



Managing the Sales Force Is Key to Long-Term Survival

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To be effective, turnaround professionals must analyze and understand a client's cost structure. Reducing costs and finding unique ways to improve a client's operations are the bedrock of the profession. An often overlooked area for long-term improvement is the management of the sales force.

How often has management of a troubled company lamented, "If only the sales force could get more for the product, I would not need a turnaround guy in my shop"? This common sentiment shows that most business owners do not understand the importance of cost management or provide guidance for their sales forces.

The long-term survival of any client company rests on its ability to sustain itself long after a turnaround professional has departed. A key to long-term survival is effective sales force management, which can be achieved by addressing three questions:

1. What are the true costs of the product or service being delivered?
2. What is the true profitability of the various customer relationships?
3. Do the sales force and management understand what margins are required to sustain the operation?

'True' Costs

Accrual accounting should be banned in most turnarounds. In the world of accrual accounting, an answer can be determined before a calculation is even started. Accrual accounting is impacted by old assumptions and beliefs of the client or the industry. A better approach to help steer a turnaround in the proper direction quickly is a simple activity-based costing approach for a company's key products and services.

Activity-based costing assigns costs to specific procedures and operations. They are not simply assigned based on general assumptions, such as machine hours or direct labor input. Activity-based costing directly measures what processes are used to produce goods and services. This direct measurement and breakdown of the process focuses turnaround efforts on activities that are expensive or unique to certain goods and services.

For example, most companies allocate overhead in a plant based on machine hours used for a specific process. This assumption often ignores the fact that some products are more complex to produce than others. Not all products produced in a plant share equally in the resources consumed. Certain products may require more setup time or a higher degree of quality control time. Because these

products consume more resources, higher amounts of costs should be allocated to them. Products that are simpler to produce should reflect the lower costs of producing them.

A client's customers may require special handling and more preparation or they may have other demands that may add significant costs. This extra work is often ignored when determining cost levels. For example, a customer may demand that minimum stocking levels be held, which may require holding massive amounts of inventory. These types of costs are easy to allocate and often result in very direct and candid discussions about what additional services and risks a client company should be willing to absorb.

The benefits of activity-based costing are many. It often shows that simpler products are more profitable than believed or that more complex (higher value-added) products are often less profitable than management thought. It can improve the overall profitability of both simple and complex products and help identify new methods for improving plant operations. It also helps a turnaround professional to focus on costs that are not absorbed fully by the company's quoted sales price.

After the true costs of products are determined, it is time to look at customer profitability.

'True' Profitability

Determining true profitability involves understanding key sales relationships of a client company. The 80/20 Rule often applies customer profitability. The large significant accounts often receive the most attention and special services from a client company. Understanding these relationships will provide a great deal of insight, especially when combined with the results of the true cost analysis.

The process of determining customer profitability involves two distinct steps. The first involves understanding the types of sales incentives a client company uses to book sales with its customers. The growth and power of key sales relationships have intensified over the years, and demands on both large and small suppliers continue to increase. Typical reductions requested by customers today involve the following:

- Volume incentive rebates
- Co-op advertising
- Defective allowances
- Prepaid freight
- Research and development subsidies

Many of these special or customer-specific deductions are often not captured in the client company's gross margin calculations. Sales incentives are frequently lumped together under "selling expenses," with no direct ties to specific accounts or customers. Once these costs are lumped together, there is no accountability for individual accounts within the organization.

The second step in determining the profitability of key customer relationships requires calculating what the author calls the "true gross margin." It is determined by subtracting the incentives to entice customers to order the goods or services from the true costs to produce the goods or services as follows:

- Develop a breakdown of all products purchased by a client company's customer and the projected amount of revenue that should be generated during a fiscal year.
- Annualize the costs of that product or service mix using the calculations performed earlier to determine true production costs of goods and services.
- Calculate a gross margin before sales incentives are added.
- Deduct specific sales incentives for each customer from the projected gross margin.

A client should be allowed to ponder these calculations for a few days. Many executives of troubled companies will have a hard

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time accepting that their true gross margins are really 19 percent and not 40 percent that they thought. A few days of soul-searching may convince a client company to rethink many of an organization's objectives. It also begins the process of determining whether certain volume accounts are really worth the effort that goes into them. This time may also result in product mix discussions that can help the sales force realize that it must be aware of the gross margin dollars customers generate versus the costs of servicing their accounts.

Understanding Margins

Determining whether the sales force and management understand what margins are required to sustain the operation will require developing guidelines to help them avoid the pitfalls that got them into trouble originally.

This process requires a client to accept that not all volume is good volume, not all sales are good sales, and not all customers are good customers. It is counterintuitive to a sales person or a CEO that selling to certain accounts results in losses or subpar returns that cannot sustain the business. Once a client begins to understand the difference between good and bad volume customers, a turnaround professional has truly done a good job.

Most companies are nervous about sharing details of their cost structures with their sales forces for a variety of reasons. If a sales person leaves the company for a competitor, for example, a client runs the risk that all of its costs will be shared openly in the industry. To avoid making management uncomfortable, simple guidelines and matrixes need to be developed.

A useful process is to break down a client's price list into high-, mid-, and low-margin products and then assign the maximum amount of incentives that can be applied to the three categories. The sales force should be reminded that focusing relationships entirely on low-margin products is never good for the organization.

To discourage that practice, a company can set commissions and other incentives based on the overall net margins of a sales person's accounts. A sales person who sells

only low-margin products then must accept a lower salary than one who focuses on higher-margin products. The key is to remind the sales force to sell a good blend of high-, mid-, and low-margin products to each customer.

Speak Up

The role of turnaround professionals is to leave behind the tools and mental framework for clients to prevent the common pricing and sales mistakes that probably played a large role in getting them in trouble in the first place. Turnaround professionals who have long-term assignments should go on sales calls with sales representatives and lead by example.

Most sales people become timid when they need to tell a client that they cannot do something or that they need to charge more for an extra service or procedure. However, most buyers respect a company that understands its costs, and they realize that a vendor needs to earn a profit to stay in business. ■

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