

"It Always Takes Longer and Costs More"

The Sales Learning Curve – Optimizing
the path to positive cash flow

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Development of Entrepreneurial Companies

- ▶ Seed Stage
 - Creating the Business Plan
- ▶ Development Stage
 - Creating the product
- ▶ Go-to-Market Stage
 - Getting Traction
 - AKA "The Chasm"
- ▶ Market Expansion Stage
- ▶ Harvest

Where the Risk Is

- ▶ Seed Stage
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Go-to-Market

- ▶ Successful Beta
 - Conversion of Beta's to customers
- ▶ Recruit / hire new VP sales
 - Typically Regional Manager level sales exec in related industry
- ▶ "Go for it"
- ▶ It is an exciting and optimistic time...

Rapid Sales Deployment -- The Seduction of the CEO

▶ Cash Considerations

- Growing expense / Zero revenue -- Cash is being consumed
- Fastest / least painful route to cash is growing the revenue line as fast as possible
- Pressure from the investors / board

▶ Competitive start-ups

- "We will not forfeit any game by not showing up"
 - ▶ Each company must deploy to the superset!
- A battle to emerge from the pack: "First Mover Advantage"

▶ Overconfidence

- "The beta went great..."
- "The press loves us..."
- "We're hot!"

-- ("...and a lot smarter than the other guys...")

The Case of Nano – Optical Customer Adaptive Software and Hardware Corporation

N O C A S H

NOCASH: Goes to Market

- ▶ With successful Beta in sight...
- ▶ Hire the VP Sales
 - Often times a “regional” level sales manager at a larger company in similar market
 - AKA:
 - ▶ SVP
 - ▶ EVP
 - ▶ EVP WW Field Operations
 - ▶ President Field Operations
 - ▶ President / COO
 - ▶ President / CEO
- ▶ New VP sets the plan and hires the sales force based on a “Capacity Model”

NOCASH: Revenue Planning -- The Capacity Model

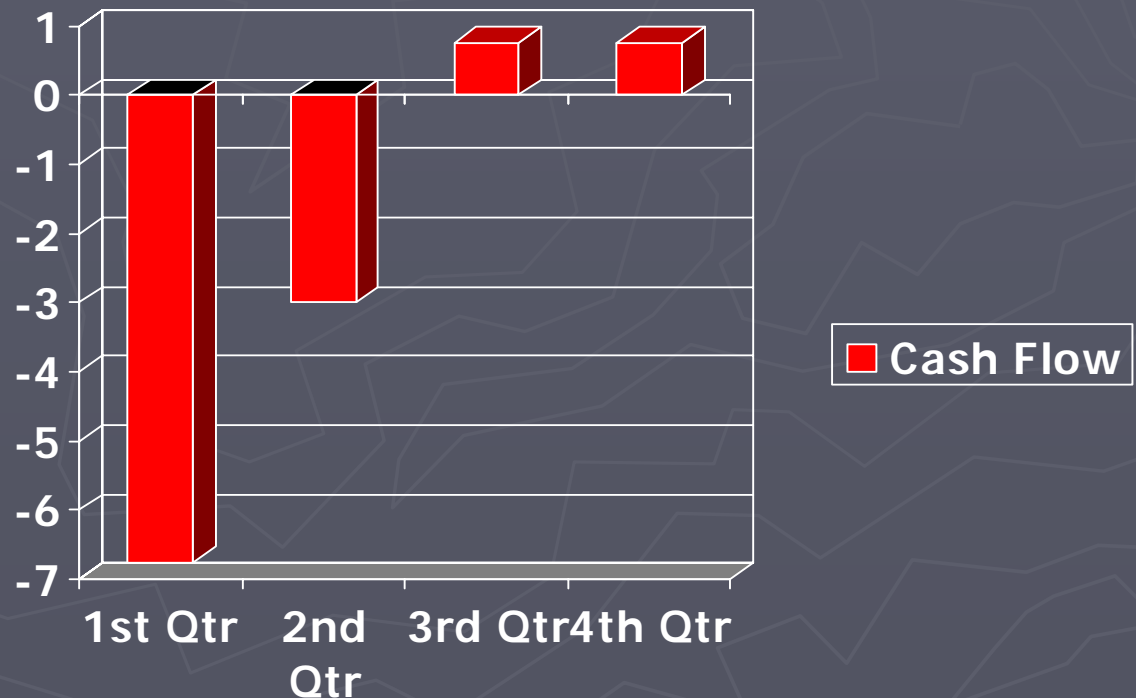
- ▶ Revenue: For each sales rep assume:
 - Quota
 - Apply the company's gross margin
 - Start up productivity ramp (by quarter)
 - Attrition
- ▶ Expense: For staffing and logistics determine
 - On-Target-Earnings (OTE) per sales rep
 - Number of sales reps per manager and cost per manager
 - Number of system engineers per Field Sales Exec (FSE) and cost per system engineer
 - Number of inside sales reps per FSE and cost per rep
 - Number and build-out of field locations

NOCASH: Revenue Planning -- The Capacity Model

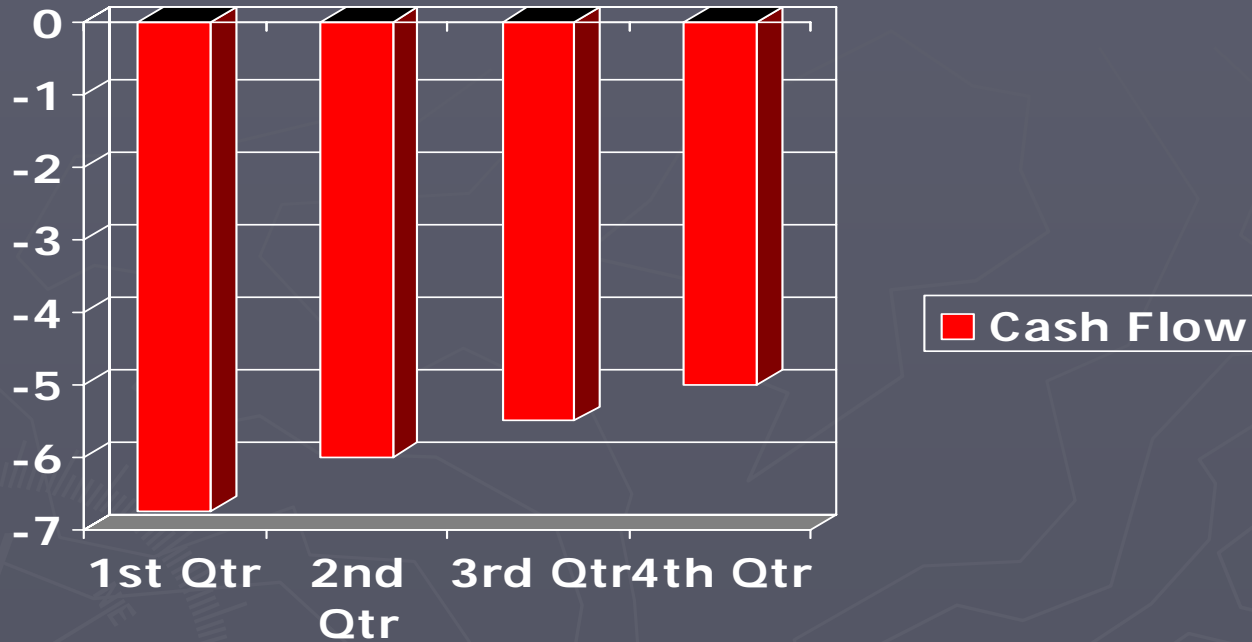
- ▶ Revenue: For each sales rep assume:
 - Quota -- \$1.5 M
 - Gross Margin – 90%
 - Start up productivity ramp (by quarter) – 0, 1/2, 1
 - Attrition – (25%)
 - ~ \$ 1,000 K / FSE per year net (after 6 months startup)
- ▶ Expense: For staffing and logistics determine
 - Number of sales reps per manager
 - Number of system engineers per Field Sales Exec (FSE)
 - Number of inside sales reps per FSE
 - Salary and commission levels
 - Number and build-out of field locations
 - > \$500K / person / year
- ▶ Marginal contribution per FSE \leq \$500K / Yr

NOCASH: The Hope

- ▶ Based on a \$1.0 M / mo burn rate starting point
- ▶ Hire 30 sales reps, get to cash flow positive by end-of-year



NOCASH: The Reality



- ▶ Fire the VP sales and most of the sales force, do a big cutback
- ▶ Maybe fire the CEO...

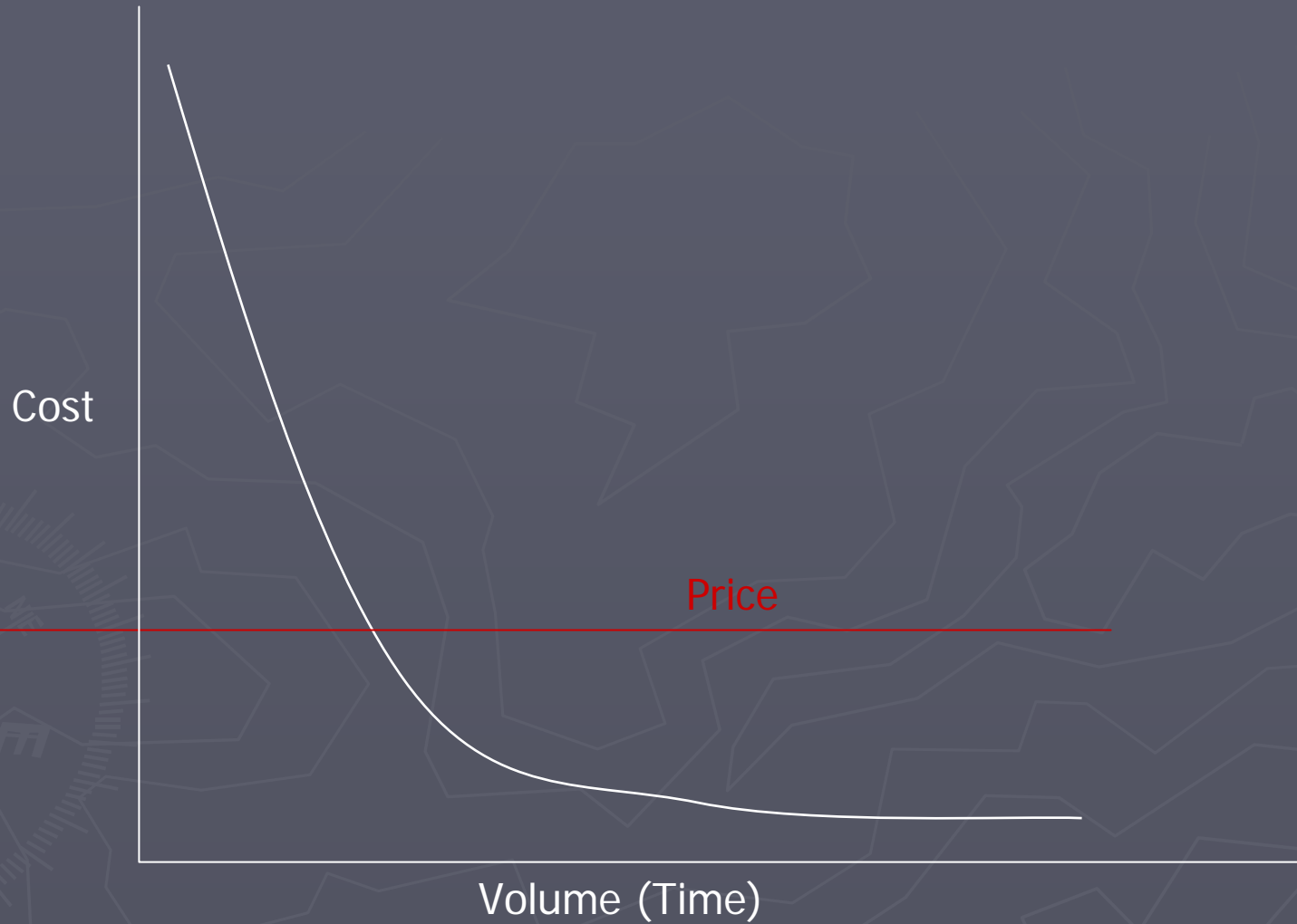
The Last Mover Advantage

*The last man standing
with cash...*

Manufacturing Learning Curve (MLC)

- ▶ Well known principle in business
- ▶ Cost decreases as volume increase
- ▶ Shape of curve differs in different industries
 - Semiconductor and Steel industry “price on the curve”
- ▶ Learning is non-predictive – everyone doing their job well
- ▶ MLC is visible to us based on available math
 - cost accounting gives us the points to plot

MLC based pricing



Sales Learning Curve (SLC)

- ▶ Analogous to MLC, but focused on sales interface rather than manufacturing
- ▶ Key variable to measure is the effect of learning on SALES YIELD
 - Equal to the average production per full time, fully trained sales rep per year
 - Not measured, not visible
 - Sales Yield is to SLC as Product Cost is to MLC
- ▶ Like MLC, learning takes place in many ways – “everyone just doing their job”
- ▶ SLC is an Enterprise effect – not just the sales department

The Product Centric Corporation



Production Line 1

Production Line 2

Production Line 3

Production Line 4

Production Facing
Departments/Employees

Customer Facing
Departments/Employees



Customer 1

Customer 2

Customer 3

Customer 4



Manufacturing Learning

Sales Learning

SLC Learning -- Product

▶ Completeness

- Features
- Installability

▶ Correctness

- Does it do what it is supposed to
- Does it do what the customers need

▶ Fit

- Does it work in the required environments

SLC Learning -- Market

- ▶ Positioning
 - Correct marketing messages
 - ROI proof
 - Market segmentation
 - Competitive Analysis
- ▶ Promotion
 - Customer success stories
 - Correct and sufficient collateral material
 - Correct and sufficient shows, PR, advertising
- ▶ Price
 - Across multiple channels
 - discounts
- ▶ Channels of distribution

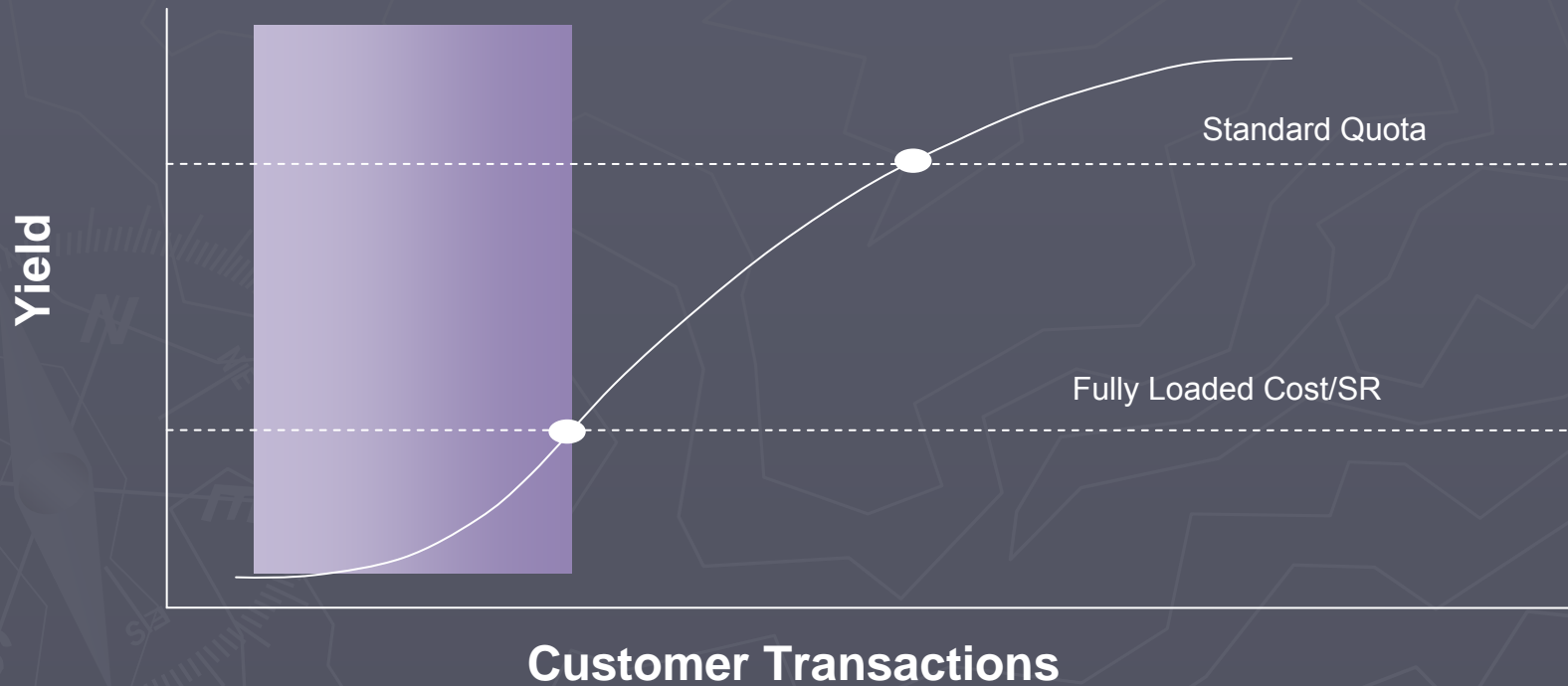
SLC Learning -- Sales

- ▶ Sales model
- ▶ Sales pitch
- ▶ Training and development
- ▶ Availability of executive selling
- ▶ Correct sales profile
 - Learning phase
 - Development phase
 - Expansion phase

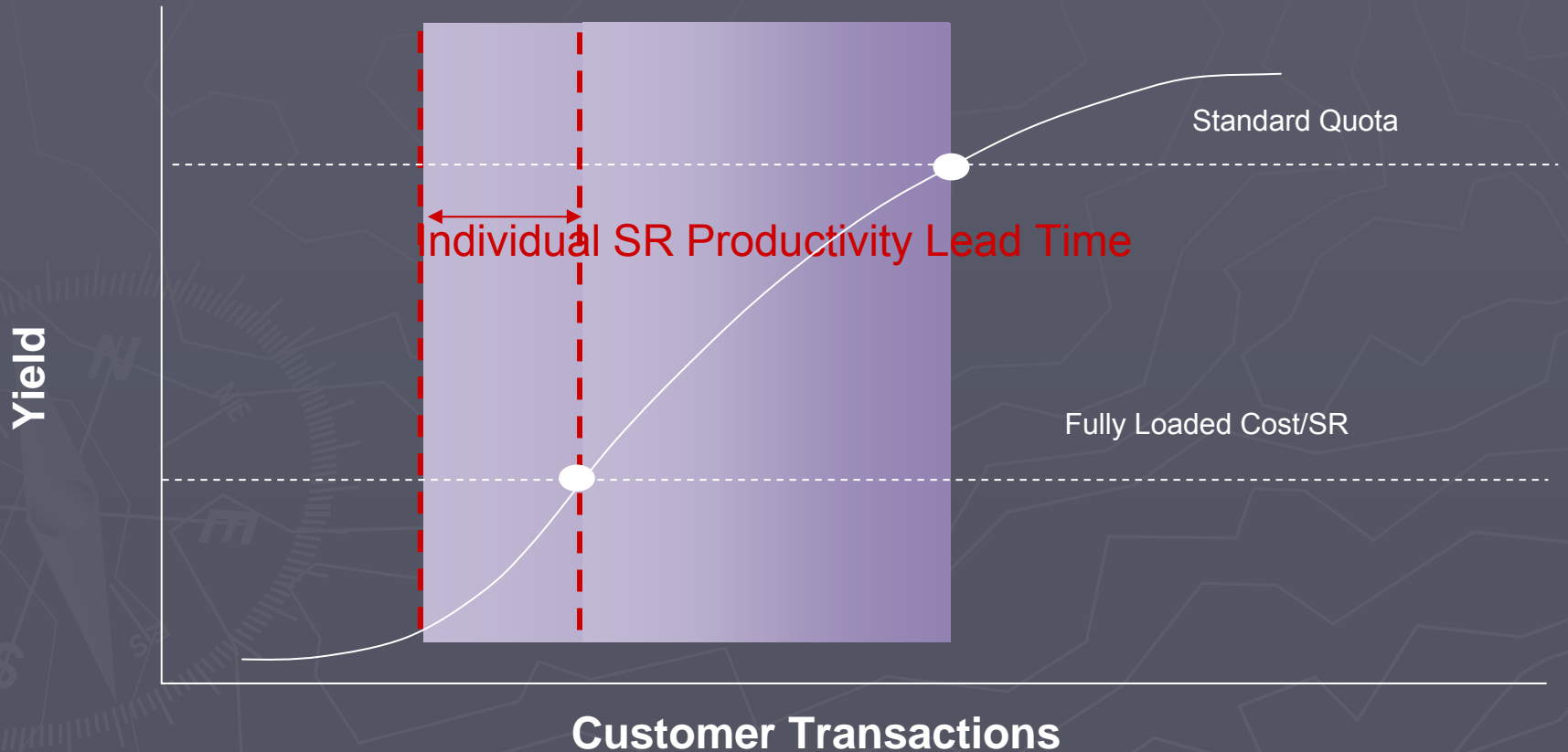
The Sales Learning Curve



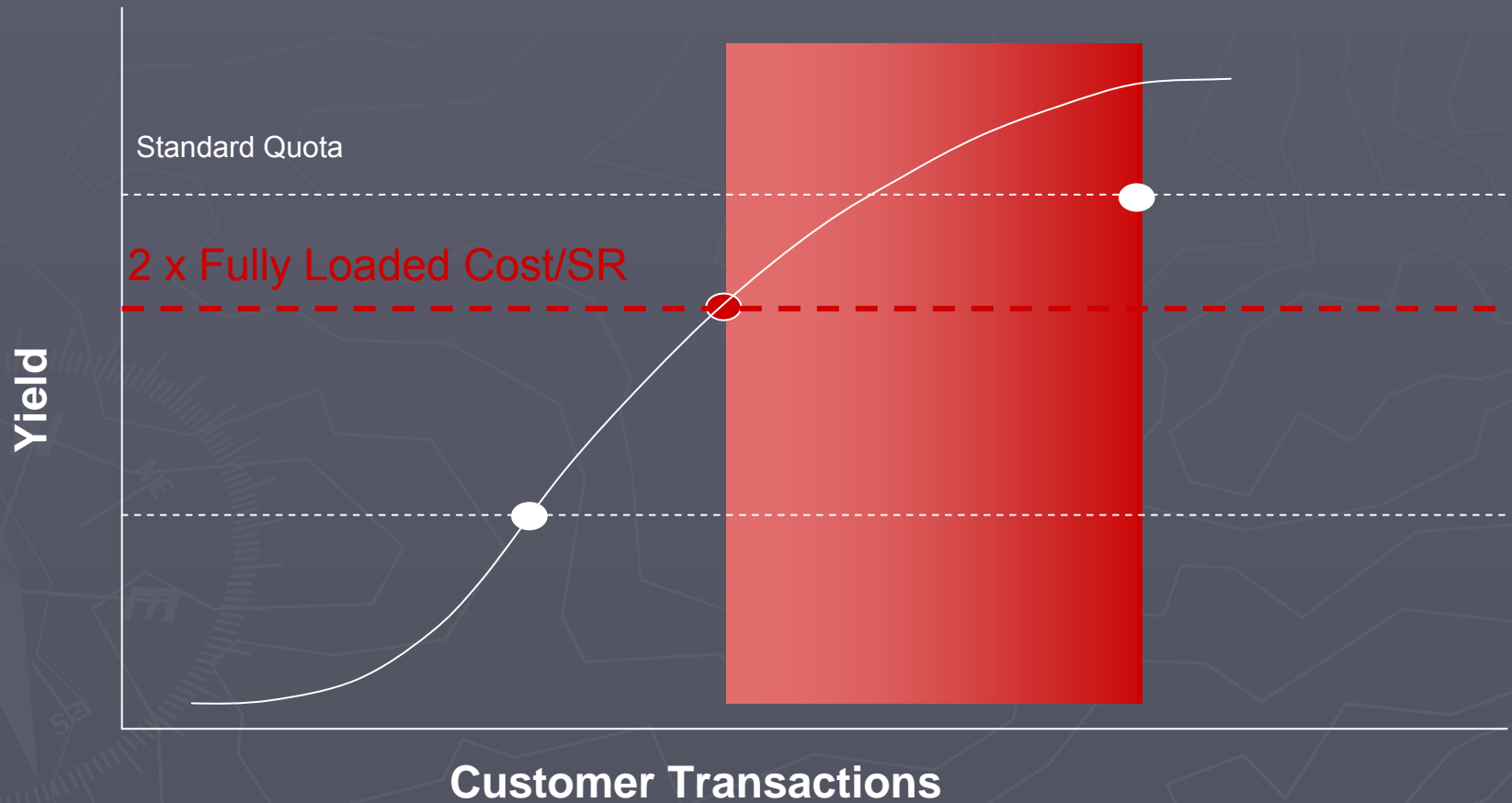
Staffing for Learning



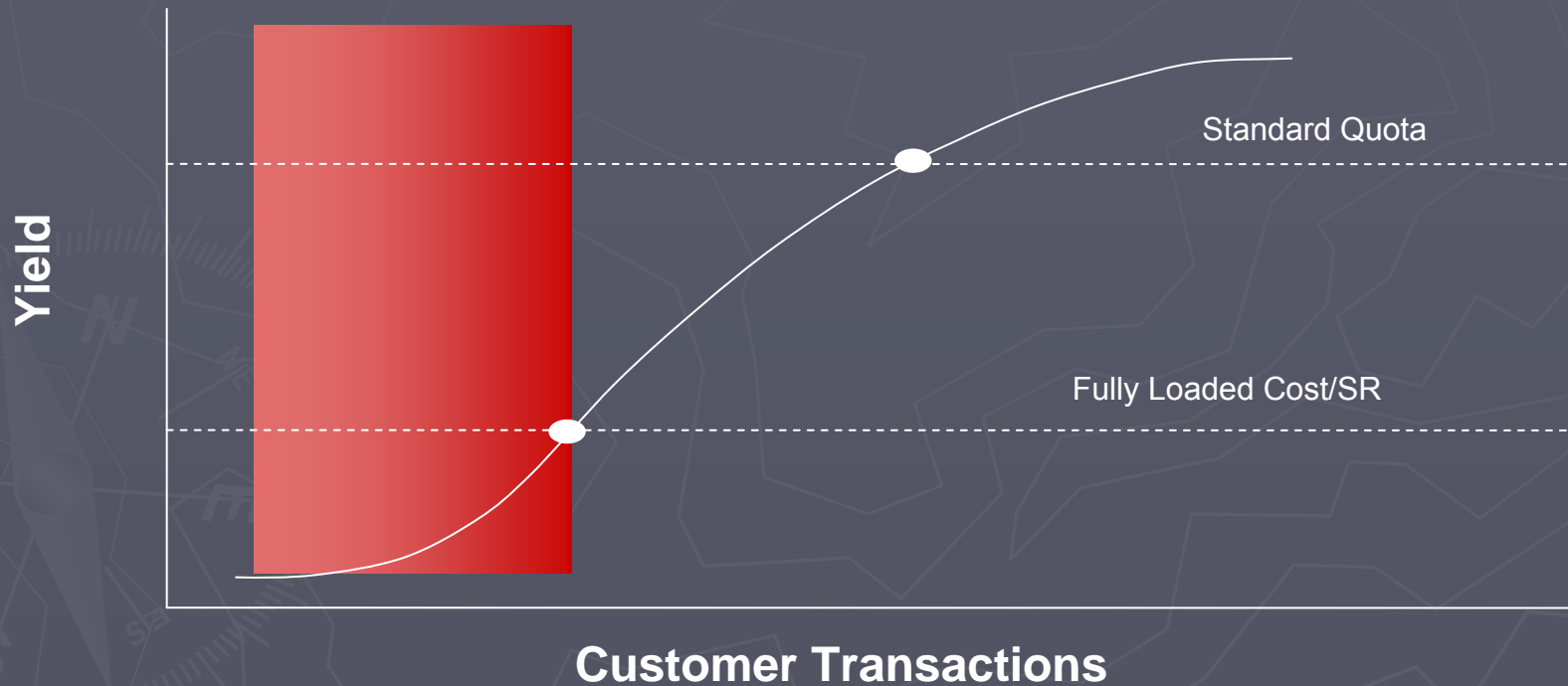
Staffing when Marginal Contribution is Visible



"Pedal-to-the-Metal" Staffing



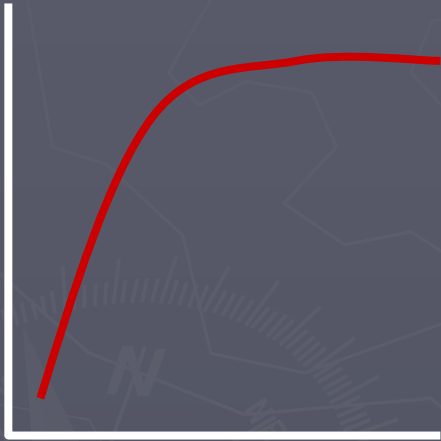
NOCASH Revisited – Pedal-to-the-Metal Staffing too Early



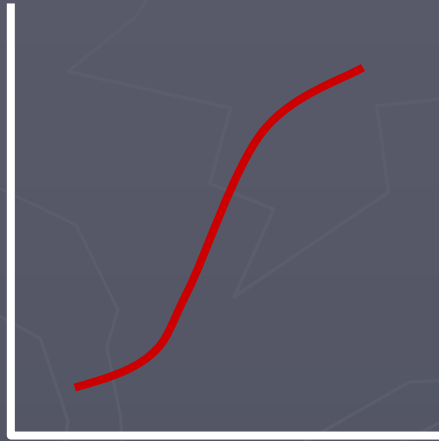
Tracking Sales Yield

- ▶ Often times very few data points
- ▶ Often time very random data points
- ▶ However, any data is better than no data
- ▶ An exercise in data smoothing
 - Six months trailing average
 - Curve fitting
- ▶ But, probably a lack of clarity
- ▶ However...
...you will probably know it when you see it

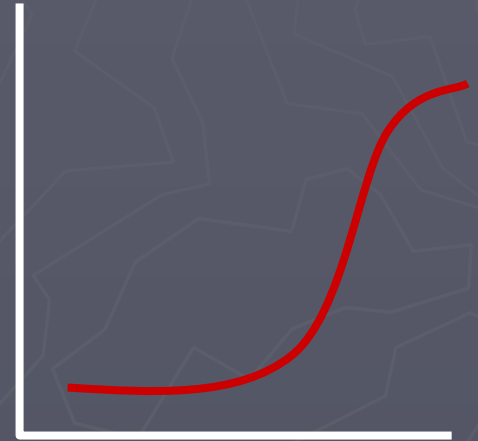
Different Types of Companies → Different Shaped Curve



"Faster, Better Cheaper"



"Innovator"

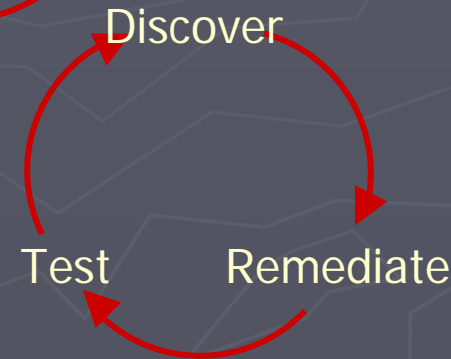
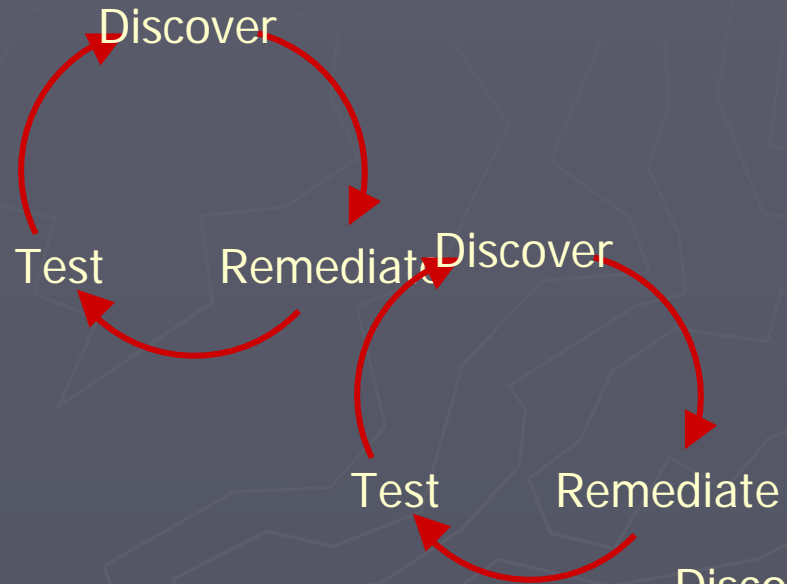


"Brave New World"

The Nature of Learning

- ▶ Sequential – Learning creates discovery
 - Learn “A”
 - Discover new Problem
 - Learn “B”
- ▶ Iterative – even after learning, need for “perfecting” – minor learning

The Nature of Learning



Planning for Learning

- ▶ Identify the specific characteristics of your company, product and market
 - Develop SLC expected model
 - Identify, track and report on the learning opportunities
 - Identify, track and report on sales yield
- ▶ Select initial sales personnel to enhance corporate learning
 - A different kind of rep
- ▶ Mobilize the company for learning
- ▶ Do not ramp up expenses
 - Perhaps reduce R&D expenses at this time
- ▶ Set investor and employee expectations to account for uncertainty and learning

Quantitative Methods

- ▶ Marginal Contribution analysis
 - Expected Gross Margin of FESR at Quota
 - **Minus** - Cost / year of a fully loaded FESR
 - **Equal** - Marginal Contribution
- ▶ Breakeven Analysis
 - Number of required FESRs at Marginal Contribution to offset fixed costs
 - **Less** effect of SLC (reduces marginal contribution)
 - Factor in organizational build-out time – NOCASH example
 - ▶ Needed 30 FESRs – example showed batch hiring of all of them
 - ▶ Would need to hire Sales VP, 4 – 5 RMs, and 20 SEs, find offices, develop training, etc.
- ▶ Sparse Data
 - Curve Fitting
 - Six months moving averages
- ▶ Sales Yield Accounting – the sales version of Cost Accounting

Channels of Distribution

- ▶ SLC principles are broadly applicable to channel selling
- ▶ All of the same issues relative to “merchantability” of the product by the company
 - Company has to make the first sales by the channel
 - And the communication with the end customer is more distant
- ▶ In addition to all other learning, need to do the learning relative to channel acceptance as well

Time to Cash Flow Breakeven

- ▶ Cash flow breakeven is achieved when requisite number of FESRs, make sufficient marginal contribution

$$(\#FESR \times MC/FESR - \text{Fixed Cost} > 0)$$

- ▶ On SLC, yield starts at zero and marginal contribution starts negative, goes positive only as company "learns"
- ▶ But, learning is **sequential** and **iterative**

Time to Cash Flow Breakeven

- ▶ Based on numerical modeling
 - Time to breakeven correlates directly to the learning curve
 - Learning → Positive Marginal Contribution → Cash Flow Breakeven
- ▶ Time to cash flow breakeven reasonably independent of sales staffing
 - More staffing may increase rate of initial discovery, but cannot make it less sequential
- ▶ **MORE STAFF DOES NOT SPEED UP LEARNING – JUST CONSUMES MORE CASH!**
- ▶ Basically, it is not ready until it is ready

A corollary: SLC impact in the Mature Company

- ▶ As companies mature they develop and release new products
 - As differentiated from new versions of old products
 - For example, in the software business, there are no “one-product” companies with revenue > \$1 Billion
- ▶ Often times new products given to existing sales force
 - Doesn't quite work right
 - Hard to sell and install
 - Sales reps need to make quota and “move on”
 - The new product is...
 - ▶ **“Radioactive”**
- ▶ Result:
 - New product fails to meet plan by a wide margin
 - New product is killed

A corollary: SLC impact in the Mature Company

- ▶ Companies forget the learning curve they experienced in their initial go-to-market
- ▶ Critical to replicate that product / market learning process
 - Segregated sales force
 - Low productivity expectations
 - Focus on organizational learning
- ▶ Only deliver to larger sales force when learning is complete and sales yield by product is competitive

“It always takes longer and cost more...” – **MAYBE NOT**

- ▶ Plan the development of companies to include sales learning
 - Plan for low initial sales productivity and focused cost management
 - Focus the company on managing and reporting on the requisite learning
- ▶ Eliminate the wishful thinking about getting to cash flow positive
 - Do it for less overall cash
- ▶ Do it with less trauma to the organization

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