



Cost-to-Serve

Putting channel efficiencies under a microscope

By Frank Lynn & Associates

An increasing number of marketers are putting their channel efficiencies "under a microscope" - finding that it is no longer acceptable to look at broad cost measures gathered through traditional accounting methods. Today, reported costs need to reflect the actual effort and investment expended. These critical elements must also be analyzed by channel, product and customer segments.

The Frank Lynn & Associates Cost-to-Serve insight tool combines activity-based costing

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techniques with channel theory and management realities. The goal of Cost-to-Serve is to produce a rich database of information and insight that can be used to help our clients incorporate relative channel

efficiencies into decision making.

Below are four key lessons we have learned after putting hundreds of companies' market strategies under the microscope.

Lesson #1 - Don't Abandon Strategy for Efficiency

Frank Lynn & Associates has found that, as a percentage of revenue, small deals, sold through a direct sales force, frequently result in 30 to 40 percent less contribution than large deals. Even worse, it is not uncommon to find that these deals are actually money losers!

But before you walk away from a deal, ask yourself these key questions:

- ¥ Do small deals within a specific account lead to large sales over time?
- ¥ Are your salespeople applying their successful large account techniques to small accounts without considering the needs of the customer?
- ¥ Are large deals simply better able to hide the limitations of your order processing, inventory management, delivery or other systems?
- ¥ Can your indirect channel partners more efficiently handle small deals within large accounts?

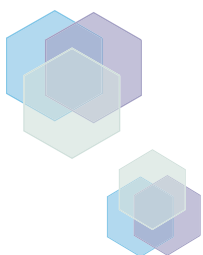
It is important to remember that efficiency alone cannot substitute for marketing effectiveness. What's the formula for success? A superior understanding of your customers, combined with a plan to market effectively, at the lowest possible cost.

Lesson #2 - Let Your Customers Define the Process

Activity-based costing efforts defined around internal processes will uncover costs ripe for efficiency gains. However, this approach often fails to provide an accurate or complete picture of how investments are actually deployed against your customers' buying needs.

In the end, most companies find ways to meet the needs of their customers. The Cost-to-Serve consulting service begins with customer activities in presale, transaction and postsale phases. Next, we identify sales, support and other resources that meet those needs.

Frank Lynn & Associates has found that this approach frequently reveals several practices





not captured by the "official" internally defines process:

- ¥ **Bootstrapping** - informal use of people and assets for other than their primary tasking.
- ¥ **Redundant efforts** - employees with multiple job titles who believe they have responsibility for the same activity.
- ¥ **Preemptive problem solving** - once burned by poor installation or postsale support, salespeople will follow a sale long after it could have been handed off.

The problem with each of these outcomes is not customer dissatisfaction, but the fact that their success in fixing procedural shortcomings makes these costs invisible to the organization.

Lesson #3 - Relatively Rules

While you may have never had a true picture of your total channel costs, the real value of Cost-to-Serve analysis comes from understanding relative differences by product and customer segment. Once you have this vital information, you will be able to examine your cost investment in relation to the revenue you earn. For example:

- ¥ What are the relative efficiencies of sales to hospitals, universities, factories, small businesses and other customer segments?
- ¥ Within these segments, are all products sold with equal efficiency?
- ¥ Do you make money on those demanding and difficult high-volume distributors? What about the hundreds of small distributors that seem to be easy money?

Frank Lynn & Associates has found that, while some patterns exist, each company's specific circumstances can produce dramatically different results - which are often entirely unknown to channel decision-makers!

Lesson #4 - Identify Your True Value Drivers

Simply understanding your costs to sell different products through multiple channels to unique customer segments may not be enough. Leading-edge companies are looking for insight to determine if they are investing in activities that are most likely to drive top-line revenue or bottom-line profits.

For example, service companies, such as airlines and telephone companies, often find that it is critically important to focus on asset utilization. For these companies, it may be more important to keep their airplanes or networks "loaded" than to focus on the discreet margins associated with individual sales opportunities.

Other insights to be gained through a Cost-to-Serve analysis include:

- ¥ The cost of attaining new customers versus those associated with retaining existing accounts.
- ¥ The total cost of growing an existing account versus account maintenance activities.
- ¥ The incremental coverage (and revenue) provided by multiple channels and whether it has been matched by an equitable transfer of selling and support costs.

Today's competitive environment demands that marketing effectiveness match channel efficiencies. To quote a well-worn observation concerning manufacturing a product at a negative margin, "You can't make it up in volume!"

