

# **Why Your Sales Process Cost Matters, and What You Need to Know to Get it Right**

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By Michael J. Webb

One of the most important management systems for the senior executive is the one that measures the costs of production. Executives must know not just the total cost of production, but also the cost of the stages of their production. Sales and marketing organizations need this every bit as much as production manufacturers. Unfortunately, sales and marketing organizations typically are not even aware that such a system is possible, much less of the profound effects it could have on management decision making.

Examples of this are playing out right now in a marketing department near you: their goal? To increase the quantity or reduce the cost of the leads they produce for their sales force. They may do it by offering some reward or a contest, for example, to individuals who agree to talk to a salesperson. How are their results measured? Increased quantities of leads or reduced costs per lead, of course.

Unfortunately, as hard as they may be working, instead of improving things, their attempts may actually have a detrimental effect. This is because while they can measure their local results, their company has no way to measure the impact of their work on the overall “system.”

This can easily happen when there is a disconnect between what marketers are producing and what the sales department needs. Marketers often define a “lead” to mean “contact information from someone who downloaded something on the website (or attended our webinar).” The sales department’s definition of a lead is usually very different: “someone who has the ability and the interest to buy what we sell within 90 days,” for example.

This common mismatch causes a condition in which marketing believes it is improving productivity, whereas the sales department is suffering from starvation. Needless to say, such a frustrating situation needs to be resolved. But how can it be done? Who is to say whether this is a real problem or a “he said/she said” sort of thing? Is this the most important bottleneck to making the numbers, or is some new market channel or product a higher priority?

Without the facts provided by a production cost measurement system, the argument is impossible to resolve.

### **The Missing Link: Measuring the Creation of Value**

Solving this dilemma requires you to go to the root of the sales process and define it correctly. By “root” I mean this: you must be able to identify the value your sales process creates. This is where most companies get it wrong, because they unwittingly define their sales process around their own actions and activities.

To get it right, you must recognize that a sales process creates value only when it gets customers to take actions. You can have as many websites, mailings, phone calls, demos, and proposals as you like: if customers don’t respond to them, no value has been created. This is a significant departure from definitions of value (and cost) in the production manufacturing world, where conformance to specifications is the issue. In sales and marketing, what the customer values is measured by the actions they take.

These actions are expressed in terms of something called the Customer’s Journey (also called the Buyer’s Journey). Basically, the only reason customers buy anything is because they believe it is the best way to solve their problems. They go through predictable stages, from being unaware of their problem, to realizing the pain, to prioritizing and uncovering the causes of the pain, to examining their alternatives, and ultimately to taking an action to resolve it (which may involve a purchase).

The key is to line up your marketing and selling with the stages of the Customer's Journey. To measure the value being created (how effective your work is), all you need is a reasonable way to count the customers who take the actions you want them to take. Their movement through the stages of the Customer's Journey is the equivalent of adding value to inventory as it moves through the stages of raw material, work in process, and finished goods.

Tracking leads, opportunities, and deals as assets (like inventory) is the missing link that enables a scientific approach to sales and marketing management.

### Sales Process Cost to the Rescue

Once the sales process is defined in terms of the Customer's Journey, it is possible to provide managers with the facts and data they need to understand incremental costs of production, as well as its impact on the entire system. It also provides a means to measure the cost of waste in the system.

**Table 1. Incremental Costs**

	<b>Operational Cost</b>	<b>Qty Prod.</b>	<b>Incr. Cost / Unit</b>
Inquiries (responded to trigger)	\$ 1,036,992.00	22,436	\$ 46.22
Interested (agreed to talk with salesperson)	\$ 310,494.00	6435	\$ 48.25
Qualified (have need, money, decision date)	\$ 54,977.00	2436	\$ 22.57
Closed (order placed)	\$ 315,721.00	609	\$ 518.43
Implemented (system installed)	\$ 330,649.00	609	\$ 542.94
<b>Total:</b>	<b>\$ 2,048,833.00</b>		
		<b>Total Unit Cost</b>	<b>\$ 1,178.40</b>

Table 1 illustrates the first step of how this is done. The left column lists the stages of the Customer's Journey, expressed in terms of the customer's actions. The Operational Cost column is the direct and indirect costs of implementing the work processes, which produced (and measured) the customer's actions. A simple employee time study technique (described in Chapter Three of "Sales and Marketing the Six Sigma Way") was

used to determine how to distribute indirect costs to the stages of production (the Customer's Journey).

The Quantity Produced column is the count of prospects who moved into each stage over a period of six months. With the operational cost by stage and the quantity of individuals who moved into each stage, it is easy to calculate the incremental cost of each unit of production (Incremental Cost per Unit).

This makes it possible to measure changes in the cost of leads, for example. A marketer might increase the number of prospects who agree to talk to a salesperson from 6,435 to 10,000 without increasing expenditures beyond \$310,494. Would she be doing her company a favor?

**Table 2. Absorbed Cost per Unit**

	<b>Operational Cost</b>	<b>Qty Prod.</b>	<b>Incr. Cost / Unit</b>	<b>Absorbed Cost</b>	<b>Absorbed Cost / Unit</b>
Inquiries (responded to trigger)	\$ 1,036,992.00	22436	\$ 46.22	\$ 1,036,992.00	\$ 46.22
Interested (agreed to talk with consultant)	\$ 310,494.00	6435	\$ 48.25	\$ 1,347,486.00	\$ 209.40
Qualified (have need, money, decision date)	\$ 54,977.00	2436	\$ 22.57	\$ 1,402,463.00	\$ 575.72
Closed (order placed)	\$ 315,721.00	609	\$ 518.43	\$ 1,718,184.00	\$ 2,821.32
Implemented (system installed)	\$ 330,649.00	609	\$ 542.94	\$ 2,048,833.00	\$ 3,364.26
<b>Total:</b>	<b>\$ 2,048,833.00</b>				
		<b>Total Unit Cost</b>	<b>\$ 1,178.40</b>	<b>Waste per Unit:</b>	<b>\$ 2,185.86</b>

To find out, you have to take the costing model a step further to consider the Absorbed Cost per Unit. Incremental cost measures the cost required to produce the next incremental stage of production. Divide it by the units produced, and you have the incremental cost. Absorbed cost accumulates total costs through each successive stage of production. This is the real cost accumulated by the system. Divide the absorbed cost by

the number of units at each stage, and you have the total cost of production (system-wide).

The absorbed cost enables the senior executive to understand several important things. First, the sum of the incremental costs (ie, value added to each unit) is \$2,185.85 less than the value added in the fully absorbed model. This represents the cost of “Inquiries” that did not move to the “Interested” stage, “Interested” that did not move to the “Qualified” stage, and so forth. This was production that was paid for, but did not yield results and thus can be classified as waste.

Second, the absorbed cost enables the senior executive to understand the impact of changes on the overall system. For example, it would be one thing if the marketing department could increase the quantity of leads while holding costs steady, and no other changes to the system took place. The cost to the entire system would stay constant, and no harm would be done. However, that is not what happens in the real world.

**Table 3. Cost of Increased Leads**

	<b>Operational Cost</b>	<b>Qty Prod.</b>	<b>Incr. Cost / Unit</b>	<b>Absorbed Cost</b>	<b>Absorbed Cost / Unit</b>
Inquiries (responded to trigger)	\$ 1,036,992.00	22436	\$ 46.22	\$ 1,036,992.00	\$ 46.22
Interested (agreed to talk with consultant)	\$ 310,494.00	<b>10,000</b>	\$ 31.05	\$ 1,347,486.00	\$ 134.75
Qualified (have need, money, decision date)	<b>\$ 124,117.00</b>	2436	\$ 50.95	\$ 1,471,603.00	\$ 604.11
Closed (order placed)	\$ 315,721.00	609	\$ 518.43	\$ 1,787,324.00	\$ 2,934.85
Implemented (system installed)	\$ 330,649.00	609	\$ 542.94	\$ 2,117,973.00	<b>\$ 3,477.79</b>
<b>Total:</b>	<b>\$ 2,117,973.00</b>				
		Total Unit Cost	\$ 1,189.58	Waste per Unit:	<b>\$ 2,288.20</b>

In the real world, all those so-called “leads” need to be followed up. This could easily require additional manpower and expenses. If the additional volume can be handled and

does not contain any more qualified leads than previously (as often happens), it is actually *less* productive, and increases net system-wide costs.

The example in Table 3 illustrates this in detail. Here, the incremental cost of the “Interested” stage has been substantially reduced. This could be done, for example, by offering some enticement that causes prospects to be willing to talk to a salesperson. Yet, if the enticement is an iPod or a chance for a vacation package (ie, unrelated to the value of the company’s offer), the results can be disastrous. Salespeople may have to talk to more people to find the ones who are qualified, thereby increasing their costs.

### **Summary**

Analyzing costs in this fashion once or twice per year provide a powerful set of data for senior executive decision-making and can prevent them from making costly mistakes in allocating resources. Such systems do not show marketing departments how to produce the right kinds of prospects, but they do provide the feedback necessary to determine whether the expected results are actually happening. They provide the information that can prevent expensive mistakes. Such mistakes go unnoticed when firms do not have the management systems in place to detect them.

### **About the Author**

Michael J. Webb, president and founder of Sales Performance Consultants, is the foremost expert on sales process improvement. Michael has helped business executives of both Fortune 500 and smaller companies apply the principles of Six Sigma and Lean to achieve greater sales and marketing results.

Michael delivered the keynote address to the first two conferences ever held on applying Six Sigma to marketing and sales. Michael has helped companies such as MAQUET, Thermo Fisher Scientific, Marriott, WaterFurnace, DDI, and many others to improve their revenue generation by identifying bottlenecks, changing behaviors, increasing

close ratios, and improving forecast accuracy. He also has extensive sales training facilitation and field coaching experience with hundreds of sales people and managers in the U.S. and Canada.

Michael is the author of "Sales and Marketing the Six Sigma Way" (Kaplan, 2006) and numerous articles. He holds several professional certifications. Michael has a BS in Mathematics from Southeast Missouri State University.

If you would like to learn more about sales process costing, check out the whitepaper

[“What Impact Does Your Sales Process Have on Your Financial Statements”](#)

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