Proposition 10*: Any firm is more likely to switch to Reps the more volatile its environment.

## Performance: Which Firms Will Do Better?

Absent substantial selling idiosyncracy or internal uncertainty, being a contrarian (going to Reps) should yield performance advantages for the supplier. But some can be

expected to perform better than others. Knowing how to work well with a third party is a capability that not all firms possess (Madhok 2002). The most capable suppliers know how to learn from their Reps and how to benefit from the Rep's complementary competencies. Which firms are likely to possess such a capability? We suggest these will be firms with a reputation for fairness in how they treat third parties in general, firms with experience in building alliances of any sort, and firms with good distributor relationships: these suppliers should be able to carry over their know-to their Rep relations. More generally,

Proposition 11: Firms with experience in building and maintaining close relationships with third parties will achieve higher performance with Reps than other suppliers that switch.

We suggest there is an order-of-entry effect in industries in which Reps are rare. The first movers face the *ex nihilo* problem of setting up a Rep, difficult but not impossible. One practice is for vertically integrated firms to set up current and former employees as Reps. This allows the firm to profit from the individual's knowledge and relationships, while fulfilling the entrepreneurial ambitions of talented people. This is already commonly used to develop franchisees and distributors. There remains, however, the problem of finding complementors, suppliers who are ready to use Reps and round out a fledgling Rep's portfolio. Suppliers that outsource selling early face a market lacking critical mass. But the first Reps are likely to spawn imitators. Thus, later switchers to Reps will have been able to observe them and discern which are the better players. This gives an advantage to later switchers, but the advantage is not indefinite. The last switchers will be obliged to find Reps among those that have not been taken—perhaps for good reasons.

Proposition 12: There is an inverted U-shape relationship between the order of switching to Reps and the performance level of the selling function. Early and late switchers will perform at a lower level than mid-range switchers.

## *Conclusions and Implications*

We study the integration of personal selling, using a meso approach. House, Rousseau, and Thomas-Hunt (1995) note that few studies examine the interplay between the individual and the organizational level, apart from high-placed individuals, such as the CEO. We underscore the importance of a middle-ranking position that is not inclusive. Curiously, the very isolation of the sales director is why s/he is so powerful in the selling domain.

Our analysis indicates that the nature of the function and the institution in question is important. An all-purpose treatment of vertical integration, in which any function is viewed the same way, overlooks the sensitivity of the selling function (which books the top line of the income statement) and overlooks limiting features of the Rep institution, such as the convention of symmetric exclusivity. We focus on the institutional details of the function under study, suggesting that they are crucial to understanding how to apply theory to a problem. For example, Pirrong's (1993) study of maritime shipping, and Nickerson, Silverman, and Freeman's (1997) study of the trucking industry rely on a thorough grasp of the operational aspects of these functions. Only with this detail could the authors ascertain opportunities for specific assets to arise in these seemingly commodity-like settings.

Research opportunities abound in this area. Compared to distributors, relatively little is known about Reps their functioning, and about how producers deal with them. Balancing the research attention affords rich opportunity to develop new theory and normative implications. In particular, Reps are entrepreneurs (as are many of the producers that contract with them). Outsourced selling offers an area for studying entrepreneurial processes and outcomes.

Grewal and Dharwadkar (2002, p. 97) call on managers to "focus on observing the obvious and studying the mundane." It is obvious that most firms of any size employ most of the men and women who book revenue, and that vertical integration of selling is mundane. Yet, today firms consider outsourcing even the human resource function, production, supply

chain management, R&D, and computing. Too many firms employ salespeople to sell too many products and services. We suggest that firms experiment with the idea that outsourcing at least some of their selling should be mundane.

## ENDNOTES

[1] The U.S. Census of Economic Activity tracks manufacturers' agents as a category separate from other types of sales agents, such as commission merchants, import agents, export agents, and brokers. All these entities are sales agents insofar as they do not purchase the goods and then resell them. Given this, the distinctions among these categories are somewhat blurred. Brokers, in particular, are difficult to classify. Technically, they represent both buyers and sellers. However, in practice, some brokers represent primarily agents and some primarily sellers. In some industries, such as fast moving consumer goods, "broker" is a misnomer: these companies are classic agents. It is noteworthy that the economic census is based largely on tangible products ("merchandise"). Comparable statistics are difficult to establish for reps selling services that are not tied to a physical product (for example, radio reps sell the advertising time of multiple, non-competing radio stations).

[2] For example, a long article in a major business magazine documents how an entrepreneur used eight employee salespeople to build a successful firm during a strong economy. When the economy softened, the owner tried every way to more productively manage his salespeople. A stubbornly high cost/sales ratio finally led the owner to pursue the only solution that he could see: firing all the salespeople and neglecting the business to become his own sales force—of one. This, too, produced disappointing results, which led the owner—and the reporter—to conclude that these are difficult times to be in business. The option of outsourcing selling is never raised (Greco 2003), even though it is plain the producer suffered from ignorance of how to manage sales and that his limited product line would benefit from being part of a larger assortment.

[3] As per the U.S. Census of Economic Activity.

[4] During a lecture in a sales force management course, one of our students gasped, “Now I understand how my father makes his living! He’s a Rep! I always wondered why he sold so many different brands.”

[5] This result assumes that p and q are neither both equal to 0 nor both equal to 1.

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# Figure 1: Four Forces Limiting The Outsourcing of the Personal Selling Function

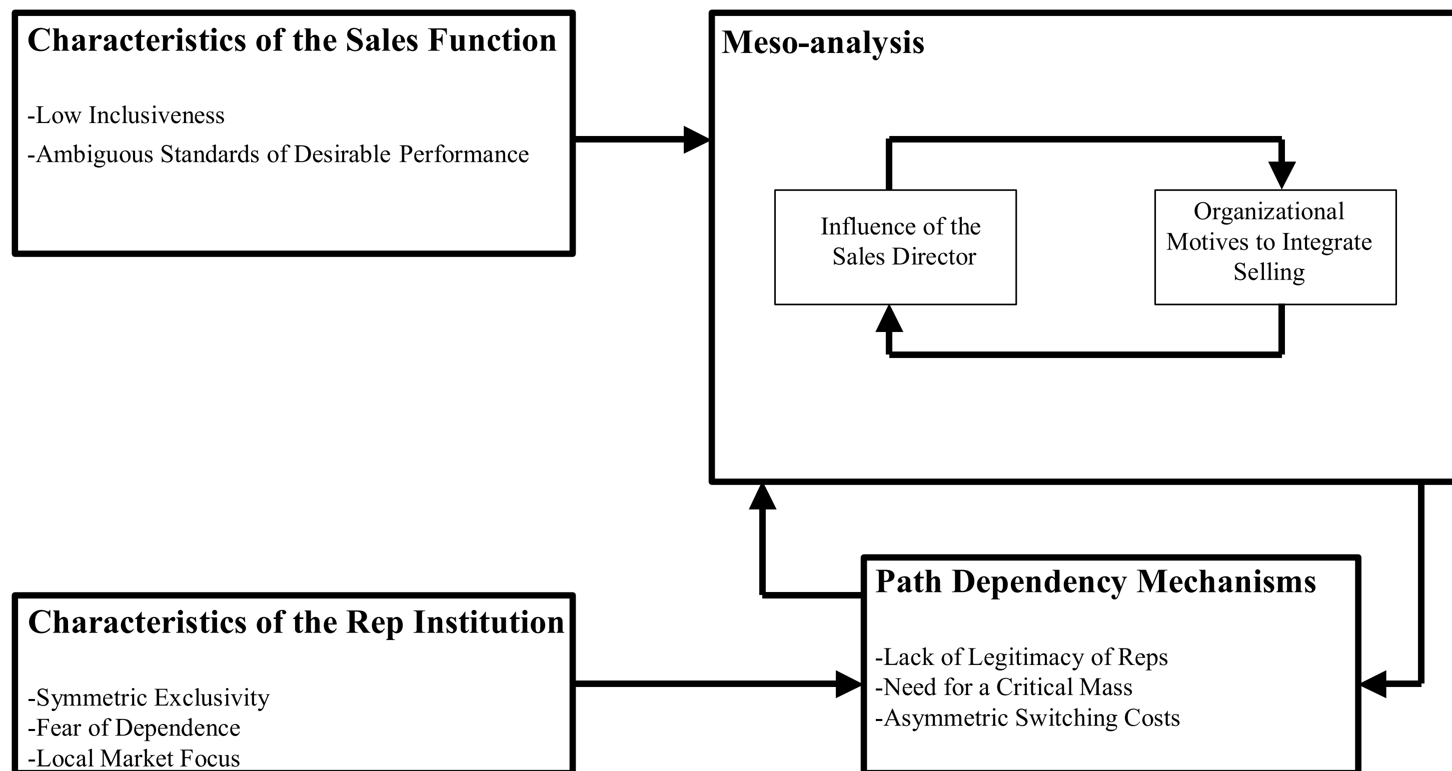
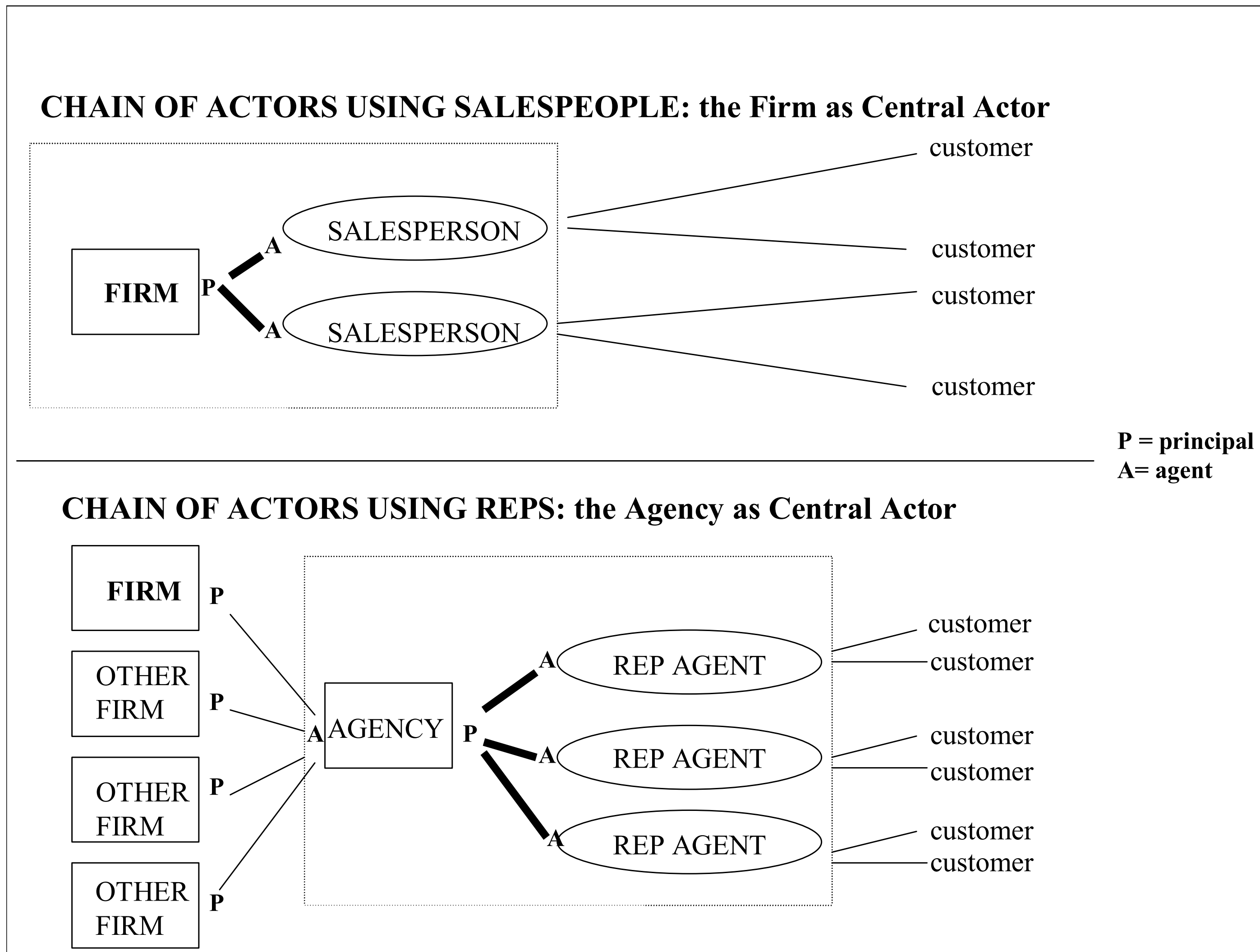


**Figure 2: Chain Agency Comparisons Between Reps and Integrated Salesforces**



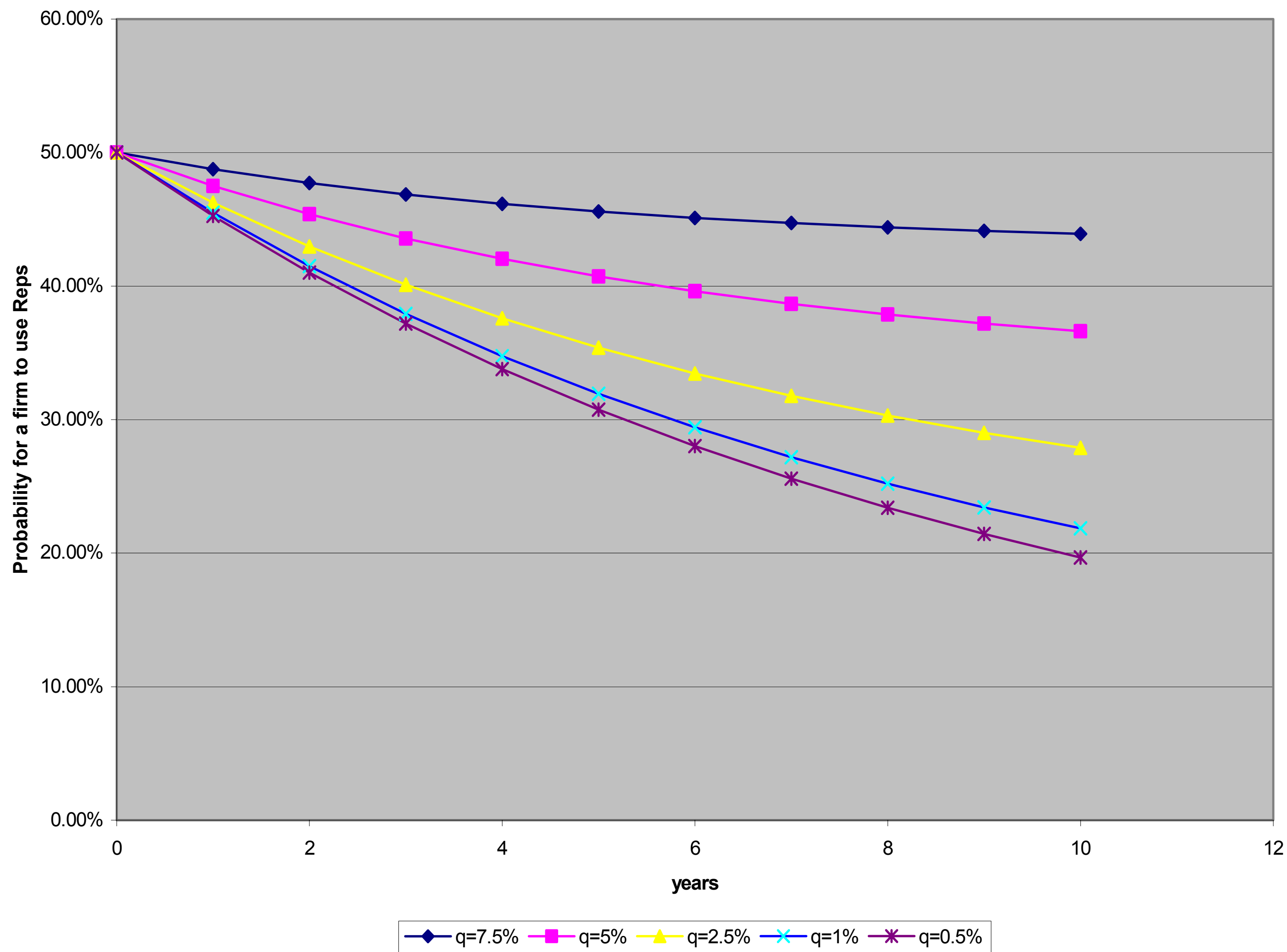


Table 3: Evolution of the Convergence Process Starting with 50% Reps, p = 10%
60.00%
50.00%
40.00%
30.00%
20.00%
10.00%
0.00%
Probability for a firm to use Reps
0
2
4
6
8
10
12
years
q=7.5%
q=5%
q=2.5%
q=1%
q=0.5%

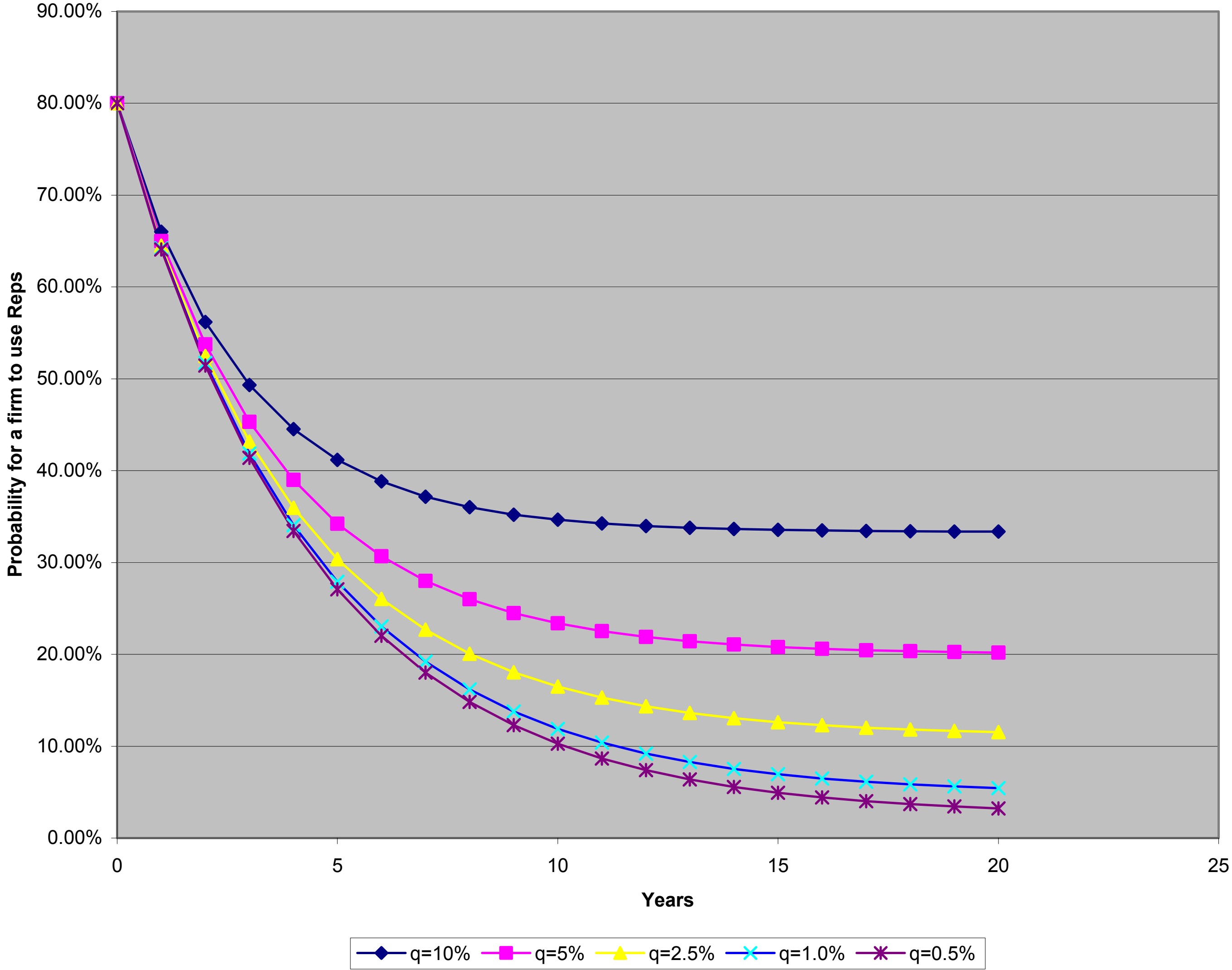


Table 3: Evolution of the Convergence Processs Starting With 80% Reps, p = 20%
Probability for a firm to use Reps
90.00%
80.00%
70.00%
60.00%
50.00%
40.00%
30.00%
20.00%
10.00%
0.00%
0
5
10
15
20
25
Years
q=10%
q=5%
q=2.5%
q=1.0%
q=0.5%

Table 1: Institutional Forces for Vertical Integration of Sales

| ***Institutional Force*** | ***Meso Level*** | ***Institutional Typology*** |
|---|---|---|
| *Force #1: Characteristics of the Selling Function* | | |
| *Low Inclusiveness of Director and of Function* | Organization | Cognitive |
| *Ambiguous Standards of Desirable Performance* | | |
| Sales performance is inherently multi-faceted | Environment | Cognitive |
| Direct sales force costs are unknown | Organization | Cognitive |
| Baseline issue | Environment | Cognitive |
| Strategic goal: signaling market commitment | Organization | Normative |
| Strategic goal: driving market | Organization | Normative |
| Strategic goal: control individuals directly (circumvent chain agency problem) | Organization | Normative |
| Strategic goal: coping with unspecified future Contingencies | Organization | Normative |
| *Force #2: Meso Analysis Within Organization* | | |
| *Influence of the Director of Sales* | | |
| Director overstates idiosyncracy | Individual | Cognitive |
| Director overstates asset value | Individual | Cognitive |
| Director prefers to manage an internal sales division to advance own career (subgoal pursuit) | Individual | Normative |
| *Perceptual Biases:* | | |
| Availability (salience in in-house personnel) | Individual | Cognitive |
| Overconfidence (ability to solve problems via employee salespeople) | | |
| Persistence of set (continue using ineffective strategies) and functional fixedness (ignore less obvious ways to use an entity or an object) | Individual | Cognitive |
| Motivated decision maker (distort evidence to justify a categorization) | Individual | Cognitive |
| Convention of stylized break-even analysis | Individual | Cognitive |
| Escalation of commitment | Individual | Normative |
| *Organization's Reasons to Accept Sales Director's Recommendation to Integrate Selling* | | |
| Organizations underestimate task difficulty of selling | Organization | Cognitive |
| Frame decision as bundle of products | Organization | Cognitive |
| Frame decision as protecting co-specialized assets | Organization | Cognitive |
| In-group trustworthiness | Organization | Cognitive |
| Perception: can't build loyalty except among employees | Organization | Cognitive |
| Perception: employee salesforce is more stable | Organization | Cognitive |

| | | |
|---|---|---|
| Perception: "Good" Reps are less available than they really are | Organization | Cognitive |
| Overlooking economies of scope | Organization | Cognitive |
| Reps in place: curse of success | Organization | Normative |
| Reps in place: closing legitimacy gap | Organization | Normative |
| Reps in place: ignorance of how to motivate 3d parties | Organization | Cognitive |
| Reps in place: scapegoating | Individual | Cognitive |
| Reps in place: malleable switching cost estimates | Individual | Cognitive-Normative Interaction |
| ***Force #3: Path Dependence Mechanisms*** | | |
| *Lack of Legitimacy of Reps* | | |
| Sales directors experienced as direct salespeople | Individual | Cognitive |
| Organizations are unfamiliar with Reps | Organization | Cognitive |
| Concern for legitimacy (mimetic isomorphism) | Organization | Normative |
| *Need for a Critical Mass of Reps* | Environment | --- (not institutional) |
| *Asymmetric Switching Costs* | | |
| Difficulty of terminating a division | Organization | Normative |
| Routine: work with employees to resolve problems | Organization | Cognitive |
| Difficulty of unlearning | Organization | Cognitive |
| Tyranny of incrementalism (don't question status quo) | Organization | Cognitive |
| Shortage of complementors once Reps become rare | Environment | --- (not institutional) |
| *Force #4: The Institution of the Rep* | | |
| Symmetric exclusivity | Environment | Normative |
| Fear of dependence | Environment | Normative |
| Local market focus | Environment | Normative |