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LEAN SALES & MARKETING

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Lean Sales and Marketing

While Sales and Marketing are often considered a separate topic, it's a mistake to think of these vital functions as of outside *Lean Thinking.* Lean organizations focus on the first principle of lean, namely *Customer Value.* The starting point of all lean thinking is a clear and profound understanding of how we create value for the customers through our products and services. The sales and marketing personnel are in the vanguard of this vital aspect of lean. Lean Accounting has a great deal of bearing on how effective these important aspects of the lean organization are. Figure 1 (below) lays out the concepts associated with Lean Sales and Marketing, which we will be covering in this article.

Value-Based Sales and Marketing Concepts

Many of the characteristics of a lean approach to selling and marketing products and services are impacted by the value-based approach. If we recognize that a correct assessment and outworking of customer value is an important – perhaps the most

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important – aspect of lean thinking, then our approach to the customer will radically change. In reality, most companies have sales people who take a value-based approach intuitively. They recognize that to win new business and grow the company, it is vital to understand what creates value for our customers and to use this knowledge to develop appropriate products and services that maximize customer value.

They also recognize that prices must be based on the value created for the customer. While many companies continue to pursue the age-old fallacy of cost-plus pricing, savvy sales people recognize that the customer will only pay a price that matches the value the customer places on the products and services provided. Further, they know the customer does not care about what it costs us to make the product or provide the service. The only major exception to this rule is government contracting. Government contracts are sometimes priced as a percentage uplift from the supplier's product costs; but even the government is moving away from this approach in recent years.

While many sales and marketing people intuitively address the customers and markets from a value viewpoint, lean organizations have standard and systematic methods of focusing on customer value throughout the entire organization and have methods to calculate the value created for the customer by the company's products and services. Customer value is widely understood throughout every aspect of the company's business is and is the primary driver of decisions and of lean improvement.

But, there are cases when the customer value focus is lost. In a recent article in *The Wall Street Journal*, a large well-known hospital system was bemoaning the fact that many of their patients[1] come to the Emergency Room for treatment on weekends. The hospital administrator stated that the Emergency Room treatment is much more expensive than a regular visit to the primary care clinic, and that these behaviors are

[1].Is it too simplistic to observe that industries with a record of very poor service to their customers often do not call a customer a "customer?" They use euphemisms like *patient* or *passenger* or *tax-payer* or (in the case of software) *users* or even *seats*.

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undermining the hospital's ability to be financially viable. The administrator did not ask why the customers are coming at the weekend. It does not take a lean sensei to ask the question; "When is the most convenient time for a person working a regular job to visit the doctor?" This hospital works on a primary care schedule from 8:00am to 5:00pm Monday through Friday. Obviously, the hospital's processes are set up for the convenience of the doctors and the administrators, not for value to the customer.

This same hospital system has value stream maps carefully drawn and elegantly presented using complicated graphics software. Their value stream maps have detailed timings of how long it takes for each of the tasks required within the value stream. But there are no timings for the customers' experience. The hospital runs kaizen events to improve their processes and improvement is made, money is saved, and waste is eliminated. But is the customers' life improved? With regard to the customer's time – no one knows because they do not take this into account when making improvements. They do not even measure customer wait times or how long the customer has to sit in the doctor's office wearing an embarrassingly scanty gown while the physician attends to other "urgent issues."

This organization will not be successful with lean transformation if these attitudes persist. They are systemically violating the first principle of lean; value to the customer. Lean thinking and improvement must be driven by a profound understanding of customer value; and – in most cases – this starts with the sales people and runs through to every process.

Understanding How We Create Value for the Customer

Understanding the value created for the customer is the starting point of lean thinking; it is the first principle of lean[2]. The starting point for understanding customer value is the customers themselves. Lean organizations and lean sales professionals

[2]. See *Lean Thinking* by James Womack and Daniel Jones, Free Press, 2nd Ed. June 2003

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spend a great deal of time with their customers in order to understand their needs and how these needs can be translated into products and services.

There are many ways that value is created for a customer. Here are a few examples:

- A superior product
- A unique product
- Converting commodity products into unique products through customization, innovation, or additional unique services
- A product that reduces the customer's costs or increases the customer's revenue
- A product that reduces cost or increases value for the customer's customer
- Providing a more complete solution to the customer's problem or need
- Lowering the life-cycle cost of ownership or use of the product
- Offering services only lean companies can provide; short lead time, reliability, perfect quality, flexibility, lower inventories, improved cash flow, cooperative relationships, etc.
- Creating esteem or prestige for your customer by being associated with your products and services
- Providing very much superior services to the customer. "Give me exactly what I want, when I want it, how I want it, and where I want it. Solve my problem completely, treat me with respect, and charge me a fair price."[3]

Once we understand how we create value for our customers then we can begin to quantify that value. These "*value propositions*" may well be different for different market segments and even for different customers. In most cases the starting point for the calculation of value to the customer is to know the baseline price – i.e. the amount the customer is paying for the product or service your products and service replace or encompass. For example, if you are providing a better valve, then the starting point for value calculation is the cost of the values your customers currently uses.

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When we know the baseline, then we can calculate the amount of savings or increased revenue created when the customer uses our products and services. Very often there are clear and "hard" financial benefits can be calculated. There may also be so-called "soft" benefits. These may involve relatively insignificant issues like convenience; or they may be important risk-reducing benefits like warranties or short lead times or exclusivity agreements. Others may involve the very substantial "soft" benefits that come from creating esteem for the customer by the use of your products. These issues are more difficult to quantify and there is usually a need to work closely with the customers (and their customers) to understand the value created by these kinds of benefits. The starkest example of this is when your products create value by being fashionable. These benefits are quantified by obtaining information from the customer through surveys, market research, and by conducting pricing experiments.

Calculating a Value-Based Price

Once we have established the value created for the customers by our products and services, we can them move to calculating the price for the product. Here's an example. If the product creates $100 more value than the previous product that was priced at $200, then the question is: how much of the additional $100 will we keep and how much will we pass onto the customer? This a pricing policy issue. We may decide to set a high price – say $275 – and recognize that at this price we may sell relatively fewer products but at the higher price. Alternatively we may price the product lower – say $225 – and hope to make less money on each individual product but make up for this by selling a much higher quantity. This is where a sound understanding of the price elasticity of demand is valuable.

Companies that have been using a more-or-less cost-plus approach to pricing often find it difficult to transfer their thinking towards a value-based approach. It takes some time before they are able to make these adjustments for their existing products,

[3] See *Lean Solutions* by James Womack & Daniel Jones, Free Press, October 2005

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but as new products are introduced into their market places these can be priced based upon value. Gradually, pricing based on customer value will grow.

Advantages of Value-Based Pricing

The primary advantage of value-based pricing, as opposed to cost-plus pricing, is that your company will sell more products and usually at higher prices. In simple terms, there are two issues arising out of cost-plus pricing; either the sales people recognize that the price is too high and they do not win the business without considerable negotiation. Or the price asked for is lower than the sales people thought and they go for an easy sale. Either way; the company loses. The company sells a great number of the products that are under-priced and very few of the products that are over-priced.

On the other hand, companies using value-based pricing will set their prices based upon the true value to the customer and the company's pricing policy. The sales people are able to give their potential customers a logical rationale for the prices based upon the benefit the customer gains from using the product. This leads to higher revenues, higher profitability, a better informed and empowered sales force, and more harmonious customer relationships.

Customer Partnerships

Lean organizations are not looking for one-time sales; they aim to create partnership relationships with their customers that build up and sustain over years. The issues we have just discussed on value-based sales and marketing are very important to customer partnerships because partnership relies on mutual respect and shared benefit.

Rather than the debilitating power struggles between customer and supplier that is so common in Western industry, lean organizations seek to work cooperatively for mutual advantage. Here's an example: an automotive component supplier understands that their customer needs to reduce the overall cost of the supply chain by 7% this year.

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The customer and supplier will then work together and use kaizen (continuous improvement) to eliminate waste and improve the processes across both of their organizations. The resulting cost reduction from making these improvements are then shared between the two organizations. There may or may not be any price reduction as such; it depends where the other savings occur. If they occur within the supplier then the financial benefit will be passed on into customer by price reductions. If the bulk of the cost savings occur within the customer, then the customer has achieved their cost reduction without the need for the supplier to reduce prices. Either way, there is mutual benefit for both supplier and customer.

It is evident that a company wishing to take this lean approach to customer relationships, cost saving, and pricing has to change the performance measurements on the purchasing processes. Traditional companies focus strongly on standard costs and purchase price variance (PPV). This supports and motivates the toxic behaviors of many Western companies. Lean companies must eliminate these measurements and replace them with measurements that motivate cooperative relationships and lowest overall cost through process improvement and waste elimination.

It takes a long time to develop these kinds of cooperative relationships because they must be built on trust and respect. In much of Western industry there is a tradition of powerful customers coercing their suppliers for price reductions. This behavior leads to the customer changing from one supplier to another to get a few pennies off the price. It leads to suppliers being forced to move production overseas to so-called “low cost” countries, and has lead to many suppliers being squeezed so hard that they fail and go into bankruptcy.

Think about behaviors of US car manufacturers in the 1990's and the 2000's. In response to increasing competition from companies like Toyota, Honda, Hyundai and others, they savagely squeezed their suppliers with the result mentioned above. The truly lean car manufacturers did the opposite. They allowed the suppliers to develop cooperative relationships and – perhaps slowly but surely – worked with them to

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eliminate waste and reduce the overall costs of their raw materials, components, and services. This has led to the curious paradox. If you are a patriotic American and wish to drive an all-American car, you must choose a Toyota or a Honda. Toyota and Honda cars that are assembled in America have the raw materials and components largely sourced within North American. The US car companies source the majority of their materials and components overseas rendering their automobiles to be largely foreign-made.

Why do Honda and Toyota take this partnership approach with their suppliers? Because this is the low cost method. Buy locally and create long-term relationships. This is the lean way, and sales and marketing people within lean organizations must learn to give up the quick sale and work to create these long term relationships.

Integrating Sales into the Value Stream Organization

The sales process is the starting point for an *order fulfillment value stream*. Sales does not stand alone. Organizationally lean companies create value stream teams consisting of all the people, processes, and skills required to fulfill the customer needs and meet their demand. Whenever possible the sales people should be within these value stream teams, in the same way as production people, purchasing people, quality, materials handling, and so forth.

In many companies this approach is not practical. Often the sales teams need to be organized by markets, geography, or other pragmatic approaches. It usually makes no sense for a customer to have to deal with more than one sales person or sales team when they buy different kinds of products from the supplier. So the sales people are often organized differently from the order fulfillment value streams of which they are a part.

The ideal is for the sales people to be tightly integrated into the value stream team, but when this cannot be done directly, there must be methods for bringing the

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sales people and the order fulfillment value stream team into cooperative relationships. Here are some of the methods employed:

- *Cooperative opportunity assessment*. When new, significant sales opportunities are apparent it is important for the decisions related to these opportunities are done cross-functionally. Some companies develop opportunity assessment methods where the in-coming requests-for-quotes are filtered to identify significant opportunities. These opportunities are posted onto a visual board together with the relevant data. Over a period of a few days – using daily short stand-up style meetings – the sales people, purchasing, production, design, and other key people work cooperatively to address the opportunity and make decisions. These approaches have proven to lead to more sales, better pricing, faster response to the customer, and better strategic decisions.
- *Sales, Operations, and Financial Planning (SOFP) process*. Lean organizations are very well planned companies. They have rigorous and formal (usually monthly) planning processes that are completed cross-functionally. The cross-functional teams include the sales people who provide sales forecasts for the future 12-18 months. The production people who provide capacity forecasts for the next 12-18 months, the new product development people providing information about when and how the new products will be introduced. And the financial people who provide financial information and create the financial forecasts that are an outcome of the planning of process. These groups work cooperatively together to create the plan and then, after the planning process is complete, to fulfill the plan on their daily work.
- *Assign sales people to specific value streams* even though they are not organizationally within the value stream team. The sales people work closely with the value stream teams to create cooperation with the sales organization, and to assist the value stream to make improvement, and solve problems.

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Team Selling

Many companies control their sales force – both internal sales people and external "reps" – by individual compensation and commissions. This method of compensation motivates the sales people to work independently to achieve the highest level of commissions. On the other hand, lean organizations are always looking to promote team-work. Team-work within the sales and marketing processes leads to sales teams that work together to address a market, geographical region, and/or product family.

These companies may continue to remunerate their sales people based upon the sales they make, but these commissions are not paid based on individual contribution but *team contribution*. These changes lead immediately to the sales people working together as a team to serve the customers and meet the company's sales needs. Cooperative selling is – in most organizations – far more successful than individual selling in fulfilling the principles of lean thinking; filling customer needs for value, working in value streams, promoting flow at the pull of the customer, empowering the people, and pursuing perfection.

Consistent Sales Processes

Lean sales organizations work hard to develop standardized work within their teams. This leads to a consistent sales process that addresses their customers' value while increasing the company's revenues and profitability. Having consistent sales processes also leads to consistent performance from the customer's viewpoint, and enables the development of long-term customer relationships.

Performance Measurements that Drive Lean Behaviors

As with most lean changes, it is necessary to change the performance measurements used to control and improve the sales processes. In traditional companies the sales performance measurements are very much based around judging the individual sales person. Lean performance measurements will focus on the processes that create excellent sale results. These measurement changes - together with a value-based approach - lead to radical changes to the way sales and marketing happen in lean companies.

Demand Management

As discussed previously, the sales and marketing teams in lean organizations are very closely involved in the planning process, SOFP. This means the sales and marketing teams are not merely providing forecast information but are an important part of the cross-functional teams that make the short-term and long-term planning decisions.

One important outcome of the SOFP process is a level schedule of production, service provision, product development processes, and demand on suppliers. The ability to create a predictable and orderly working environment is critical to creating highly productive value stream processes. In many companies there are sales policies that militate against a level schedule. These include providing customers with discounted prices for large orders; leading to spikes of demand that do not fit well into lean production.

Similarly, companies that press heavily on their people to achieve the budgeted month-end and quarter-end results usually manage to undermine their lean transformation. If a sales person or team is motivated strongly to achieve month-end or quarter-end sales revenues based upon a budgeted goal, then the sales team will work hard to achieve it. But this will often be achieved by bringing in sales that are not linear. One company we work with stated that they are a lean company for 3 weeks of the month. When the 4th week comes around they are forced to revert to the traditional

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month-end tricks to meet the budgeted goals. Lean companies use methods that are the opposite of these because they want to promote lean flow and stable production[4].

Instead if rewarding customers that place large batch orders, lean organizations apply discounts to motivate many smaller orders. It is better for a lean company to receive small orders daily than to get a large monthly order. The company's sales and promotional methods change to motivate small, frequent orders. Similarly, some companies provide discounts to the customers that place orders linearly over the year or quarter. Other companies provide bonuses to sales teams that bring in linear orders from their customers.

Target Costing

The purpose of target costing is to drive the company's lean change and improvement directly from customer value. This requires a deep understanding within the value stream of the value created for the customer by the value stream products and processes. From this we can move to calculating the price of the product and the *target cost* required to meet the customers' needs for value while satisfying our own needs for profitability and cash-flow and fulfill the company's short and long-term goals. We then split the target cost into sections according to the materials costs and the various major sub-assemblies manufactured during the value streams process. This leads to a process that is fundamentally lean; continuous improvement within the value stream is directly driven from customer value.

There are four major steps in the Target Costing process:

- Understanding customer needs.
- Quantifying customer needs

[4] Everyone working in manufacturing these days knows the Japanese word *muda* – meaning waste. Fewer people know the other two important words, *mura* and *muri*. Mura means instability or fluctuation, and Muri means over-burdening people or equipment. Mura and Muri are more important than muda because they are primary causes of muda. These kinds of sales policies lead to increased mura and muri.

- Calculating target costs
- Attaining target costs through continuous improvement

The first two steps are similar to the process for calculating customer value, described previously. Once we know the value we can assess the price of the product in our various markets. The product target cost is then calculated by subtracting the required profitability from the price. The fourth step is to systematically and relentlessly use this information to drive continuous improvement throughout our processes to bring the costs into line with the target costs and to create superior value for the customers[5].

Kaizen - Continuous Improvement

Everyone in a lean organization is required to make operational improvement to their processes using a series of lean improvement and problem solving methods. Sales and marketing is not an exception. The sales and marketing people are required to achieve 5S, and to do kaizen events to improvement their own processes.

Once the local improvements have been achieved, then sales and marketing people will work with the value stream teams to improve the order fulfillment process and integrate the sales activities more closely.

Sales and marketing people also participate in kaizen improvement efforts throughout the organization. Very often they take the role of “fresh eyes”; the people in the value stream team with no direct knowledge of the process being improved but who can ask the direct questions and provide a broader business view. They also enable the teams to be more focused on customer value.

[5]. Further information on Target Costing can be found in *Practical Lean Accounting* by Brian Maskell & Bruce Baggaley, Productivity Press, 2004 or *Target Costing and Value Engineering (Strategies in Confrontational Cost Management Series)* by Robin Cooper & Regine Slagmulder, Productivity Press 1997

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Summary

Many companies make serious mistakes when they approach the transformation to a lean organization. One of these mistakes is to think of lean as a manufacturing issue. Lean manufacturing cannot succeed unless all other aspects of the business are similarly transformed by lean thinking. In our experience sales and marketing are the most neglected parts of the business by companies claiming to be “going lean.”

As with other business processes, sales and marketing in most companies needs to be radically changed for lean to be successful. The focus must move to customer value, the sales people must work in teams, create customer partnerships, create even flow of demand, use standardized work, and apply continuous improvement to every aspect of their work.

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