■ Allegheny Marketing Group ■

Seeds…

Issue Number 9

Sales Channels

How effective are your sales channels? Do you have the right channels for growth? Do you have the right number of feet-on-the-street?

In previous *Seeds…*, we discussed methods to analyze and compare different types of sales organizations. Analyzing the effectiveness of what you have in place today is a starting point for selecting or changing channels.

While sales channel selection varies with overall business strategy, measurement of effectiveness is a constant. The problem is one of trying to be objective. (What business executive hasn't beaten up on the sales force when sales are down?)

There are various methods to measure effectiveness. A method Allegheny Marketing has used is a three-pronged approach that covers:

- Sales Productivity
- Geographic Territory Coverage
- Customer Penetration Level

These three measures are used because they balance each other. Sales productivity can still be high if you are undercovering your territorial potential. Territory coverage can appear high by simply obtaining business from a few large customers spread throughout the territory. Customer penetration can be high as a result of overcovering the territory with salespeople – which reduces sales productivity. By measuring all three components independently, a true picture of sales effectiveness can be made.

A further, more accurate picture can be obtained by benchmarking your sales channels against your major competitor's channels. This requires looking at your competitor's deployment of people by geographic location, sales function and market segment.

This sounds like a lot of work…and it is. However, it's not a bad idea to periodically measure one of your most valuable assets. Most companies measure their product costs to the nth degree – very few measure how effectively they are sold.

Strategic Marketing

The past two decades have seen the age of new strategic thinking that has resulted in many “Winner Take All” markets. From Wal-Mart in the retail business to Microsoft in the computer software business, the giants of their markets have reached monopolistic market share positions. The strong get stronger and the weak go out of business. What is driving this change in strategy?

There are both demand and supply side factors at work. From the supply side, economics of scale give even larger advantages to dominant players in large niche markets. While economics of scale have always been important, a simple exercise in cost accounting shows how this advantage has been magnified.

In the typical manufacturing operations of the “Old Economy”, the fixed costs (buildings, machinery, land, R&D) accounted for roughly 30% of the total cost. In today’s high-tech industries, these fixed costs now account for 70% or more of the total cost (due to large R&D expenditures). This change in cost structure gives companies with a larger market share even greater cost advantages.

For example, let’s take two companies with the same fixed costs. Both are selling a widget for $1.00, however, one company (XYZ) sells 25% more widgets.

In the new high-tech economy, XYZ Company could use its cost advantage to obtain even higher market share by selling their widgets for less than $1.00. With greater sales, the cost gap between ABC and XYZ would widen even further and ABC would find itself in a vicious downward cycle. This is why in some high-tech businesses when a company’s share goes down 10%, it can quickly fall to zero.

This is the theory behind the mega-store concept in the Office, Home Improvement and Pet Supply businesses. It is possible today through specialization and new technology that the best performer in each niche can replicate its success across the nation and even the globe.

From the demand side, we have what experts call the “network effect”. The theory of the “network effect” is that buyers will gravitate towards the supplier that wins the early round of competition, even by a small amount. It’s a self-reinforcing cycle. Examples consumers can relate to would be airline hubs, VHS-sized videocassettes, and classified ads in newspapers. Examples closer to home include Microsoft and Intel computer chips.

THE OLD ECONOMY		
	ABC Company	**XYZ Company**
Annual Production	1 million units	1.25 million units
Fixed Costs	$300,000	$300,000
Variable Costs	$700,000	$875,000
Total Costs	$1,000,000	$1,175,000
Costs Per Unit	$1.00	$0.94 6% cost adjustment
THE NEW ECONOMY		
Annual Production	1 million units	1.25 million units
Fixed Costs	$700,000	$700,000
Variable Costs	$300,000	$375,000
Total Costs	$1,000,000	$1,075,000
Costs Per Unit	$1.00	$0.86 14% cost adjustment

Whether or not the “network effect' applies to your business is debatable. However, there is no doubt that if your business requires fixed costs greater than 50% of your total costs, then your business will soon exhibit dominant supplier behavior. If so, market share is critical and marketing strategies leading to being the number one or two supplier are essential.

Pricing

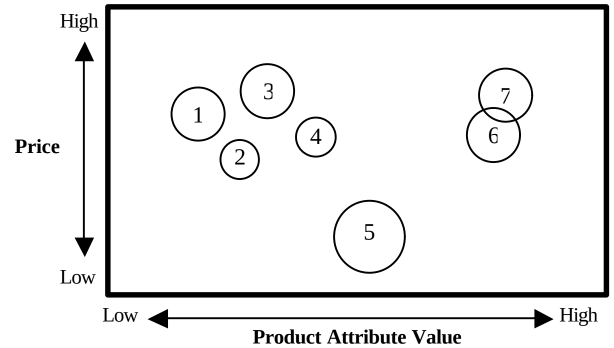
What do you do when a new competitor comes in 15 – 20% under your current prices? Unfortunately, there is no happy answer – at least in the short term. Either meet the competitor's price level (or close to it) or pass and go after the next bid. The trade-off decision between these choices would be the margin dollars you believe are recoverable with other customers. Volume-Price trade-offs are dependent on direct product cost margins your product lines generate.

Longer term there are better choices. The greater the depth of your product lines, the greater the defense against low cost predators. While there are many examples of companies developing new low-end products to compete, there are also companies who already have the capability to create product depth – they just don't realize it.

In several of our Pricing to Value studies, we have discovered that there are product attributes that certain customer segments do not value. Our clients believe the attributes have value and thus are unwilling to either eliminate or modify them.

A composite profile of several recent studies provides excellent examples. When we plot product attribute value versus price for a family of similar products, we frequently see the positioning of products shown in Figure 1.

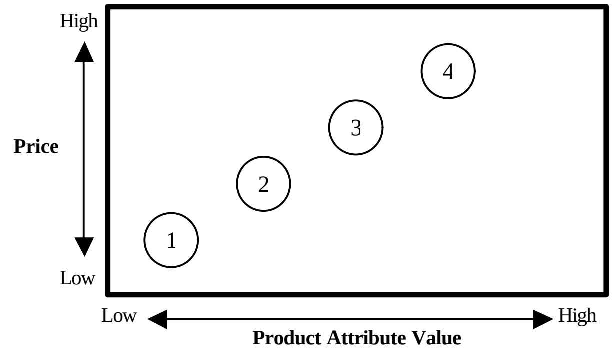
Figure 1



The circles represent similar products from different manufacturers with the size of the circle representing relative market share. The company (client) currently has two products on the market - #6 and #7. The client has 5 competitors, each with one product.

From the profile in Figure 1, you can see all products except Product 5 are priced within a narrow band. You also see that customers within the industry have a wide range of values. The client has two products that are positioned closely together and, in fact, probably cannibalize each other.

Figure 2



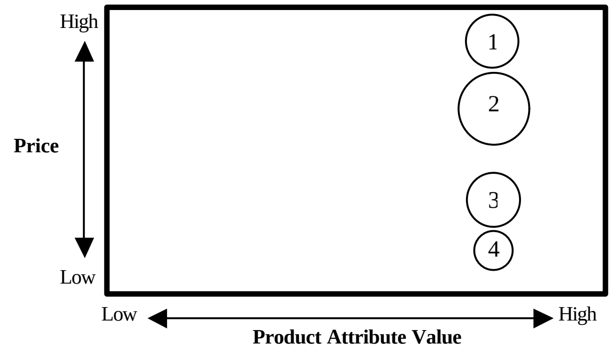
The product strategies available to the client are:

1. Reduce the value of Product 6 and lower the price.
2. Increase the value of Product 7 and raise the price.
3. Develop new Product 8 with values close to Products 1, 2, 3, and 4 and sell at a price lower than Product 5.

Reducing the value of Product 6 may simply mean eliminating selected product features.

Ideally, you want to create a product portfolio that looks similar to those shown in Figure 2. The combination of these products would capture the highest market share.

Figure 3



The best defense against low-cost predators would be to develop a product line like the one shown in Figure 3. This product portfolio provides the best defense against price and margin erosion.

The trade-off for multiple products is the cost of carrying the product line.

Marketing Thoughts

Another one of the 22 Immutable Laws of Marketing – **The Law of Success!**

Success often leads to arrogance – and arrogance to failure.

Success leads to the often fatal trap of line extensions. When a brand name is successful, the company assumes the brand name is the primary reason for the brand's success. So they look for other products to plaster their name on. Examples: Tangueray Gin – Tangueray Vodka, Coors Beer – Coors Water, Levi's Blue Jeans – Levi's Shoes. All short term successes and long term failures. What they forgot is the brand got famous because they made the right marketing moves.

Ego is the enemy of successful marketing. Ego can be an effective driving force in building a business, but a killer when injected in the marketing process. What makes for brilliant marketing is the ability to think like a customer thinks – and not impose your own view of the world on the situation. Examples: General Motors, IBM, DSC, and Sears – they all imposed their view of what customers needed and they all failed (since rectified).

If you are a busy CEO, how do you gather objective information on what's really happening? How do you get the bad news as well as the good?

Like kings, CEOs rarely get honest opinions from their ministers. As Gorbachev told Reagan, "It is better to go out and see once than to hear a hundred times". There is nothing better for the ego than to have customers personally show you how your product could work better.

Why have small companies grown faster than large companies? They are mentally closer to customers and haven't been tainted by the law of success.

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