

Evaluation of Sales Organization Effectiveness

MARKETING AUDIT

Although the term audit is most often used to refer to financial audits (i.e. inspection of an organization's accounts) carried out by accounting firms, the audit concept is extended to other functions in recent years.

A marketing audit is a comprehensive, periodic, and systematic examination of a company's marketing plan, environment, objectives, strategies, tactics, performance, organization, and people with a view to find out opportunities and problems, and recommend an action plan to improve the company's marketing performance. It also evaluates the long-term business growth alternatives of the company.

As per a study, an average US Corporation loses half of its customers in five years, half of its employees in four years, and half of its investors in less than one year. This indicates some weaknesses. Organizations that become aware of their weaknesses must carry out a thorough study that is called a marketing audit. A complete marketing audit is a large project that is time consuming, problematic, and costly. But the rewards can be substantial.

A marketing audit covers a company's total marketing system. The audit concept can be applied to a company's major functions within the marketing management. For example, a company can audit the sales function, or the marketing research department. Often outside sources, like management consulting firms, are employed to carry out the marketing audit to ensure unbiased approach.

SALES AUDIT

A sales audit is a comprehensive, systematic, diagnostic, and prescriptive tool. The purpose of a sales audit is to assess whether a firm's sales management process is adequate, to give direction for performance improvement, and to recommend the needed changes.

Sales audit is a good method for evaluating the effectiveness of a sales organization. Because auditing should be objective, it should be conducted by someone from outside the sales organization. This could be someone from another functional area within the firm or an outside consulting firm. However, members of the sales organization should participate actively, as most of the information is provided by sales managers and salespeople.

The sales audit is an expensive and time-consuming process, but the benefits are much more than monetary and time costs. Marketing and sales audits should be conducted on regular basis, so that the company can identify and correct potential problems before they become troublesome.

The Evaluation Process of a Marketing/Sales Audit

Whether it is a marketing audit or a sales audit, the evaluation process is the same. It consists of three stages, as shown in Figure 7.1.



Fig. 7.1 The Evaluation Process of Marketing/Sales Audit

It is the responsibility of the company's management to find the following:

What Happened

The company should get the information by comparing the actual performance with the goals or targets. This will show favorable or unfavorable variations. For instance, if the actual performance on sales at the end of first quarter of the year 2016 is `90 million against a sales goal of `100 million, it shows a negative or unfavorable variance of `10 million.

Why It Happened

This stage is more difficult and time consuming. What specific factors have contributed to the negative variance? There are many factors, including environment, competition, marketing mix elements, salespeople, and sales managers. Which of these factors have contributed, for example, for the negative variance mentioned in stage 1?

What to Do about It

In this stage, the corrective actions are decided and implemented to solve the problems, overcome the harmful conditions, or leverage the favorable conditions. For example, if the customer service is not as per the customer expectations, first find what kind of service needs improvement – presales, during sales, or post-sales – and then implement suitable corrective actions.

Since a full marketing audit is costly and takes a long time many companies evaluate different elements of marketing. For instance, one company may analyze its sales volumes only, but another firm may decide to analyze sales, marketing cost, and profitability. We shall, therefore, discuss analysis of sales volume (or sales analysis) first, and later, marketing costs, profitability as well as productivity analyses.

EVALUATION OF EFFECTIVENESS OF A SALES ORGANIZATION

Sales organizations have many goals and objectives. Therefore, many factors need to be analyzed to evaluate the effectiveness of a sales organization. (Here, the effectiveness means an organization that gives expected or targeted results consistently). Figure 7.2 shows four types of analyses that are usually needed to develop a comprehensive model for evaluation of a sales organization. These are: (i) sales analysis, (ii) marketing cost analysis, (iii) profitability analysis, and (iv) productivity analysis.

Each type of analysis can be done in different ways. For example, sales analysis can be done by total sales, sales by territory, sales by products, sales by customers, and sales by salesperson. Actual sales can be compared with sales quotas (or sales goals/targets), sales of previous periods, or sales of competitors.

Sales analysis should be done at different levels of the sales organization, such as regions, branches, districts, and territories. Many companies, in a study, use sales analysis for evaluating their sales organizations, but few companies use reports on marketing cost, profit contribution, net profit or return on assets analyses.

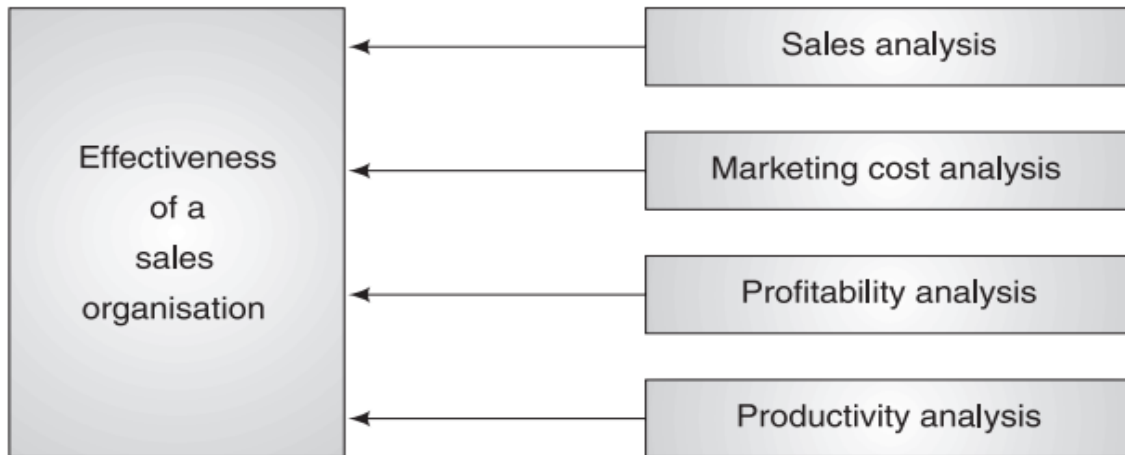


Fig. 7.2 Effectiveness Model of a Sales Organization

Sales Analysis

Sales analysis (or sales volume analysis) is an important element for evaluating the effectiveness of a sales organization, because the purpose of a sales organization is to generate sales. Sales managers use sales analysis to evaluate current performance, take corrective actions, and do future planning.

Sales analysis is described as a detailed inspection of a company’s sales data, which includes collecting, classifying, comparing, and drawing conclusions. All companies collect sales data in the form of customer sales invoices or cash register receipts, which are needed for maintaining their accounting records.

Definition of what is meant by a sale is necessary before starting a sales analysis. The company must decide when a sale takes place – whether at the time an order is received, shipped (and invoiced), or paid for. Most companies define a sale when an order is shipped or transported and invoiced. The sales organization should develop an information system based on whatever definition of sale is decided.

Another point companies have to decide is whether to concentrate on sales value (e.g., Rupees or Dollars), or sales units (e.g., tons or numbers). It is often useful to include both sales value and units in a sales analysis, because each one gives different type of evaluative information.

Framework for Sales Analysis

There are many alternatives available to a company for analyzing Sales Volume of a sales organization as shown in Figure 7.3. These alternatives are grouped in three important decision areas: (i) all levels in the sales organization, (ii) different type of sales, and (iii) different type of analysis.

All Levels in the Sales Organization

Sales analyses should be done at all levels in the sales organization. There are two reasons for this:

(i) for evaluation and control purposes, sales managers at various levels need sales analyses. At higher levels, that is national sales managers and regional sales managers, sales analysis is needed not only at their levels but also at the next level(s) below for evaluation and control, and

(ii) for identifying problems (or strengths and weaknesses), companies use a hierarchical sales analysis. This includes evaluation of sales performance from the company level down to the last level. For instance, the sales analysis is first done at total organization level, by comparing the actual sales with the sales budget of the company, both in value (Rupees or Dollars) and units (numbers, tons, or liters). If the actual sales performance of the company is not up to the budgeted level, the sales analysis of the next level, say, regional level is done to identify which region(s) are having problems in reaching their sales quotas.

Next, sales analyses are done for all the branches (or districts) reporting to those problematic (or weak) region(s). This would identify low sales in specific branches. Further sales analyses are done for all territories in those low sales branches. This would point out territories which are not achieving their sales quotas. Further analysis is needed to find out why these territories are not achieving their sales quotas by carrying out analyses of customers in the territories, talking to customers, salespersons, and the branch manager(s). Corrective actions can then be taken to increase sales from these problematic territories. Thus, the hierarchical sales analysis method is a systematic way to carry out a sales analysis, to identify strengths and weaknesses (or problems) in the sales organization.

Different Type of Sales

Analyses of different type of sales, shown in Figure 7.3, at different organizational levels definitely increases the sales manager's ability to discover problem (or weak) areas in the company's sales performance. But it makes the evaluation process confusing. A better way is to extend the hierarchical sales analysis, by focusing different type of sales on to the problematic territories. This would help understand the sales problems of the territories completely, by knowing which products and customer types are having low sales as compared to the sales quotas. Additional analysis would be needed for these products and customers to find out why sales are low and what needs to be done to improve sales performance.

Different Type of Analysis

In Figure 7.3, different types of analyses are mentioned. Out of these, comparisons of actual with sale quotas are widely used by companies because it gives interesting information. Comparisons of actual performance with sales forecast or sales budget are done at the company level. Based

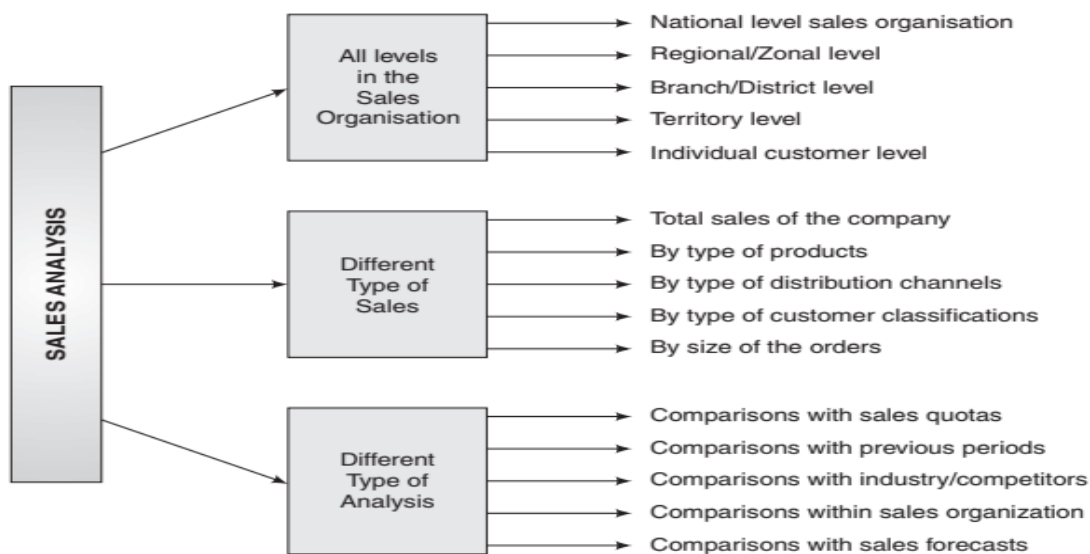


Fig. 7-3 A Framework for Sales Analysis

on the company sales budget, sales quotas are set at regional, branch or district, and territory levels. Some examples are presented to show how comparisons are done between sales quotas and actual sales in Tables 7.1 to 7.4. Table 7.1 explains the performance of different branches. Table 7.2 shows sales analysis by product lines for a consumer durable products company. Table 7.3 indicates sales analysis by customer classification. Table 7.4 is a composite measure of sales effectiveness, sales growth, and market share. In Table 7.4, an effectiveness index can be calculated by dividing the (actual) sales by the sales quota and multiplying by 100. This index helps to compare the sales effectiveness at different organizational levels. As shown in an example in Table 7.4, sales growth of this year over last year's sales is another useful analysis for the four regions of the company. Market share analysis is also done for the four regions of the company by dividing the (actual) sales by the industry sales and multiplying by 100.

Table 7.1 Sales Analysis by Branches

Regions	Sales Quota	Actual Sales	Difference (+/-)	Performance (% of Quota)
Delhi	400	376	-24	94
Kolkata	300	273	-27	91
Mumbai	410	418	08	102
Chennai	390	402	12	103
Total	1500	1469	-31	98

Table 7.2 Sales Analysis by Product Lines

Product Line	Sales Quota	Actual Sales	Difference (+/-)	Performance (% of Quota)
Ceiling Fans	425	415	-10	98
Table Fans	240	264	24	110
Exhaust Fans	175	190	15	109
Lamps and Accessories	360	353	-07	98
Total	1200	1222	22	102

Table 7.3 Sales Analysis by Customer Classification

Class of Customers	Sales Quota	Actual Sales	Difference (+/-)	Performance (% of Quota)
Class 'A'	970	922	-48	95
Class 'B'	315	343	28	109
Class 'C'	215	210	-05	98
Total	1500	1475	-25	98

(Note: All figures in above tables are in ₹ million)

Table 7.4 Different Types of Sales Analysis

	Northern Region	Eastern Region	Western Region	Southern Region
Sales (₹ million)	23	22	28.5	27
Sales Quota (₹ million)	25	20	30	25
Effectiveness Index	92	110	95	108
Sales Last Year (₹ million)	22.5	19	28	24
Sales Growth (%)	2	16	2	13
Industry Sales (₹ million)	250	200	300	250
Market Share (%)	9	11	10	11

Often, a sales analysis alone does not give complete information for evaluating effectiveness of a sales organization. The benefits of extending the sales analysis to marketing cost and profitability analysis are very much recognized. However, the most widely used measure of evaluation of a sales organization continues to be sales analysis.

Marketing Cost and Profitability Analysis

While sales analysis is useful as one of the elements for evaluating the effectiveness of a sales organization, for comprehensive evaluation other elements like marketing cost analysis and profitability analysis should also be considered, as shown in Figure 7.2 earlier in this chapter.

A marketing cost analysis is a study of a company's marketing costs. The purpose of marketing cost analysis is to determine the profitability of sales (or marketing) units, like market segments, sales territories, and products. This is done by subtracting the marketing costs from the sales revenue, associated with the particular sales unit. Marketing cost analysis is a managerial tool that is used for planning and control of a company's future operations. Often, an analysis of past financial events helps as a guide for future operations. For example, a study on a bank's cost and profitability found that 30 percent of the bank's branches were unprofitable, and 60 percent of their customers generate losses⁴. For carrying out a proper marketing cost analysis, the company must have an account classification system.

Companies need to measure the profitability of their territories, customer groups (or market segments), products, distribution channels, and customers. This information will help the management to decide whether any sales and marketing activities or products should be expanded, reduced, or eliminated in future.

Procedure for Marketing Cost and Profitability Analysis

The procedure followed for conducting a marketing cost and profitability analysis for a sales organization includes the following steps: (i) state the purpose of the analysis, (ii) identify functional (or activity) expenses, (iii) convert (or change) natural accounting expenses into functional expenses, (iv) allocate functional expenses to market segments, products, or other marketing/sales units, and (v) prepare the profitability of the marketing/sales units.

State the Purpose of the Analysis

Before starting the marketing cost and profitability analysis, the sales manager should decide the purpose. Whether the purpose is to find the profitability of sales territories, market segments, products, branch offices, or sales representatives? Depending upon the answer, the marketing costs are classified as either direct or indirect costs. For instance, a salesperson's salary is a direct cost with respect to an allocated territory, but an indirect cost with regard to various products or customer groups. By stating the specific purpose of the analysis, the costs can be classified.

Identify Functional (or Activity) Expenses

Each company should prepare a list of major activities (or functional) marketing costs that are relevant to its own marketing program. A manufacturer of material handling equipment, for example, performs different activities compared to a retail chain. However, a typical list of marketing cost, as shown in Figure 7.4, includes personal selling expenses, advertising and sales promotion expenses, order processing expenses, packing and delivery expenses, warehousing and inventory expenses, and administration expenses. Administration expenses consist of costs of sales offices, including salaries of sales managers and staff, travelling, and office maintenance costs. Order processing expenses include costs of processing customer's purchase orders and billing.

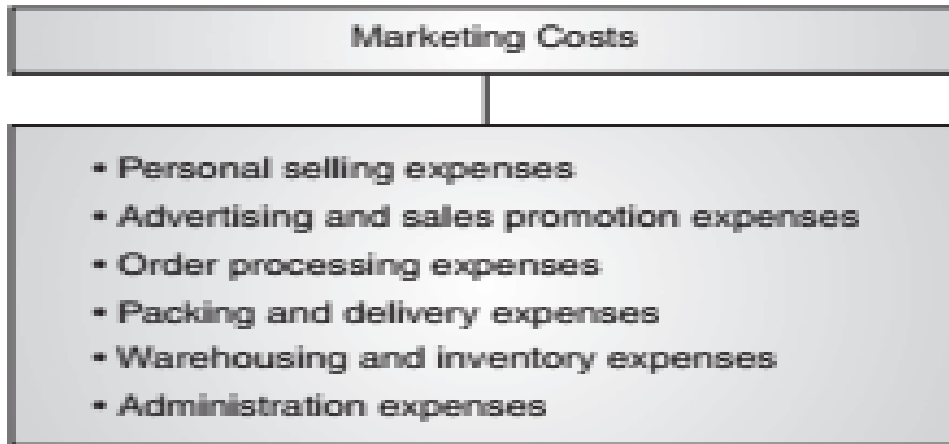


Fig. 7.4 Major Functional/Activity Expenses List

Convert Natural Accounting Expenses into Functional Expenses

In typical accounting records, expenses are classified according to the object of expenditure. The natural (or traditional) ledger accounts may classify marketing expenses as office rent, sales salaries, and advertising costs. However, for an effective marketing cost analysis these accounting expenses are converted (or changed) into functional (or activity) expenses. A more accountable method for allocating costs is activity-based costing (ABC), which allocates costs to marketing/ sales units on the basis of how the units actually spend or cause these costs (or expenses). Costs are gathered and then allocated to the units by suitable factors that drive costs up or down.

We shall take an example of Saragam Aluminum Company’s simplified profit and loss statement, presented in Table 7.5. We take each natural expense and allocate it to various activities (or functions). Salaries are dispersed to the functional areas where the recipients work, as shown in Table 7.6.

Travel expenses include food and entertainment expenses incurred in personal selling and are therefore allocated to personal selling expenses. Similarly, entire natural expenses on advertising and sales promotion are allocated to the functional expenses of advertising and sales promotion. However, the expenses on supplies and telephone are allocated to each function (or activity group) that incurs this expense. Rent is allocated to the various functions in proportion to the floor space used by them. Allocations of natural expenses to functional expenses are shown in Table 7.6.

Table 7.5 Saragam Aluminium Company's Profit and Loss Statement

Sales		₹75,00,000
Less cost of goods sold		₹52,00,000
Gross margin		₹23,00,000
Less sales expenses		
Salaries	₹11,00,000	
Rent	₹3,50,000	
Supplies and telephone	₹1,50,000	
Travel	₹1,20,000	
Advertising and sales promotion	₹80,000	
Total sales expenses		₹18,00,000
Net profit		₹5,00,000

Table 7.6 Saragam Aluminium Company: Natural Expenses Allocated to Functional Expenses

Natural Expenses	Total	Functional Expenses				
		Personal Selling	Advertising and Sales Promotions	Warehousing & Inventory	Order Processing	Administration
Salaries	11,00,000	6,00,000	1,50,000	1,00,000	1,00,000	1,50,000
Rent	3,50,000	100,000	40,000	1,40,000	35,000	35,000
Supplies and telephone	1,50,000	40,000	25,000	35,000	30,000	20,000
Travel	1,20,000	1,20,000	--	--	--	--
Advertising and sales promotion	80,000	--	80,000	--	--	--
Total	18,00,000	8,60,000	2,95,000	2,75,000	1,65,000	2,05,000

(Note: All figures are in Rupees)

Allocate Functional Expenses to Marketing Units

To find the marketing costs and profitability of marketing units, such as branches, regions, market segments, products, or channels, the functional expenses should be allocated to the marketing unit under study. There are several bases for allocating functional expenses to different marketing units, which are presented in Table 7.7. Before we present cost allocation, let us first differentiate between direct and indirect expenses.

Direct expenses are incurred with respect to a single unit of sales or marketing operation. Hence, they can be allocated to a particular marketing unit (e.g., market segment, product, or sales territory). For example, personal selling expenses can be directly allocated to sales territories, if a territory cost analysis is being done and each salesperson has a territory. Here, personal selling expenses include the

salesperson’s salary, commission, travel, food, and customer entertainment. Costs of local newspaper advertisements and point-of-purchase (POP) materials can be charged to a sales territory.

Indirect costs are shared by more than one marketing unit and hence, allocation problems happen with these costs. For instance, if a product cost analysis is done, personal selling expense are allocated based on selling time given by a salesperson to each product. In a cost analysis for market segment or customer group, the personal selling expenses may be distributed based on the number of sales calls on each customer group. In case of indirect costs, some costs are partially indirect and some are totally indirect, For example, administration costs, including salary and office staff cost of general manager (sales), are totally indirect. Methods used for allocation are: (i) divide administration costs equally among territories, products, or market segments, (ii) allocate the indirect administration costs in the same proportion as the total direct costs. Both methods are easy to do, but can be inaccurate.

Table 7.7 Bases of Allocation of Functional Expenses to Marketing

Function	Bases of Allocation of Expenses
Personal selling	<ul style="list-style-type: none"> • Direct to sales territories for a territory cost analysis • Selling time given to each product for product cost analysis and for market segment cost analysis, number of sales calls to each customer group or market segment
Advertising	<ul style="list-style-type: none"> • Direct or by circulation of media to sales territories • Direct or media space given to each product and market segment
Sales promotion	<ul style="list-style-type: none"> • Direct or equal charges to marketing units
Warehousing and Inventory	<ul style="list-style-type: none"> • Physical unit of goods handled, shipment, or orders received (applicable to all marketing units)
Order processing	<ul style="list-style-type: none"> • Number of customer orders (applicable for all marketing units)
Administration	<ul style="list-style-type: none"> • Equal charges among territories, products, or market segments, or in proportion to direct costs of marketing units

Prepare Profitability of Marketing Units

Profitability analysis of marketing units (i.e. regions, branches, channels, products, or market segments) can be developed by preparing profit and loss (or income and expense) statements for marketing units. However, the question comes how to allocate indirect or shared expenses to various marketing units. There are two approaches of allocating marketing costs for profitability analysis: (i) full-cost (or net profit) approach, and (ii) contribution (or profit contribution) approach.

In the full-cost approach, all marketing expenses, both direct and indirect, are allocated to the marketing unit under study. By allocating all marketing costs, the company is trying to find the net profit of each marketing unit. This is presented in Table 7.8. In the contribution approach, only the direct expenses are allocated to each marketing unit, for which profitability analysis is being done. The indirect or shared expenses are not included. After deducting the direct costs from the gross margin, the amount that remains

is the contribution of the marketing unit to cover the overhead (indirect) expenses and a profit. An example, which includes both approaches, is shown in Table 7.9.

Table 7.8 Full-Cost versus Contribution Approaches

Full-Cost Approach	Contribution Approach
Sales	Sales
Minus : Cost of goods sold = Gross margin	Minus : Cost of goods sold = Gross margin
Minus: Direct expenses	Minus: Direct expenses
Minus: Allocated Indirect expenses = Net profit	= Contribution (available to cover overhead expense and profit)

The example presented in Table 7.9 uses full-cost approach for evaluating the profitability of western region and the contribution approach for assessing the profitability of the three branches within the western region. The profitability calculations of branches include branch sales, cost of goods sold and branch direct selling expenses. This generates profit contribution for each branch. The profitability calculations for the western region include branch selling expenses, western region direct selling expenses (that are not allocated to the branches), and allocated portion of indirect expenses. This gives a net profit figure for the profitability evaluation of the region. Table 7.9

Table 7.9 Example of Profitability Analysis

	Full Cost Approach Western Region	Contribution Approach		
		Branch A	Branch B	Branch C
Sales	400	150	130	120
Less cost of goods sold	300	112.5	97.5	90
Gross margin	100.0	37.5	32.5	30
Less branch direct selling expenses	12.7	4.5	4.2	4
Less west region direct selling expenses	12.0	--	--	--
Profit contribution	75.3	33.00	28.3	26
Less allocated indirect expenses	36.3	--	--	--
Net profit	39.0			

(Note: All figures are in Rupees million)

There is a considerable argument over the relative merits of contribution and full-cost approaches. Supporters of full-cost approach state that the purpose of a marketing cost study is to decide the net profitability of the marketing unit under study. They think that contribution approach does not satisfy this purpose. Besides, full-cost supporters think that a contribution approach may be misleading, because a product or market segment may show a positive contribution, but after deducting allocated indirect expenses, the product or market segment may show a loss.

Supporters of contribution approach argue that it is very difficult to arrive at a satisfactory procedure for allocating the indirect costs. Therefore, contribution approach is more objective in evaluating the profitability of a marketing unit. Further, these advocates point out that a fullcost approach may show that

a product or a branch has a net loss, whereas, this marketing unit may be contributing positively to the overhead costs.

In reality, both approaches are useful in marketing costs and profitability analyses. A full-cost approach is useful when making a long-term study of the profitability of different products or market segments. The contribution approach is useful for short-term marketing decisions, such as evaluation of profitability of branches and regions, when only direct costs are allocated to them. Branch and regional managers are responsible for direct expenses incurred by them and are not responsible for indirect expenses, over which they have no control. There seems to be a trend towards the contribution approach, for a short-term analysis.

Productivity Analysis

Productivity analysis is useful for complete evaluation of effectiveness of sales organizations. Productivity is usually measured by ratios between outputs and inputs. For example, sales per salesperson are used by many companies as a measure of productivity. There are other productivity ratios, such as selling expenses per salesperson, sales calls per salesperson, and quotations submitted per salesperson. One main benefit of these productivity ratios is that they can be compared directly across the sales organization levels (e.g., sales branches) within the company and also with other sales organizations. For instance, productivity analysis between different branches within a sales organization shows specific areas of high and low productivity. The productivity analysis gives useful information that is not available with sales, marketing cost, and profitability analyses done earlier. Sales profitability and productivity are interconnected. Profitability analysis has a financial view, whereas productivity analysis has a more managerial orientation. Improvement in sales productivity should get converted into increase in profitability.

Companies are using some of the following methods that are focused on increase in sales and internal cost cutting, for improving the productivity:

- Hiring independent sales agents (also called manufacturer's representatives), who are paid on a straight commission basis.
- Reducing the size of the sales force.
- Relying on the internet, telephone, direct mail, and video conferencing to reach customers.
- Increasing participation in trade shows or exhibitions to present the products to a large number of potential customers within a short duration.
- Using the latest communications and computer technology to help the selling process.
- Removing or minimizing

Return on Assets Managed (ROAM)

It includes some elements of productivity by comparing profits and asset investments. The formula for calculating ROAM is:

$$\text{ROAM} = (\text{Profit contribution}/\text{Sales}) \times (\text{Sales}/\text{Assets managed})$$

Here, the profit contribution can be either a net profit figure from a full-cost approach or profit contribution from a contribution approach. Assets managed usually include inventory, accounts receivables or any other assets at each sales organizational level.

EVALUATING AND CONTROLLING THE PERFORMANCE OF SALESPEOPLE

One of the most important responsibilities of sales managers is to evaluate the performance of their salespeople. However, performance evaluation process is time consuming. It is also a difficult process, particularly for the sales manager who has to tell poor-performing salespersons how and why their performance is not up to the expectations.

We shall first look at the purposes or objectives of evaluating the sales force performance, and thereafter, discuss the procedure and different methods of sales force evaluation.

Purposes of Sales Force Performance Evaluation and Control

The basic objective of the performance evaluation of salespersons is to determine how these salespersons have performed. The outcome of sales force performance review can be used for other sales force management purposes⁶ such as to:

- Improve the salesperson's performance.
- Decide the appropriate increment in pay and incentive payment based on the actual performance of the salesperson.
- Identify the salespeople who may be promoted.
- Determine the training needs of the individual salesperson and the entire sales force.
- Identify the salespersons whose services may be terminated, after giving adequate chances for improvement.
- Motivate salespeople through adequate recognition and reward for good performance.
- Find out their strengths and weaknesses.

The salesperson's performance appraisal should be carefully developed and implemented in order to make available information needed for several purposes mentioned above. For example, if the purpose of performance evaluation is to identify salespersons for promotion to the first level of sales management positions (such as district or branch sales managers), then the performance evaluation should focus on those criteria that are relevant to the effectiveness as a sales manager. This should be done in addition to the current performance as a salesperson. The same points that are mentioned above are also applicable when we talk about the importance and the objectives of performance evaluation of salespeople.