

Understanding CCOS: “What is the *Right Cost of Sales* for My Company?”

By Joseph DiMisa and Dennis Spahr



Knowing a company’s compensation cost of sales (CCOS) and the factors that influence it are essential to creating and maintaining a competitive sales effort. Going a step further, and comparing the CCOS to those of similar or competing organizations or the industry as a whole provides perspective about how effectively and efficiently an organization is reaching its customers through various geographies, channels and/or job roles.

Simply defined, CCOS is the total compensation dollars¹ (not including perquisites like Sales Promotion Incentive Funds (SPIFS),² president’s clubs, sales contests or benefits) paid to individuals involved in a sale (including “overlay” sales roles and sales management roles), divided by the credited sales revenue that is produced for that effort or sale. Although it gets technical, understanding the company’s CCOS will be well worth the effort.

Rules of Thumb

The following rules of thumb can help an organization comprehend its CCOS:

- CCOS is not universally measured the same way. One company’s CCOS may include marketing, advertising and distribution costs; another’s may only include direct sales compensation. It is important to know what is included in comparable figures.
- CCOS varies by industry. Based on surveys conducted by Sibson Consulting and others over the years, the median CCOS for business-to-business sales forces tends to fall between 3 percent and 9 percent, quite a large range.
- Further, there is no one correct CCOS for an industry (as illustrated by the data presented later in this article). The correct CCOS for a company depends on its sales strategy, channel strategy and other factors.
- CCOS varies within a given company; representatives with higher productivity have a lower CCOS than representatives with lower productivity. Different types of sales representatives (e.g., channel representatives, product specialists, major account managers) have different CCOS.
- Larger companies typically (but not always) have lower CCOS.

¹ Total compensation dollars can be broken out as base salary or fixed compensation cost of sales and commission or bonus dollars (variable compensation cost of sales). When looking at variable pay, the amounts used need to be directly attributed to the revenue credited for particular sales.

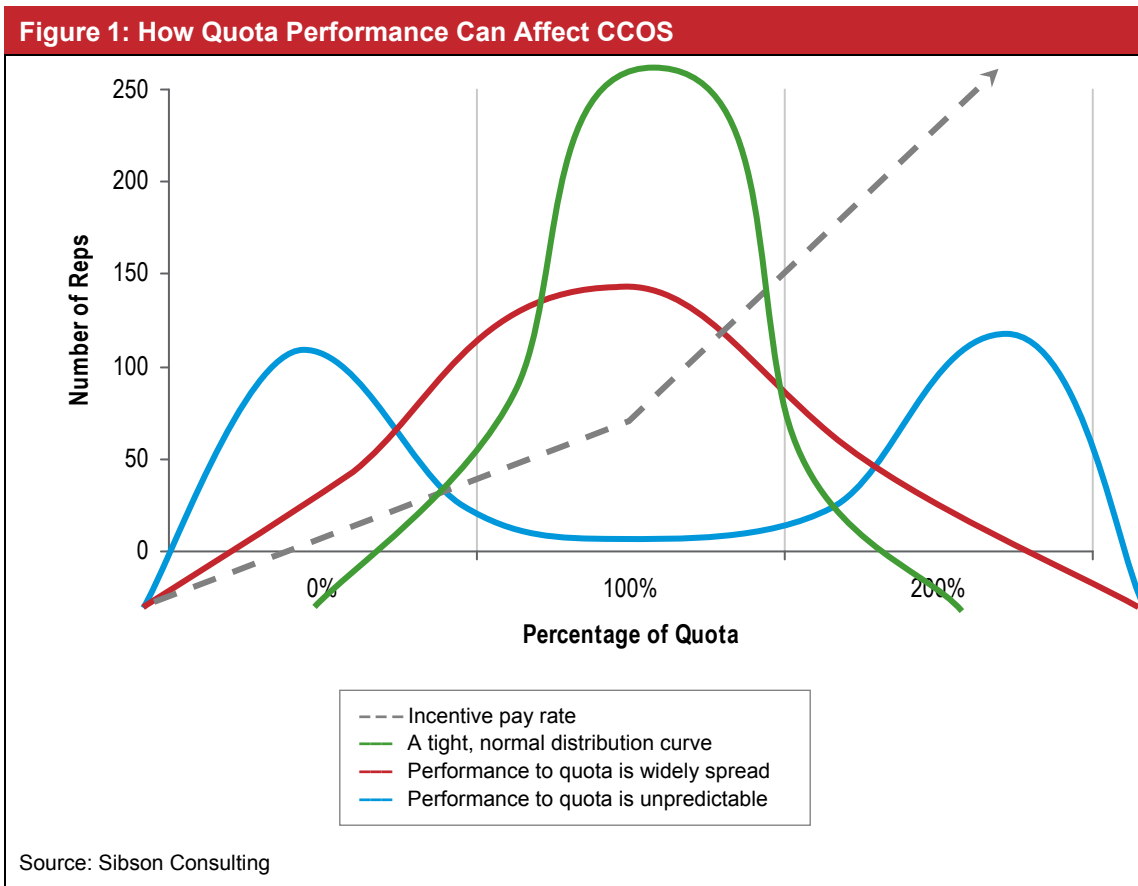
² A SPIF is an immediate bonus paid directly to a salesperson for selling a specific product.

Factors that Influence CCOS

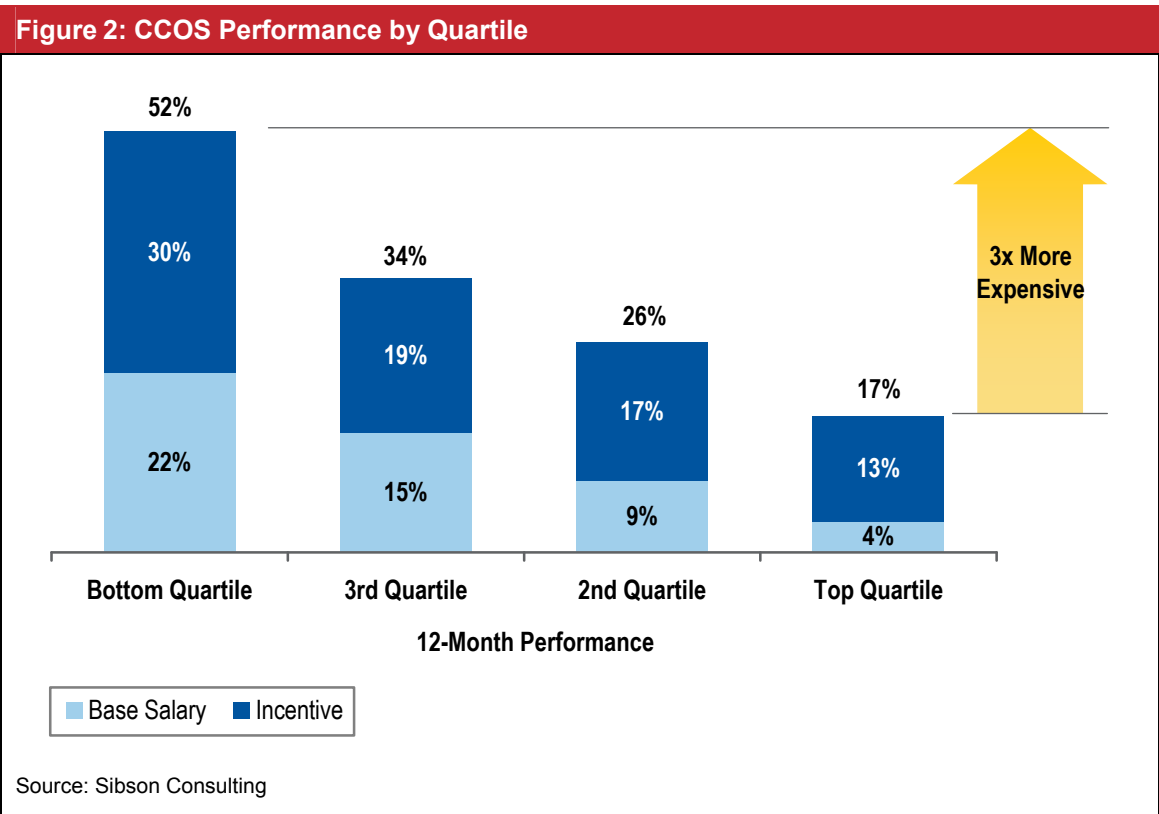
A number of factors that influence a company’s CCOS need to be taken into account:

- **Product Margins** High-margin businesses or products have more room and/or are more willing to use their margins to drive sales performance. This manifests as higher rates of pay or commissions. In industries with very high margins (e.g., software), the compensation costs will be much higher. Specifically, the more a company sells products with high margins, the more it will be willing to pay its sales force.
- **Volume Deal Size** Typically, high-volume or large deals (in total dollars) have lower CCOS. The reason is relatively simple: The effort to close a \$20,000 deal is usually not 20 times more than it takes to close a \$1,000 deal. This may also extend to multi-year deals if revenue is credited after the year (not a common practice). Most multi-year deals have larger extended volume or residual annual revenue, which will tend to lower CCOS if it is counted. One important point is that if volume takes a seller into high commission rates or accelerators, CCOS may increase as volume increases.
- **Business Maturity** Less-mature or early-stage businesses tend to have higher CCOS compared to more established businesses because growing a market is more important and strategically more significant for less-mature companies. “Any sale is a good sale” may be part of the strategy since market share will be low. This philosophy can drive companies to pay more for a sale. On the other hand, many early-stage or start-up companies have less sales support (allowing dollars to be shifted to sales costs) and are more leveraged toward at-risk pay.
- **Revenue Crediting** How an organization credits its revenue can also affect CCOS. Recurring revenue and/or multi-year contracts can create measurement complications. Traditionally, CCOS calculations are based on 12 months of revenue. Recurring revenue that comes in after a 12-month period or from a multi-year contract that is not credited in the current year will not be factored into the revenue calculations. Revenue crediting issues come up when costs are paid upfront for a sale yet revenue is not recognized at that time. Some industries with very low “churn” (e.g., insurance and financial services) typically will pay for new revenue, understanding that accounts will recur for many years to come. In some cases, companies that pay a sales rep for multi-year revenue at the time of bookings will increase CCOS in any given year (while decreasing it in future years when the revenue arrives).
- **Pay Philosophy** Pay and pay philosophy are typically generally linked. Having a pay philosophy that states, “We want to pay above market” will obviously cause CCOS to rise. Similarly, having a philosophy that states, “We pay at or below market” will reduce CCOS. Historically, companies tend to target certain levels of pay (e.g., 60th percentile). If quota or revenue volume is also at the 60th percentile of market, the CCOS overall will be at the 60th percentile too.
- **Tenure and Job Roles** The cost of breaking in new hires or new channels may outstrip that of experienced reps or channels. Different job roles have different costs associated with them. Knowing the costs for each role can help ensure the proper job resources and roles are deployed to the right opportunities. It will also demonstrate the costs of adding “overlay” positions in an account.
- **Quota Setting and Performance vs. Quota** Many perceived problems with the sales compensation plan and high CCOS can be tied to inaccurate quota-setting and/or unpredictable performance versus quota. When accelerated commission rates are included in the sales compensation plan (allowing top performers to earn significantly more than target incentive), even a tight, normal distribution curve (shown by the green curve in Figure 1 below) results in a higher CCOS than just summing up the target incentive amounts for all sales representatives. When performance to quota is more widely spread and/or

unpredictable (shown by the red and blue curves, respectively, in Figure 1), the CCOS can be even higher.

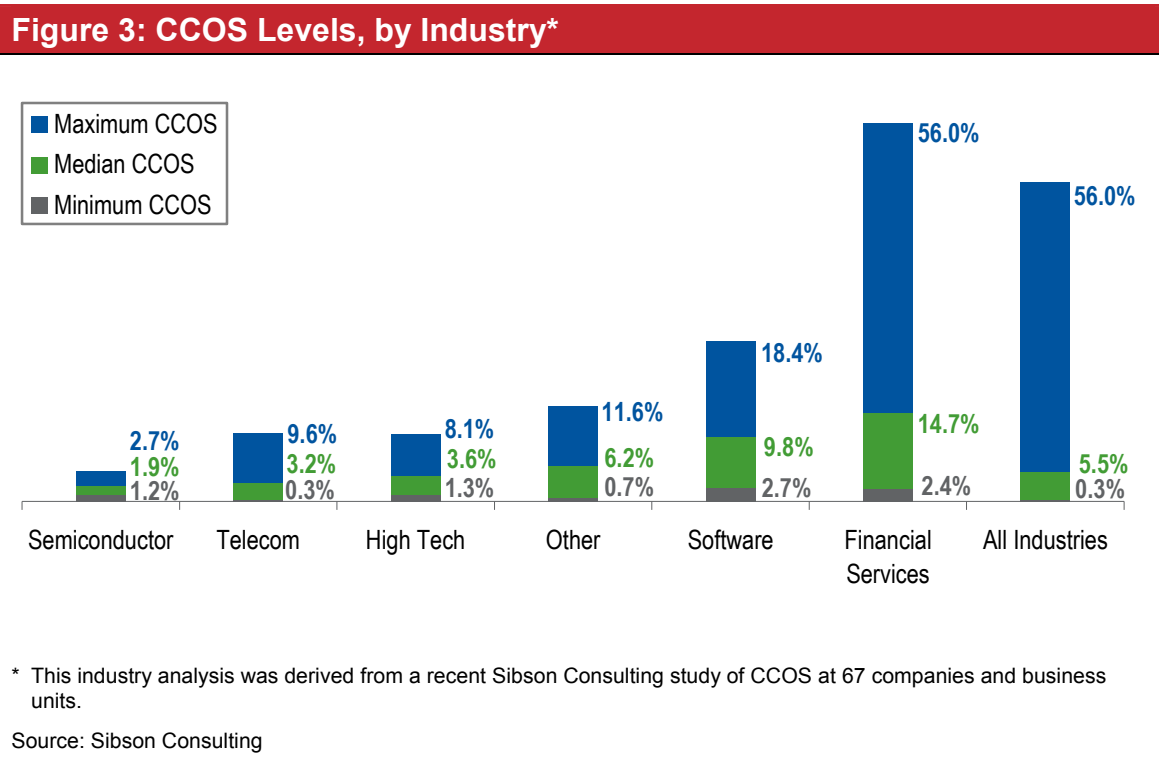


Additionally, the CCOS at the individual level can vary significantly based on the revenue the individual produces. In Figure 2 below, the sales representatives performing in the bottom quartile (on the left), have a 52 percent CCOS whereas the top-quartile performers (far right) have a CCOS of 17 percent. The CCOS is lower because the top-quartile performers are bringing in significantly more revenue. They are three times more effective than are those in the bottom quartile.



Different Industries and Selling Models = Different CCOS

In addition to the factors that influence CCOS, it helps to understand the CCOS for the company’s industry and for other industries with similar selling models. Note that CCOS can differ significantly by company within an industry as well as by industry. CCOS can range from a median of 1.9 percent in the semiconductor business, which has historically has a very small CCOS because of the size of the deals, to 14.7 percent in financial services, which is highly people intensive. (See Figure 3 below.)



Some industries will pay more because they have higher margin products. Others will pay less because they benefit from a large embedded base of revenue and their sales process is more retention-oriented than acquisition-based.

It also helps to understand how a company’s selling model and, ultimately, its pay philosophy compare to others. For example, the financial services and software industries are primarily acquisition driven, so they will pay more for new business (new clients or new revenue). Telecom and semiconductor companies pay less. Telecom companies have a high embedded base of revenue; semiconductor companies generally have a long sales cycle and large deals.

Conclusion

In today's uncertain economy, knowing an organization's CCOS can provide a much-needed competitive advantage. It is good to remember there is no one “correct” figure for an industry or a type of company. Whether it is a mature organization with multiple channels, job roles and go-to-market complexities or a less-complex organization with a simple sales process, knowing the CCOS and understanding the factors that influence it are essential to creating and maintaining a competitive sales effort.

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This article is from the June 2010 issue of *Perspectives*, Sibson Consulting's e-magazine. It is available on the following page of Sibson's Web site:
http://www.sibson.com/publications/perspectives/volume_18_issue_2/understanding-ccos.html.

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