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COST CONTROL

Expense Control in Sales and Marketing

Eugene F. Finkin

The most important question to ask when looking into cost reduction and control of sales and marketing is: How many separate sales organizations should be maintained? Multidivisional firms often have a single sales organization for all their products. Sometimes each division has its own sales staff.

The right question to ask is whether the overhead arising from having duplicate sales organizations is needed to effectively sell various products. Combining sales organizations could allow substantial economies: elimination of separate sales offices, elimination of highly paid management positions, and fewer salespeople. One should assume that separate sales organizations can be combined unless a good, convincing case is made to the contrary.

However, one convincing argument for separate sales organizations springs from a company's selling a product with entirely different market characteristics than the primary products. For example, Alloy Rods, recently spun off from Allegheny International, Inc., is the leading U.S. manufacturer of high-quality welding rod, wire, and other welding products. Its primary products are high-volume, low-value items sold primarily for original equipment manufacturers (OEM) use.

Alloy Rods also has a line of low-volume, high-value products (Allstate-brand hard facing and maintenance electrodes), which were selling poorly. Sales of these products eroded over eight years from $6 million to $2 million annually. To solve this problem, a separate Allstate sales organization was established at a different location, with its own warehouse to provide faster delivery. Within two years, sales climbed back to $6 million and are expected to climb even further.

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What to Look For

A poorly organized sales and marketing function can never exist in a successful company. The following elements allow a company to maintain a successful sales function.

A Source of Market Intelligence

The sales organization is the company's primary source of market intelligence. Does the sales organization have effective marketing services capable of collecting and analyzing meaningful data from sales figures? Does it know in detail about changes in competitors' product offerings and market prices? Does the sales organization know about:

- Orders won and lost at major customers—and by whom:
- Market share shifts;
- Problems of customers that can be exploited; and
- External effects that are likely to impact sales—and how they will have an impact?

If the sales department does not know this information—which is common—the company has a sales function but no mar-

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keting function. The absence of a marketing services capability must be corrected.

Repair and Replacement Parts

Orders for repair and replacement parts can be the most profitable segment of any business, but they are, by definition, a separate business and must be managed separately. Explicit sales responsibility must be assigned for this part of the business; having separate responsibilities can forfeit a golden opportunity.

Credit

A meaningful credit function must exist. The credit manager must be organizationally located in either the finance department or the sales department. Usually, locating the credit function in the finance department is the best alternative, since this eliminates a potential conflict of interest. In either case, the responsibilities are the same: Prevent undue risk. An insolvent customer who cannot pay its bill is not a customer at all. A company is often so hungry for sales that it accepts orders that should be rejected. There must be a competent credit manager with authority to prevent this.

Sales Force Expense

What level of sales expense should be maintained? Is this an area in which to make deep reductions, or should even more be spent? To answer these questions, look at the specific business and determine whether sales representatives and other sales expenses are truly the basis of obtaining sales.

Do most sales come from repeat orders of well-established customers? If so, the sales rep is probably not selling the product. Rather, he is maintaining good relations with the customer, showing that the company cares about him, and continuing to obtain his business.

The sales rep in this situation is not responsible for gaining the business—the orders would most likely have been mailed in anyway.

If the product is widely sold to many customers, the sales organization may be large and expensive. When no single sale is critical to the business plan of the manufacturer, the risk of a minor potential reduction in sales, which, in practice, usually does not occur, can be traded off to obtain a major reduction in sales expense. For a troubled company selling standard products to repeat customers, the sales organization may be a luxury that can be severely curtailed.

Remember this: If the product is standardized and made by a few well-known firms, most current sales probably do not arise from the sales effort of the organization. The following two examples give insight into this subject.

Alloy Rods: Setting Up Master Distributorships

Alloy Rods, the manufacturer of welding rod and wire, was selling about $85 million worth of its products through 400 distributors to about a dozen large OEM customers. With the highest market share and the most efficient manufacturing plants in the business, its profit levels were still not satisfactory.

Marketing expenses were significant. Sixty sales representatives were thought to be required to service the large number of accounts. To reduce these costs, a different selling approach was adopted.

A number of the large distributors agreed to become master distributors, substituting their large sales force for Alloy Rods' sales force. They serviced their nearby smaller distributors, in place of Alloy Rods' own force. This then allowed Alloy Rods to reduce its sales force to twenty-five persons, creating a substantial overall savings.

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Allegheny Ludlum: More Profits by Closing Sales Offices

Allegheny Ludlum is another example of a company selling a standardized product in an industry with a few well-known competitors. Allegheny Ludlum, a leading producer of stainless steel, is solidly profitable, in stark contrast to most steel companies.

Over a ten-year period, Allegheny Ludlum slowly closed down three quarters of its sales offices, which were once located in important markets. With each closure, sales increased—the opposite of conventional marketing wisdom. An extrapolation implied that closing all their sales offices might overwhelm them with sales (no one took this seriously).

This is another case in which standardized items are sold to established customers. Under the old system, the business was supporting the sales effort rather than the sales effort supporting the business.

Controlling Expenses

Today's customers buy on price, performance, and delivery. Business is more competitive than ever. High entertainment expenses are a relic of the past.

Many steel companies, for example, stress expensive golfing affairs with their customers' top executives as part of their marketing approach. Everyone has a good time and much money is spent. No steel gets sold. That's because for some years steel has been an item bought on price.

If, on the other hand, the company wants to seek new customers that do not have a history of buying a particular product from them, these customers can be developed only with a significant sales effort. Direct person-to-person contact is essential. Without it, sales will not materialize.

Sturtevant, a recently divested division of Westinghouse Electric Corporation, was a manufacturer of large blowers, used to provide forced air to power plants, coal mines, steel mills, cement plants, etc. For many years, it dominated the power plant niche of the market. (It held a 40 percent market share or greater.) But the company had little penetration of the many other industrial market segments. It had market shares of 10 percent or less.

With the decline in the early 1980s of new power plant construction, Sturtevant was faced with a bleak long-term business outlook. Its solution, outlined in its strategic plan, was to build up its market penetration in the non-power plant portion of the market. However, it hired no sales reps experienced in these areas and spent little in marketing support. This resulted in no appreciable increase in non-power plant sales and continuing losses.

The Blaw Knox Food & Chemical Equipment Company had a relatively large sales organization, which was needed for its highly engineered products which customers purchase infrequently. As a cost savings, its sales reps were prevented from traveling. For a typical month, its airline travel costs were only $1,000. This was extremely foolish. Why have sales reps if they cannot visit customers? The policy was reversed, with sales people ordered to be on the road three or more days per week. Almost immediately the level of incoming orders increased.

A review of sales expenses is mandatory. Norms for travel and entertainment have to be developed and enforced; otherwise, significant costs will be needlessly incurred. Usually a reduction in sales expenses will not hurt in the short run, and it will directly benefit cash flow.

Should a Product Line Be Pruned?

Many companies and their marketing departments like to boast that they are full-

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line suppliers, or to say that they have the broadest product line in the industry. Such a situation can be the basis of excessive costs.

The lowest-volume items in a product line frequently have disproportionately high manufacturing setup and changeover costs per unit. As production requirements dictate a minimum batch size, slow-moving items often cause disproportionately high inventory costs because of their low turnover. Significant accounting and paperwork costs also accompany these items. Therefore, the lowest-sales-volume products of any product line should always be candidates for pruning.

Two questions must be answered before a product line is pruned: Does the company have to be a full-line supplier to be successful, and does the profitability of the slow-moving items, by itself, warrant their continuance?

Looking at a competitor's product breadth often gives insight. Sometimes one will find that larger, more profitable competitors have a narrower product line, possibly having pruned it long ago. Carrying slow-moving, not particularly profitable items is usually not necessary to protect the market position for faster-moving items if the customers are buying from several sources. Inexpensive customer surveys can be taken before making a decision.

One possible approach to eliminating slow-moving items is to apply a ROI test to these products. This method is a good indicator of the inappropriate products in a company's offerings and can indicate which prices may be selectively increased to meet a minimum ROI as an alternative to immediate pruning.

If finished goods exist that will be dropped from the product line, an analysis should be made whether to let them dribble out of the system, to sell them off all at once at a reduced price, or to scrap them.

Makers of equipment spanning a wide range of sizes, capacities, and so on may have their manufacturing plant and its machine tools best suited to one end of this product spectrum. By offering goods at the other end of the spectrum, they may be incurring either actual losses or profitless sales (which, nonetheless, require extensive working capital).

Most products follow the well-known "product life cycle." Over time, the number of competitors and the degree of price competition change. A product that once was a profit maker may not be today. But people seldom think about this. There is an inertia in companies inhibiting the pruning of product lines. It is important to ascertain whether the product is, or can be, manufactured economically. If it cannot be, purchasing it for resale, perhaps offshore, may be a viable alternative that would permit the product to continue to be marketed (if that is deemed important).

Danly Machine Corporation's manufacturing of mechanical stamping presses is a good example. The company is best known for its custom-designed, high tonnage presses (which range in size from 500 tons to 5,000 tons capacity), which are sold primarily to the automotive industry. These presses are normally made in quantities ranging from one to ten for a given design. The company also made small OBI presses (25 tons to 150 tons capacity), which were of a standard catalog design.

The manufacturing operation (i.e., its machine tools, procedures, and overhead structure) was geared to manufacturing small numbers of large presses. Hence, it could not be cost-effective on making large batches of small presses, although the company had offered them for years. An analysis of the actual cost experience on six orders for small presses revealed total costs averaging 180 percent of sales price. A decision was made to cease manufacturing small presses.

In summary, a number of facets must be examined when reducing sales and marketing expenses. Asking the right questions and cutting expenses in the right places have a positive effect on the bottom line.

"A poorly organized sales function can never exist in a successful company."

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