White Paper on Pipeline Management Principles

Prepared by

Strategic Partners, Inc.
60 State St.   Suite 700
Boston, MA 02109
(617) 988-2830
www.stpartners.com

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Overview

One of the most important keys to success in companies with complex sales processes is to be able to accurately forecast revenues. Revenue resides at the top line of the income statement and is the single most sensitive variable in determining profitability. A 10% miss in a revenue forecast can translate to a 50% miss in corporate profitability.

In addition, revenue forecasts have more to do with establishing credibility with outside investors than perhaps any other variable. In a public company, meeting earnings per share estimates are a direct reflection of accurate forecasts. In a private company, the CEO ultimately establishes credibility with the board of directors through consistent revenue performance relative to plan.

At the heart of achieving more accurate forecasts in companies with complex, multi-step sales cycles is the direct correlation with better Pipeline Management and a consistent, “Repeatable Sales Model”. An adequate pipeline of accounts, both in dollars and in mix, is absolutely essential to achieving accurate forecasts, and the management of that pipeline is, to a great extent, is a science. This paper discusses the importance of Pipeline Management, the keys to successful management of the pipeline, and how it can help define that elusive repeatable sales model.

Pipeline Management

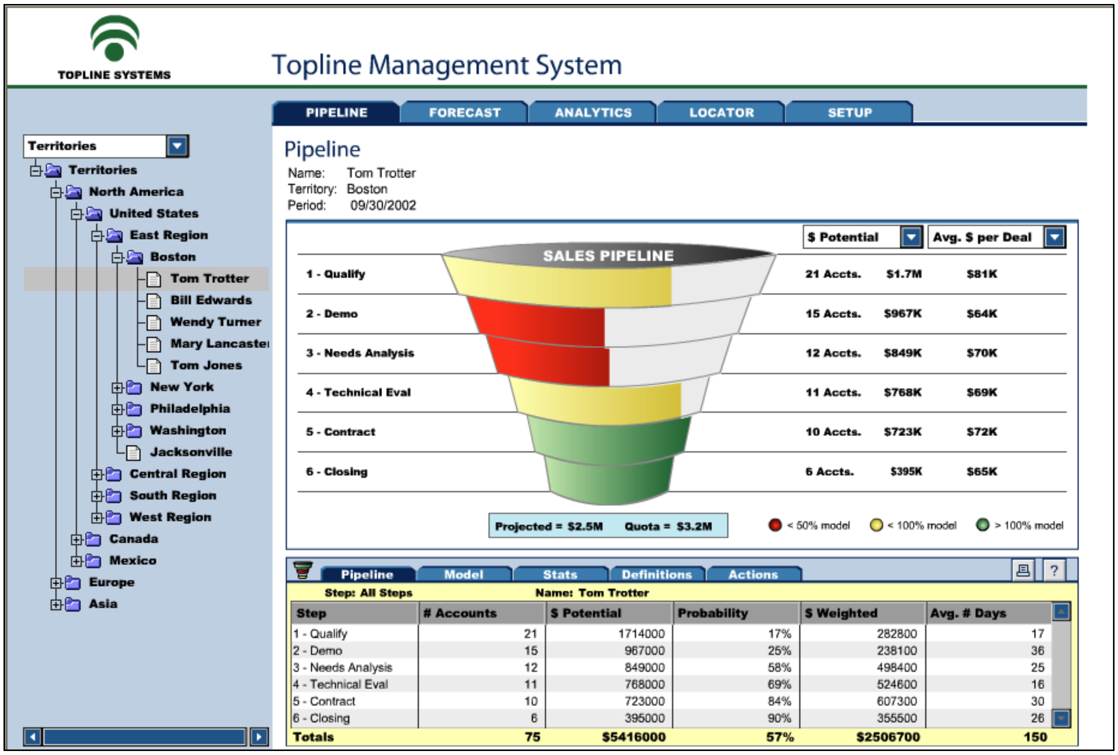
A good definition of Pipeline Management is:

> ***“The management and assessment of all sales opportunities as they progress through a multi-step sales cycle to a successful close.”***

- A *pipeline* (or sales funnel) consists of multiple action steps that lead to the successful closing of revenue producing contracts.
- A *pipeline* consists of accounts within each step of the sales cycle that need to be managed and assessed on a consistent basis.
- A *pipeline* consists of forecasts for each account with expected close dates and probabilities of closing.
- A *pipeline* is a management tool to review accounts with sales reps and sales managers, and to provide pipeline visibility for all other departments of the company.

Pipeline Management includes the visibility and analysis of the opportunity pipeline for every sales manager and every sales representative. By adhering to a disciplined process of Pipeline Management, the likelihood of meeting quota goes up dramatically. To this day, there are very few value propositions in business processes that have a greater impact than the revenue-producing impact of better pipeline management.

The following is a picture of a typical pipeline for a high technology company sales rep. There are steps, accounts within steps, conversion ratios from step to step, timing for each step, and a forecast based on which accounts are expected to close by which dates.



From this diagram it can be seen that this rep, Tom Trotter, has a "bottom loaded funnel". In other words, he is is good shape to meet forecast for the next quarter, but he is in trouble for subsequent quarters. He simply does not have enough accounts in Step 1-3 to meet quota in the later months. For example, this sales rep has only 21 qualified accounts in Step 1 and 15 accounts in the Demo phase. These represent only 50-70% of the required, or model, number of accounts needed to meet quota. He is severely "underpiped". Unless he has extraordinary conversion ratios, he will fall far short of quota. It becomes very clear that a sales organization needs a pipeline equal to multiples of the forecast to consistently meet sales quotas.

Everyone has a pipeline...... Every sales rep, every sales manager, every sales executive, every CEO has their own pipeline. People in everyday life work off pipelines all the time. A high school senior applying to college applies to several colleges, submits applications, visits the campuses, and eventually attends one of the schools. Whether he knows it or not, he went through a mini-pipeline process to reach his goal.

When is it appropriate to use pipeline management principles? Pipeline management is particularly useful in the following types of businesses:

- Multiple-step, complex sales processes using direct sales reps
- High ticket selling prices where decisions are based on value proposition
- Longer sales cycles where it takes several points of contact to close a sale.
- Competitive selling environments where there are probabilities of closing

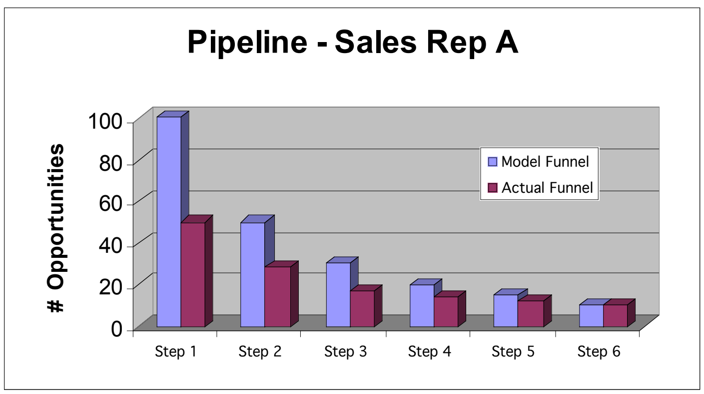
Model Funnels

It is common in financial analysis to measure actual vs. budget on a monthly basis. The same fundamental comparison should be made with pipelines. The Model Funnel for sales reps is the required pipeline necessary to meet quota performance. It consists of the required number of accounts and dollars at each step, and the required conversion ratios at each step, that will result in that rep meeting his quota. A branch or regional manager would have a Model Funnel that is the composite of all of the sales reps in his territory.

The pipeline shown on page 4 shows red, yellow and green bars at various steps of the sales cycle indicating actual vs. model performance. A red bar occurs when the actual pipeline < 50% of the model pipeline for the same step of the sales cycle. A yellow bar occurs when the actual = 50-100% of model, and a green bar occurs when actual > 100% of model.

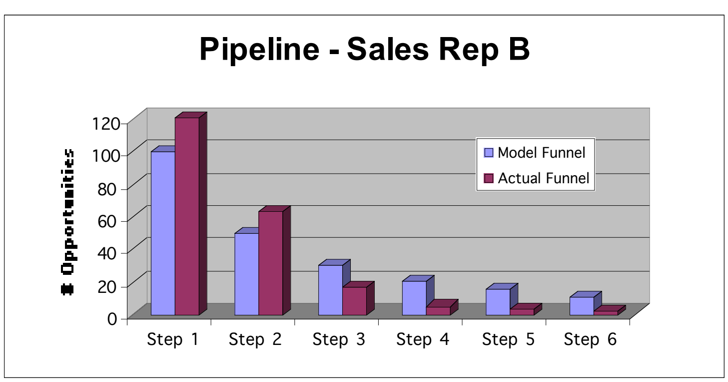
What can you tell from the look of a pipeline? The beauty of the graphics on page 4 and the bar charts below is that one can quickly see where the problem areas and shortfalls exist in the pipeline. Several types of typical funnel representations may result:

a. ***Bottom-loaded Funnel:***



This is a common situation where reps have an adequate number of accounts at the bottom of their funnel, but are inadequately prepared at the top of the funnel. Sales Rep A above may meet quota for the next quarter, but is in serious trouble for 90-180 days out. This type of funnel is an “under-piped” situation where there is an immediate need for more qualified leads at the top of the funnel. This may involve accelerated lead generation from Marketing, or additional cold calling and prospecting by the rep.

b. ***Top-loaded Funnel:***



This type of funnel is indicative of many reps where there is "congestion" at the top of the funnel. Sales Rep B needs to move existing leads and accounts at an accelerated pace down through the funnel into the later stages. His average number of days spent in each step is probably very high. Sales management plays an important role in this type of funnel by coaching the rep on which opportunities should be prioritized and what strategies to use.

Pipeline Metrics

We previously reviewed the importance of accurate forecasting and its direct correlation with sound pipeline management principles. Effective pipeline management requires a set of metrics just like any business unit. The following metrics are important to successful pipeline management:

- Conversion Ratios from step-to-step
- Overall funnel Conversion Rate
- # Days spent within each step
- Overall length of sales cycle (velocity through the funnel)
- Average deal size within each step
- $ Shortfall, and # accounts shortfall, within each step
- Required Pipeline to meet forecast
- Forecasting Accuracy by rep

By measuring these metrics on a consistent basis, the entire sales organization will be better prepared to meet forecasts on a more consistent basis.

Another important metric is Pipeline Trend. Managing a corporate pipeline is a dynamic science, not a static one. Once the Model Funnel is known for a given sales rep, the team can strive each month to achieve that model. This requires weekly, monthly, or quarterly monitoring of the size, shape, and mix of the funnel. Growth of pipeline is an important measure of a company's progress toward better forecasting accuracy.

A final metric for pipeline management is called Pipeline Grading. It is essential that each step have well-defined "entry and exit criteria", so that all managers and reps are on the same page. Typically, this would include 3-5 action items to be concluded before an account can advance to the next step. These action items should contain specific deliverables, and be easily measured. There needs to be an agreement between manager and rep that all actions were completed before elevating the status of the account to the next step.

Forecasting

There are three major types of forecasting that can be used in companies utilizing pipelines:

1. The first method is a Weighted Probability approach where each account is given a "Probability of Close" based on the stage, competitive situation, and time frame. Each opportunity is assessed as follows:

	$ Potential	x	Probability of Close	= $ Weighted Forecast
Example:	$100,000	x	50%	= $50,000

This type of forecasting is only useful when you have sufficient numbers of accounts where the probability approach is meaningful The number of accounts in the pipeline needs to be large enough so that the probabilities make sense.

2. A second method of Forecasting is called the Specific Account Approach. This approach is particularly useful when you have a smaller number of total accounts and are seeking a simple "Close or No Close" forecast of each account. This binary approach to forecasting puts the emphasis on the sales rep and sales management to make a firm, "commit" decision on whether or not an account is going to close in a specified month.

3. A third method of forecasting is called Extrapolation which takes a macro view of total dollars, or # of accounts, and simply extrapolates from the trend of prior months. It does not necessarily rely on a forecast of each account. This method is only useful when a consistent sales model is in full effect, and revenues are highly predictable.

Some sales executives may even use a mix of these methods to come up with their best estimate of forecast. It is not uncommon to do a roll-up of forecasts from sales rep to sales manager to the Vice President Sales level. At each level, the manager may adopt a more conservative view of the forecasts of those working for them. Over time, a sales manager begins to calibrate the forecasting accuracy of his reps, and as a result, comes up with a more realistic adjusted forecast of his own. By measuring forecast accuracy, this individual calibration is based more on science than feel.

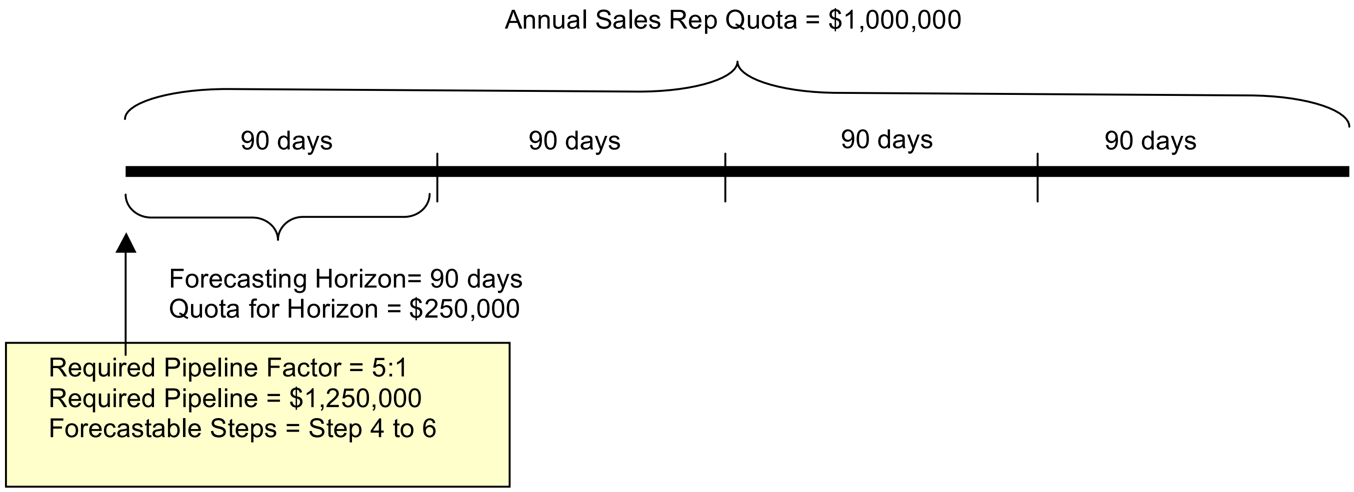
Link between Pipeline and Forecasting

There is a direct correlation between a company's Pipeline and their Forecasting System. Regardless of whether you employ a probability-weighted forecasting method or a Specific Account method of forecasting, the accuracy of a sales reps' forecast will depend highly on the strength of their pipeline.

For example, if a sales rep's quota is $1 million per year, and your reasonable forecasting horizon is 90 days, then the rep's quota for 90 days will be ¼ x $1 million = $250,000 for a rolling 90-day period. The required pipeline necessary to hit that quota for the 90-day period is usually a multiple of the quota. As an example, in the high technology business selling $100,000 capital items, this Required Pipeline Factor may be 4:1 or 5:1. In other words, a sales rep would need $1.0M to $1.25M in "Forecastable Pipeline" at any point in time, in order to consistently meet his forecast. Here is the summary of this pipeline logic:

Sales rep Annual Quota	$1,000,000
Forecasting Time Horizon	90 days
Quota for Time Horizon	$250,000
Required Pipeline Factor	5:1
Required Pipeline to meet forecast	$1,250,000

In developing more accurate forecasts, we need to better understand the Required Pipeline necessary to meet forecast. This pipeline number, called the **Forecastable Pipeline**, is a subset of the overall pipeline number. As a result, a sales manager may only want to forecast from those accounts in Steps 4 to Step 6 out of a six step sales cycle under the assumption that those accounts are the only ones with a chance to close during the time horizon. Accounts being developed in Steps 1-3 may be considered too early in the sales cycle to rely on for forecasting in the next 90 days. This focus on the bottom of the funnel is a very good way to insure better accuracy in forecasting. The following is a diagram of the Forecastable Pipeline and the use of a Required Pipeline Factor.



Value Proposition

There are very few business processes that have such a dramatic impact on Value Proposition than that offered by better pipeline management. Consider the following case study to understand the leverage potential in pipeline management.

Case Study:

Multi-step sales process; complex sale
Average deal size = $50,000
100 sales reps
10 Sales managers
Average Quota per rep: $1,000,000
Company Revenue at quota: $100,000,000

Usually within a sales organization, there are top producing reps, average producing reps, and below average reps.. For purposes of the case study, assume the following:

A reps: 20% of the reps are meeting quota or better (20)
B reps: 50% of the reps are between 60% and 100% of quota (50)
C reps: 30% of the reps are below 60% of quota (30)

By utilizing better Pipeline Management Principles, and hence, more accurate forecasts, we assume that most of the improvement in revenue generating capacity will come from the bottom two categories. The top producing reps are likely to exceed quota regardless of what system is put into place. Therefore, even by limiting the benefits to the lower producing sales reps, the revenue enhancement for relatively small improvements in pipeline management are very attractive.

% Improvement in Pipeline Management	Revenue Enhancement
2%	$1.4M
5%	$3.6M
10%	$7.2M

How to implement your own Pipeline Management System

Once the principles of Pipeline Management are understood, a company can define their own system. The following is a “how to” checklist of the various action steps needed to create a repeatable sales model.

1. Define the several steps of your sales process using definitive, end-point words for each step. As an example, rather than say “Qualifying” for a step, use the word Qualified. Using a participle like “Qualifying” or “Evaluating” implies an open-ended process with no definitive end point. Each step needs to have a defined end point, so that manager and rep can both decide it is time to move on to the next step. The number of steps can be anywhere from 4 steps to 12 steps, but it is important to note that everyone in the company may be viewing this information. Therefore, keeping step definitions memorable and concise will be a benefit to all departments.

2. Define the 3-5 action items necessary to close out each step in order to move on to the next step. The Exit criteria for Step 2 will be the Entry Criteria for Step 3. These action items need to be easily measurable, leaving no doubt in either the manager’s or sales rep’s minds that they have been achieved. It is important that both manager and rep be on the same page – in clear agreement - when deciding in which step an account belongs, and what has to be done to move that account forward.

3. Define the Model Funnel for each of your sales reps, sales managers, and the entire company. This Model Funnel will define the number of accounts, $ potential and probabilities of closing for each step of the sales process necessary to meet quota performance. It will also define the target number of days that will be required to complete each step in the sales cycle, the sum of which will equal the Total Sales Cycle for the business.

4. Measure Actual Pipeline vs. Model Funnel. This measurement will highlight which sales reps have adequate pipeline and which ones have shortfalls in pipeline. This will also highlight the nature of the pipeline for each sales rep, i.e. whether they have a top-loaded funnel or bottom loaded funnel. One can also see which accounts are slow-moving and which steps tend to be bottlenecks in the sales process.

5. Define several reports that should be calculated on a weekly basis. Examples of these reports should include Pipeline by Rep by Step, Pipeline vs. Model Funnel, Forecastable Pipeline by Rep by Step, etc. These reports can be done in Excel or utilizing an opporntunity management system that specializes in this area of management.

6. Communicate the Pipeline Reports to all departments. It is very important to all departments to have **Visibility** into the pipeline. Manufacturing needs it to better plan production. Finance needs it to better plan revenues and cash flows. Product development needs it to understand what is selling and what is being requested well in advance of orders. The CEO and the board need it to understand the momentum of the business and to better communicate with the shareholders.

By creating an internal discipline for pipeline management, your company can find that elusive “repeatable sales model” that can be leveraged. A repeatable sales model will allow you to hire additional reps into your organization with the confident knowledge that once hired, they will product $X dollars of revenue for $Y of investment.

Summary

By implementing these Pipeline Management Principles in your own company, you are well on your way to finding that elusive Repeatable Sales Model.

- A well-defined sales process results in more aggressive prospecting, improved conversion rations, more closes, and shortened sales cycles – finally, a repeatable sales model.

- A more repeatable sales model results in more accurate forecasting, increased market share, and a confident hiring plan.

- More accurate forecasting breeds more confidence and credibility throughout the organization.

- More credibility in forecasting helps the company execute and perform better at all levels of the organization including production, product development and finance.

- Whether you are a public or private company, this credibility in forecasting directly affects your ability to attract new investment from shareholders.