WHY PAY COMMISSION?

Government of South Australia
South Australian Tourism Commission

AN EXPLANATION ON THE IMPORTANCE OF PAYING COMMISSION ON SALES

WHAT IS COMMISSION?

Commission is a method of payment for a service provided to your business. All business services have a cost. For example, fees are paid for insurance, banking, accountants and maintenance.

WHAT SERVICE IS PROVIDED WHEN COMMISSION IS CHARGED?

The service that is provided is the introduction of a customer to your business and (better still) a sale generated by that introduction.

WHO RECEIVES COMMISSION?

Travel agents, booking agents, some visitor centres, wholesale agents and inbound agents each require a fee for the service they provide. They each have a different role to play and therefore require different levels of commission.

WHAT DOES AN AGENT OR ONLINE DISTRIBUTION CHANNEL DO THAT I CANNOT DO MYSELF?

Their job is to reach travel consumers to offer them products available for purchase. Their goal is to generate sales. Their only means of income is the commission they get from those sales.

As a tourism operator, you can generate your own sales but there is only one of you. How can you meet all the people who potentially may wish to purchase your products? Why not utilise the thousands of agents who can assist you to generate sales? They focus entirely on selling and are specialists at selling.

SALES TRANSACTION FLOWS AND COSTS

		Operator Pays
1	Customer → Operator	**0%**
2	Customer → Retail agent (10%) → Operator	**10%**
3	Customer → Retail agent (10%) → Wholesale agent (10%) → Operator	**20%**
4	Customer → Retail agent (10%) → Wholesale agent (10%) → Inbound agent (5%–10%) → Operator	**25%–30%**

HOW MUCH COMMISSION DO I HAVE TO PAY?

As a rule of thumb, the following applies:

- Retail travel agents (eg Travelscene, Flight Centre + VICs) = 10%
- Wholesale agents (Qantas Holidays, Great Aussie Holidays, Infinity etc.) = 20%
- Inbound agents (AOT, Goway Travel) = 25%-30%

BUT I CAN'T AFFORD TO PAY COMMISSION.

Can you afford to turn sales away?

This issue needs to be addressed from three different perspectives:

1. How you incorporate the right amount of commission in your prices
2. How much money you make if you pay commission on a sale
3. How much capacity you have to fill

1. PRICING TO INCORPORATE COMMISSION.

The price of your product is made up of the following cost components:

Fixed costs or overheads – light, power, marketing, telephone, admin wages etc

Variable costs – the costs associated with supplying the service – eg laundry, cleaning, inclusions

Profit margin – the small amount that will contribute to your end of year profit

Average Commission – an allowance to be able to pay commission to travel agents

GST – if you operate in the GST system

The sum total of all the above costs is your **market price** or **gross price**.

See the ***Interactive Pricing Calculator Tool*** which is available on the South Australian Tourism Commission's corporate website www.tourism.sa.gov.au which can assist you to calculate the cost of your product.

WHAT IS AVERAGE COMMISSION?

It is the 'average' amount of commission you will pay over one year and takes into account paying no commission on some sales, 10% on some sales, 20% on some sales etc. Calculating Average Commission is very important and very simple.

This chart will assist you to make the calculation:

A	B	C
Commission Type	**Proportion of Your Annual Sales**	**Weighted Amount of Commission**
0%		
10%		
20%		
30%		
	100%	**Average Commission =**

To calculate Average Commission . . .

In column B, estimate the proportion of annual sales you receive for each of the four different commission types over a year. They must total 100%.

Then multiply each of the commission types in column A, by the sales proportions in column B. Place the answers in column C.

The sum total of column C is your **average commission** for the year. This amount should be included in your product costing calculation.

Here is an example:

A	B	C
Commission Type	**Proportion of Your Annual Sales**	**Weighted Amount of Commission**
0%	53%	0%
10%	35%	3.5%
20%	10%	2%
30%	2%	0.6%
	100%	**Average Commission = 6.1%**

WHAT DOES THIS MEAN?

Using the above example, this means:

1 To cover the cost of paying all commission for the year, the above operator needs to incorporate an extra 6.1% in their cost structure.
2. This will allow the operator to pay 10% commission on 35% of their sales.
3. This will allow the operator to pay 20% commission on 10% of their sales.
4. They can even afford to pay 30% commission on 2% of their sales.
5. If they start getting more sales that require commission, they may need to review the previous chart when they calculate rates for next year. Small adjustments do not have a major impact on price.

2. THE MONEY YOU MAKE IF YOU PAY COMMISSION ON A SALE

It is useful to look at the effect on your bottom line of paying commission on any one sale. The following chart compares the impact.

	A	B	C
Commission	**None**	**10%**	**20%**
Advertised Price of Product	$160	$160	$160
Variable Cost (costs incurred because you made the sale eg cleaning, laundry, consumables	$50	$50	$50
= Gross Profit	$110	$110	$110
Less commission	($0)	($16)	($32)
What you receive: (This is known as a contribution to overheads because it contributes something towards operating your business. And something is better than nothing.)	$110	$94	**$78**

Each of these scenarios generates cash that contributes to your overheads. Even column C contributes $78 to your bank account and cash flow. This is still better than refusing a booking. And customers using your services generate word of mouth – the best form of advertising!

Plus, you have compensated this commission payment by incorporating the 6.1% average commission into your price.

It is, however, unsustainable if a significant proportion of your sales suddenly need to pay commission that you have not allowed for.

WHAT HAPPENS IF YOU DON'T PAY COMMISSION?

If you are at full capacity 100% of the time, you have nothing to gain by paying commission. But few tourism businesses enjoy that level of occupancy in South Australia. And those who do achieve high levels of occupancy usually achieve this by paying commission on sales.

If you do have any spare capacity, then you may miss out on receiving a significant contribution to the cost of running your business **if you don't pay commission.** Therefore...

– The cost of refusing a 10% booking could be $94 in the above scenario.
– The cost of refusing a 20% booking could be $78 in the above scenario.

If you do not pay commission, you could be missing out on valuable income.