Sales Benchmark Index

Benchmarking Best Practice Discussion

September 2007

Sales Metric	Cost of Sales

Inquiry

"My company is trying to determine the true cost of sales. However, we are ***lacking common definitions and units of measurement****.*

This is causing us much wasted time debating the basics versus getting the answer.

Can you provide me a best practice from the membership on how to best calculate cost of sales?"

Response

Selling expenses, the "S" portion of SG&A line on an income statement, are typically the second most expensive item on a financial statement, trailing only cost of goods sold (COGS) in magnitude.

Selling expenses are also a key driver in calculating a company's Return on Sales (ROS) metric, and therefore directly affect the company's stock price.

Your question is understandable -- there is much confusion surrounding the most accurate and efficient method to analyze cost of sales.

Best Practice: Cost per Call
A peer-produced best practice is to concentrate on Cost per Call as the unit of measurement for calculating Cost of Sales. This is because a company's total cost of sales can be thought of as the sum of each sales call and its associated expense.

Cost per call measures the total amount spent for every call made to customers. It helps executives determine the cost-effectiveness of each dollar of revenue generated.

Response (continued)

Calculating the Cost per Call (CPC)

To determine cost per call, the following three variables must be determined:

- Sales Expenses per Time Period: **SE**
- Total number of selling days in that time period: **SD**
- Average number of calls per day: **CPD**

What is *Sales Expense per Time Period (SE)?*

The sales-expense data is based on historical expenses, with greater emphasis assigned to more recent time periods. Sales people incur additional expenses in the course of their annual selling activities, including those associated with transportation, entertainment, and support costs. If a company's sales force is new (perhaps previously the company's products were sold by an independent agency, or online) then historical data may be insignificant or non-existent. In this case, data can be acquired through a market-research firm or industry trade publication.

What is *Total Number of Selling Days per Time Period (SD)?*

The total number of selling days in the chosen time period will vary by company because of differences in vacation policies, training days, time required for internal meetings and similar non-selling activities. Executives will need to determine total selling days for each person in the sales force if an accurate, individual measure is required. While totaling all sales days and dividing by the number of sales people will produce an average, it will not reflect the specific selling and non-selling schedules of individual sales representatives.

What is *Average Number of Calls per Day (CPD)?*

The data for the average number of sales calls per day can be gathered at the individual sales rep or team sales levels. If an average without regard for specific individual performance is required, the total number of sales calls made by the team divided by the number of team members in that time period will provide that information. But accurate individual performance reviews will require executives to calculate each individual representative's performance.

Response (continued)

The Formula for Cost per Call CPC
Using the three variables described above Cost per Call can be calculated using the following formula:

$$CPC = \frac{SE}{CPD * SD}$$

Determining *Sales Expense per Time Period (SE)*
The average compensation (base salary plus bonus and commissions) for all sales people in the United States in 2006 was US$ 121,440[1]. This figure is only part of the total sales expense, however, and you must also account for fringe benefits (e.g. insurance). In this example, we have added a value of $15,225 per sales rep (roughly 12.5%) to account for these additional expenses.

Loaded Compensation Expense	
Salary, commissions, bonus:	$ 121,440
Fringe benefits (insurance, etc.):	$ 15,225
Total:	**$136,665**

Direct Selling Expense	
Automobile:	$ 12,636
Lodging and meals:	$ 9,856
Entertainment:	$ 5,181
Communications:	$ 7,076
Promotional Materials:	$ 2,780
Miscellaneous:	$ 2,654
Total:	**$40,183**

Thus, SE is equivalent to the sum of Loaded Compensation Expense and Direct Selling Expense or **$176,848** ($136,665 + $40,183).

[1] Sales Benchmark Index's information repository – Mar 13, 2007 data cut

Response (continued)

Determining *Total Number of Selling Days per Time Period (SD)*

This value is determined by taking the total available selling days in a year and subtracting the number of days allotted to non-selling activities. In this example, we will use the industry standard 260 days (52 weeks * 5 work days per week) as the value for Total Available Days.

To determined non-Selling Days, we add up the following allotments:

Vacation	10 days
Holidays	10 days
Sickness	5 days
Meetings	18 days
Training	12 days
Total:	55 days

Thus, SD = 205 Net selling days (260 – 55)

Determining *Average Number of Calls per Day (CPD)*

In our example, the Sales Operations staff has previously determined that an average sales rep can complete 3 sales calls per day.

Calculating *Cost Per Call (CPC)*

Using the formula described above, we can now determined CPC as follows:

$$CPC = \frac{SE}{CPD * SD}$$

$$CPC = \frac{\$176,848}{3 * 205} = \mathbf{\$287.56}$$

This example captures all the relevant data and shows how much it costs the organization to service, support, and sell via their sales reps.

Conclusion	Executives must grow the business by finding new customers and getting existing customers to buy more products. Therefore, they must allocate their limited time toward the best customer prospects. However, sales people need to know how much their time is worth and the expense of making contact with each customer, so a cost per call metric should be done for each rep. In calculating such a metric, executives must account for each of these components described earlier to accurately forecast their total selling expenses to determine a valid cost per call (CPC) figure. World Class sales organizations succeed because they scour their activities rigorously to maximize selling time to the right customers. Measuring cost per call (CPC) enables executives to determine the costs to make each sales call. Cost per call is a useful tool in the beginning of any sales plan because it forces the executives to think carefully about the many expenses incurred in pursuing a sale. However, it is just one of several key planning steps. More on those in other Sales Benchmarking Advisory Discussion Documents.

About this Document

Sales Benchmark Index offers this ongoing series of best practices discussion documents to compliment the sales benchmarking services we provide to each member. These documents help our members connect cause and effect and enable them to take the next step to address the deficiencies revealed through relevant peer group comparison.

We hope this document addressed the member's initial question. Any follow-up questions or further assistance should be directed to your Client Management Team. Please contact them at 888-556-7338 or visit us at www.salesbenchmarkindex.com.