

Key Strategies to Increase Revenue and Net Profit by 25 Percent or More

By Tim Allen and Mike King

CFOs are starting to focus on sales and marketing investment to positively impact profitability outcome by earlier recognition of inefficiencies and opportunities. They are asking:

- What is our cost to sell?
- What is the cost to serve our customers?
- What is the optimal mix of products to sell in specific sales channels that will increase gross profit?
- What customers are providing the best profitability?

In the process, they are exploring the new frontiers for managing resources and making decisions, as well as opening up future sales strategies.

From a cost-cutting perspective, there simply isn't much left to do. Lean programs, outsourcing and other cost reduction strategies to impact below the gross margin line — the operational side — have been the CFO mindset. Now it's time to look above the gross margin line at sales and margin analytics to identify trends and other indicators to understand, for example, when expenses are going above thresholds and which customers are more profitable.

Reducing cost-to-serve metrics

How are companies going to be more efficient from a sales perspective? Often overlooked is the cost-to-serve metric. This is a cost-reduction strategy that can positively impact revenue by looking at profitability by customer.

A customer stratification approach considers service investment of four types: A-ranked customers are highly profitable and low-cost to serve; B-ranked customers are moderately profitable with low cost to serve; C-ranked customers are marginally profitable

with moderate cost to serve; and, D-ranked customers are unprofitable with high cost to serve requiring handholding and special reporting requirements. For example, some large companies will penalize suppliers if they don't ship their goods in a certain mode and time. These customers are very high cost to serve if that supplier is inefficient or ineffective in managing distribution or logistics.

Companies need to look for ways to migrate D-ranked customers up to the A level. Oftentimes, there's a start-up curve to get a new customer going but education and guidance can move that customer up to an A. More efficiency and flexibility can be possible by getting information on future demand. Setting that customer up correctly in the ERP system with advanced negotiation of contractual issues can eliminate specialized reporting and make the order-entry side less time intensive.

Case in point: An electronics manufacturer conducted a customer stratification analysis and



uncovered \$600,000 in customer service-based costs specifically attributed to several unprofitable, "D" ranked customer accounts. Some of these accounts had service contracts that were about to expire. Company executives met with those sales representatives assigned to the unprofitable accounts and devised specific strategies to negotiate new

contracts to reduce or eliminate specific service costs or raise prices. As a result, the company reduced more than \$450,000 in unsupported service costs without jeopardizing the revenue base generated by these accounts and, thus,

improving the company's profit margins. The fact that the company actively performed a stratification analysis helped them uncover this hidden-cost reduction opportunity.

Tracking profitability via dashboards

Many companies are looking at web-based order entry by training their customers to enter and manage their own orders, which can provide substantial savings. This strategy can often lead to a reduction in order entry costs for administration and labor expense and can speed up a company's cash to cash cycle by reducing the time it requires to get an order set up in a company's ERP system.

Automating the customer stratification process with a capable BI solution such as IBM Cognos or SAP Business Objects can help companies quickly discern which customers are significant contributors to profitability and those that are draining profitability through unsupported service costs.

Case in point: One manufacturer of navigational electronics has effectively used its existing IBM Cognos Business Intelligence solution to provide a monthly dashboard tracking of customer profitability. This company has significantly increased gross margins by weeding out

customers that have high cost-to-serve and low margins. In many cases, the company has migrated high cost-to-serve customers to products that have higher margins providing ample cost coverage. In other cases, tough decisions have been made to discontinue certain customer relationships/contracts with little or no probability of paying higher prices.

Reducing SG&A by \$7 million annually

A significant cost savings in sales/general administrative (SG&A) expenses of an industrial equipment manufacturer demonstrates the potential for CFOs to go beyond operational efficiencies. By a mere glance at the sales side of the P&L, the question was raised: "Why is our sales head count per revenue number so big compared to other companies in our industry?"

After a "deep dive" into the data, the cost of the sales demonstration process indicated a sizable investment in vehicles and equipment used to showcase the company's products. Managed internally, more than 1,000 sales representatives in North America had their own demo trailers and were responsible for hauling equipment to customer sites. By consolidating vehicles and equipment and outsourcing this logistics process, the company saved \$7 million annually and added 2 percentage points to operating profit margin.

Searching for a consistent sales definition

To understand sales efficiency, CFOs want to know how effective their expenditures for sales and marketing are against gross margin. Are they getting a fair return for their investment in sales labor, travel, marketing, advertising and other sales campaign expenses? Many CFOs are asking: "Isn't there a different way to look at the P&L and discover opportunities for sales and marketing investments and efficiencies?"

A consistent definition of sales across the enterprise is essential to grasp an apples-to-apples comparison of gross margin. Clarity is essential to determine the net sales number. Does it include rebates or exclude warranties? Does the cost of sales include allocations or actual hard numbers? Are the accounting standards the same in India as they are in England? For manufacturers, what is the cost of goods sold? For service firms, what is the cost of services?

Once sales are defined, it should be a matter of simple mathematics to arrive at gross margin. Yet most finance



departments face a major problem in collecting this information: **it isn't automated in one place.**

Many jump through hoops to get the data for sales analytics, which then gets trapped in multiple spreadsheets. This is why most CFOs rarely can use this information to make proactive decisions because they are looking at the past either once a month or once a week. Financial analysts, sales



managers and others run the spreadsheets, which offer up a variety of data views with different metrics because they aren't necessarily calculated in the same way. They may be easy to use and swap, but a consistent definition of sales is not readily accessible or even possible.

If a CFO sees an abnormally high cost of sales in one region versus another, does he or she really understand what's driving that? Maybe it's a regulatory requirement. Or maybe the sales force is just not very efficient. Or maybe there are differences in costs — such as selling in New York City versus Milwaukee. How is it possible to understand what's driving that sales cost and the metrics that can be controlled?

Sales analytic tools also add to the spreadsheet confusion. They have been brought into the organization in "stovepipe" fashion so that data views become divergent. They may take some of the same data but at different intervals, with different period destiny and granularity. They may call something a certain metric or dimension but it's not necessarily the same thing. Again, it's not an apples-to-apples comparison.

Besides tool sets, many CFOs have looked to methodologies that the I.T. department would employ for any system development, whether it's to implement an ERP system, cash flow management system or store register system.

The waterfall methodology, for example, helps facilitate

business analytics systems development by assuring each successive step is followed and approved before continuing with development. Once design is completed and a walk-through meeting is conducted, establishing a design document that's signed off by all technical participants is paramount to beginning the build phase. This assures all aspects of the business analytical framework are complete.

Another methodology uses Agile Systems Development, which can make a significant impact on the overall success of deploying a business analytics system. It provides a quick turnaround in development and deployment by creating a series of smaller deliverables that refine the overall project.



Building systems to house the data has been the focus to date, yet little is thought about how to extract that data in a meaningful way. That's why approximately 80 percent of financial analyst time is poured into finding and consolidating data, rather than analyzing it.

Thus the problem with sales analytic tools has been an emphasis on how to build a system to house the data versus how to integrate the data across the enterprise. Without coordination of information across the enterprise, businesses are starved for information and a consistent definition of sales remains elusive.

Driving revenue based on predictive analytics

Frustration is high among organizations dealing with spreadsheets across the enterprise or companies going through lots of acquisitions and system integrations. They need visibility to understand what's happening, the ability to control it and take actions sooner on the sales side of the business.

Automation offers the ability to integrate data across the enterprise and manage it in such a way as to gain a variety of views so that sales can see the same data for its analytical needs the finance department. Salespeople that ask: "Who are our customers and how can we increase cross-selling

opportunities?” are looking for the same information as when financial analysts ask: “Who are our most profitable customers?” Both have been using different systems to gain this customer information.

Yet now with enterprise-wide automation combined with sales analytic tools, such as IBM Cognos and SPSS, CFOs are opening up a new frontier: predictive analytics where executives can draw from the same data and operate on



information prior to its impact on the business to create positive change. It's taking ERP data and building it into a dashboard using a prescribed, predictive fashion.

For example, rising fuel costs should have CFOs and sales managers thinking about how to become more efficient from a sales perspective. What does this mean from a logistical

standpoint and can the business increase prices? If not, what are the alternatives? To be competitive, it's necessary to take a closer look at the customer side data.

The key difference in the methodology to gain predictive information is creating reports around analytical processes rather than around a database system.

In the latter scenario, the users ask for their favorite reports that the system is built to support. However, when changes occur in the organization or marketplace, new information will need to be chased down, such as the “deep dive” taken by the aforementioned manufacturer. Reports are built repeatedly based on changing conditions.

Predictive information is possible when a framework of analytical components is identified based on key metrics that drive the organization. The components can be, for example, list generation or customer scoring. They are objects that can be moved around — reorganized, decoupled and recoupled — to establish an analytical environment that is built once for multiple uses.

An example of an analytical environment could be combining the scoring and list generation objects with customer segmentation data to create a relationship marketing campaign based on campaign targets and desired outcomes.

The end vision — business goals and objectives — is the place to start, not the kind of reports that users order up. Do CFOs want to look for expense reductions or expense enhancement opportunities? Is the daily sales outstanding information the most important measure to view or inventory turns?

In the end, it is the ability to measure: How has the business performed? How is the business doing today? What are the trends that will impact future business? Predictive analytics will help CFOs to see what issues in the economy they may need to navigate, avoid future pitfalls, and identify and take advantage of opportunities coming their way. It pulls the information out of an ERP system more quickly and efficiently to take action sooner that positively impacts the P&L.

Exploring sales side frontier

Building a culture that can operate in a predictive analytical environment will be the responsibility of CFOs so that people are willing to change based on what's on the horizon. Sales and marketing teams have to understand and buy into it. And, in order to change sales behavior, rewards and incentives should be structured differently based on measurements, such as percentage on gross profit. Otherwise, salespeople are only interested in selling as much as possible. They will not be motivated to make changes that impact profitability or customer quality or cost to serve if they are rewarded based on straight revenue.

With globalization come more complex customer relationships and differences in selling strategies. All require a higher level of efficiency and effectiveness that goes beyond wringing all the costs of the supply chain and operating expenses. This is the new frontier that CFOs are going after as their CEOs and boards call upon them to expand their roles.



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