How Much Does That Sale Really Cost You?

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Do you know what your direct sales channel is costing the organization? Do you know the cost of your telesales or indirect channels? For that matter, do you know what your sales organization as a whole is costing you?

As economic uncertainty swells, companies are scrutinizing their sales and marketing budgets, their overall margins, and the organization's compensation cost of sales (CCOS). Of the three, top-performing sales organizations increasingly view the CCOS measure/benchmark as the definitive standard for judging the effectiveness of both their compensation plans and their sales efforts.

Knowing what your CCOS is and how it relates to your overall profitability and organizational sales strategy can tell an interesting story. Taking it a step further and comparing your CCOS to those of similar or competing organizations or your industry as a whole provides perspective about how effectively and efficiently you are reaching your customers through various geographies, channels, and/or job roles. A CCOS analysis also shows how you are rewarding your sales talent for their efforts.

What Exactly Is CCOS and How Do You Access It?

Simply defined, CCOS is the total compensation dollars[1] (not including perquisites [SPIFFS], president's clubs, sales contests, or benefits) paid to individuals involved in a sale, divided by the credited sales revenue[2] that is produced for that effort or sale. (See *Graph 1*)

Graph 1

DEFINING COMPENSATION COST OF SALES (CCOS)

All compensation paid to individuals in the sales process

Depending on Type of Company, may Include:

- Systems Engineers
- Account Managers
- Sales Management

= CCOS

Defined as: Often tied to sales credited revenue (rather than total revenue) for companies where a large amount of revenue automatically recurs without sales involvement

Source: Sibson Consulting

[1] Total compensation dollars can be broken out in base salary or fixed compensation cost of sale (FCOS) and commission or bonus dollars or variable compensation cost of sale (VCOS). When looking at variable pay, the amounts used need to be directly attributed to the revenue credited for particular sales.

[2] Typically, sales credited revenue is best defined as revenue credited to the sales force for a particular sale. For companies with recurring revenue, annual or 12-month revenue may be used. This is to help review results with cross-industry benchmarks. (Many companies with multi-year deals or recurring revenue will credit past the 12-month period, so it is important to know what type of revenue you are comparing when looking across industries.)

A company's CCOS may be influenced by:

- **Product margins**

  High margin businesses or products have more room and/or are more willing to use their margins to drive sales performance. This manifests as higher rates of pay or commissions. In industries with very high margins (e.g., software), the compensation costs will be much higher. Specifically, the more a company sells traditional license products (with high margins) the more it will be willing to pay its sales force.

- **Volume deal size**

  Typically, high-volume or big deals (in total dollars) have lower CCOS. The reason is relatively simple: The effort to close a $20,000 deal is typically not 20 times more than it takes to close a $1,000 deal. This may also extend to multi-year deals if revenue is credited after the year (not a common practice). Multi-year deals typically have larger extended volume or residual annual revenue, which will tend to lower CCOS if it is counted. One important point is that if volume takes a seller into high commission rates or accelerators, CCOS may increase as volume increases.

- **Business maturity**

  Less mature or early stage businesses tend to have a higher CCOS compared to more established businesses because growing a market is more important and strategically more significant for less mature companies. "Any sale is a good sale" may be part of the strategy since market share will be very low. This philosophy typically will drive companies to pay more for a sale. On the flip side, early-stage or start-up companies typically have less sales support (allowing dollars to be shifted to sales costs) and are more leveraged toward at-risk pay.

- **Revenue crediting**

  How an organization credits its revenue can also affect CCOS. Recurring revenue and/or multi-year contracts can create measurement complications. Traditionally, calculation of CCOS is based on 12 months of revenue. Recurring revenue that comes in after a 12-month period or from a multi-year contract that is not credited in the current year will not be factored in to the revenue calculations. Revenue crediting issues come up when costs are paid upfront for a sale, yet revenue is not recognized at that time. Some industries with very low churn (insurance, financial services) typically will pay for new revenue, understanding that accounts will recur for many years to come. In some cases, companies that pay a sales rep for multi-year revenue at the time of bookings will increase CCOS in any given year (while decreasing it in future years when the revenue arrives).

- **Pay philosophy: CCOS**

  Pay and pay philosophy are typically tightly linked. Having a pay philosophy that states, "We want to pay above market" will obviously cause CCOS to rise. Similarly, having a philosophy that states, "We pay at or below market" will reduce CCOS. Historically, companies tend to target certain levels of pay (e.g., 60th percentile). If quota or revenue volume is also at the 60th percentile of market, the CCOS overall will be at the 60th percentile too.

You Get What You Pay for…Maybe

Everyone knows the old adage "you get what you pay for." In the case of sales, however, you may not always get the sales that you are paying for through expenses and incentives. Knowing and monitoring your CCOS framework and doing the proper analysis can help you drive the right costs to the right area and ensure you are paying an appropriate amount for each sale.

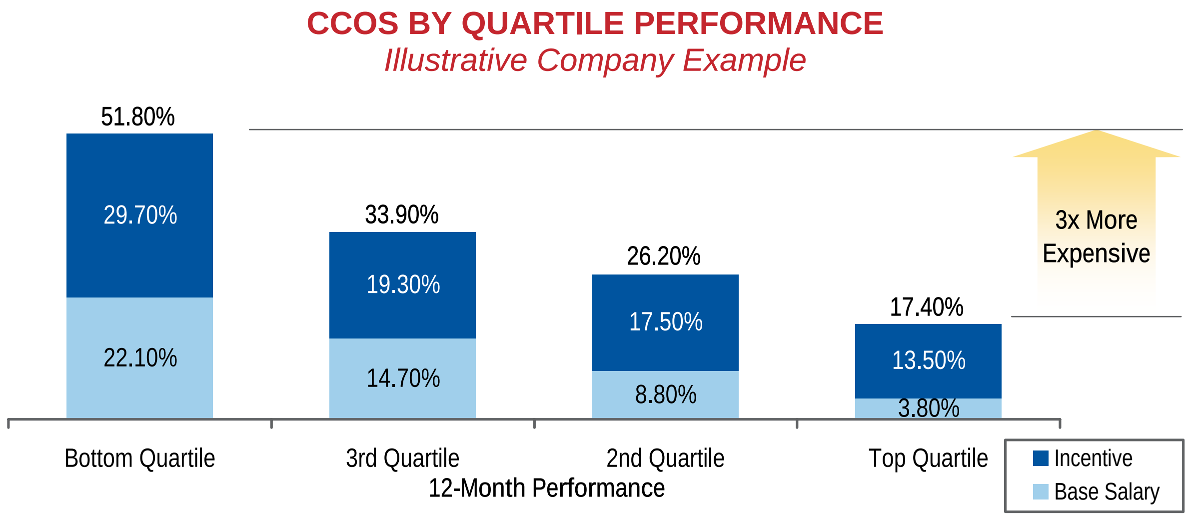
A key point in knowing and monitoring your CCOS is understanding how different time periods or cycles affect your costs or revenue. At certain times of year, companies may have higher expenses with less associated revenue. Conversely, if you are measuring recurring revenue that has already generated incentive payouts, you must understand how the cycles of your revenue and expenses play into the equation. In addition, some companies, as a supplement, will monitor other rewards and incentives (i.e., bonuses of SPIFFs) that are paid at different times during the year. Any changes in market factors, merger and acquisition activity or "adjustments" to sales effectiveness disciplines may change the pulse of your CCOS analysis.

The best way to track CCOS—and truly know what you are paying for—is to look at its component elements. These include:

Tenure	The cost of breaking in new hires or new channels may outstrip that of experienced reps or channels. Please note that different job roles and channels may have different ramp up times as well.
Performance	Breaking out CCOS by performance quartiles can help you understand the cost of lower-performing reps vs. higher performers. In most plans, because of fixed base salaries, lower-quartile performers can be up to three times as expensive as top-quartile performers.
Job Roles	Different job roles have different costs associated with them. Knowing the costs for each role can help ensure the proper job resources and roles are deployed to the right opportunities. It will also demonstrate the costs of adding "overlay" positions in an account.
Pay Components	Knowing how pay is delivered, through what pay components and the overall cost of that pay, can aid decision-making about what pay components are having the biggest impact and what that impact is costing the company.

Some pay components and positions may cost significantly more than the revenue they produce. In *Graph 2* on the following page, the lower performers, in the bottom quartile (on the left), have a 51.8 percent CCOS whereas the top quartile (far right) is 17.4%. The lower CCOS is due to the fact that the performers in the top quartile are bringing in significantly more revenue. They are three times more effective than those in the bottom quartile.

Graph 2



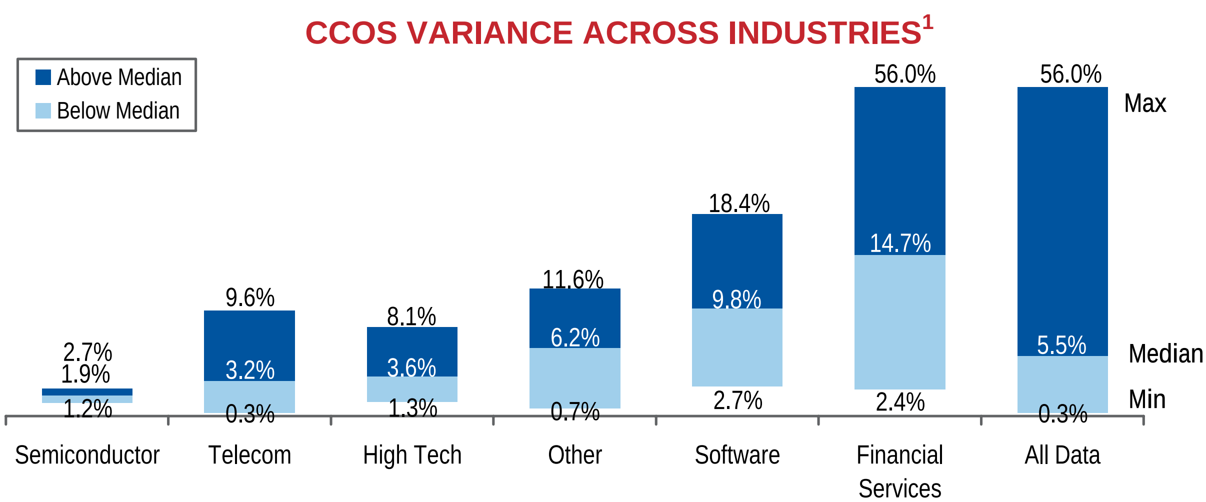
Source: Sibson Consulting

Different Industries and Selling Models Have Different CCOS

Now that you have a handle on your CCOS, it can also be helpful to compare across your industry or to look at companies in other industries that may have similar selling models. This will help show how your sales organization compares at a market level in terms of incentives, talents, and paying for the ultimate revenue your company generates.

Keep in mind that CCOS can differ significantly by company within an industry as well as by industry (see *Graph 3* below). By industry, CCOS can range from a median of 1.9 percent in the semiconductor business (which has historically had a very small CCOS, because of the size of the deals) to 14.7 percent in financial services (which is very people intensive).

Graph 3



Source: Sibson Consulting

1 This industry analysis was derived from a 2008 Sibson Consulting survey of CCOS at 67 companies and business units.

Some industries will pay more because they have higher-margin products. Others will pay less because they benefit from a large embedded base of revenue and their sales process is more retention-oriented than acquisition-based. It is important to understand how your selling model and—ultimately, your pay philosophy compare to others. For example, the financial services and software industries are primarily acquisition driven, so they will pay more for new business (new client, new revenue). Telecom and semi-conductor companies pay less—telecom has a high-embedded base of revenue; semiconductor companies generally have a long sales cycle and large deals.

Start Measuring Your CCOS Today!

Whether you are a mature organization with multiple channels, job roles, and go-to-market complexities, or a less complex organization with a simple sales process, knowing how much you are paying for a sale and the overall costs of your compensation systems is key to determining how effective your organization is in managing its go-to-market approach. Additionally, ensuring you are not overpaying or underpaying your sales reps helps to build stronger value for the organization as a whole and can pay off in recruiting and retaining the right talent.

For more information or specific data for your industry, region or channel please contact Sibson's Sales Force Effectiveness Practice.

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