Sales Budgeting- The Concept

- Sales budget is a blue print of sales. It is an estimate of sales volume, revenue earning, selling expenses and net profit.
- The real uncertain data, therefore, in budgeting process, is the sales volume.
- Sales budget starts with sales volume objective which is based on sales forecast.
- Top management involvement is a pre-requisite for sales budgeting.

Sales Budgeting-The Objectives

1. To focus attention of management on sales opportunities, sales objectives, and sales quotas to bring about reasonable performance level.
2. To commit reasonable financial investment and funds to attain the business objectives.
3. To assist cooperation between various departments in the organisation like production, finance, marketing, sales, advertisement, publicity etc.
4. To balance between sales efforts, sales expenditure, sales volume and sales performance as per plan.

Sales Budgeting-The Objectives

5. To provide means of feedback and. control of efforts and performance against planned programme and tasks.
6. To improve business performance to attain and sustain competitive advantage by identifying profitable product mix, marketing areas, existing customer regimens and prospects.
7. To evaluate objectively the performance of individuals in sales force and encourage them through awards and rewards.

Sales Budgeting-The Methods

- Basically there are two broad classifications of methods of preparing budgets.
- In each of these, we have a number of variations.
  - Evaluate need against affordability
  - Evaluate sales volume against profitability
- By and large budgets are prepared for a period of one year. In some companies budgets are prepared for longer periods like 5 years or more.

Sales Budgeting-The Principles

- Parity between authority and responsibility.
- Delegation of authority and accountability.
- Proper accounting system to identity performance product-wise, territory-wise, customer-wise and sales person-wise.
- Ensure planning premises (assumption) are made based on accurate information obtained from dependable sources.
- Sales forecast is reliable.

Sales Volume and Revenue

- Basically sales budget consists of forecast of sales volume and profit.
- From sales volume we derive sales revenue by multiplying the volume with price per unit.
- Having estimated sales revenue, we estimate net profit by reducing the expenses from sales revenue.
- Thus sales budget mainly consists of following sections:
  - Sales volume section
  - Sales expenses section

Sales Volume

- Sales volume section is further divided into various sub- sections.
- Following are the sub-sections.
  - Product-wise sales
  - Regional-wise sales
  - Quarter-wise sales and
  - Customer (Account)-wise sales

Form and Content

- Form and content of sales volume section of sales budget are:

a) Product-wise sales volume contributed by various geographic region/territories

b) Regional sales are later broken down to quarter-wise sales. Repeat for each region

c) A further breakdown of sales is made by arranging customer accounts wise sales of products for each quarter.

P. R. Matrix

Product-Regional Distribution of Sales

Territories / Product	R1-Eastern Region	R2-Western Region	R3-Central Region	Total
P1	200	100	400	700
P2	300	250	600	1150
P3	500	450	700	1650
Total	1000	800	1700	3500

P. Q. Matrix
Product-Quarter-wise Sales
for Eastern Region

Quarter / Product	Quarter I	Quarter II	Quarter III	Quarter IV	Total
P1	30	40	60	70	200
P2	50	70	80	100	300
P3	100	120	180	100	500
Total	180	230	320	270	1000

P. C. Matrix
Product-Customer-wise Sales Volume for First Quarter for Eastern Region

Customer Class / Product	C1	C2	C3	Total
P1	10	12	8	30
P2	25	10	15	50
P3	40	35	25	100
Total	75	57	48	180

Sales Section Budgeting
The Concept

- Net profit is obtained from the following equation:
  - Net Profit = Sales Revenue – Expenses
- Budget will focus on "optimum profit" for short-term period compared to "maximum profit" as a long-term objective.
- "Strategic marketing investment" is a new concept in which initial expenses incurred on marketing is considered as an investment for future sales.
- Sales budget must therefore, take into consideration short-term and long-term sales plans in estimating sales expenses.

Method of Estimating Sales Expenses

- Deciding how much to spend on field sales activities is, one of the most difficult task in sales budget.
- Following methods are used here:
  - Historical data.
  - Percentage of sales method.
  - The Work load method.
  - Standard costs method.

Historical Data Method

- In this method, the expenses of previous/last year form the basis.
- To this, allowances are added to each head of such expenses, to take care of inflation and changing conditions.
- Even though, this is the simplest method, this method has many errors/limitations as it does not take care of customer needs, sales potential, company resources, and changes in market conditions including competitive forces.

Percentage of Sales Method

- Here it is assumed, that industry standard of sales expenditure are available under various heads such as salaries, sales commission, travel expenses etc.
- Certain professional journals like "Sales and Marketing Management" publishes these figures, at periodic intervals.

Standard Costs Method

- This is the most accurate but easily the most difficult method. This involves the following steps:
  - Identify all selling activities.
  - Estimate unit expenditure of each of such activities.
  - Give allowances for variation of standard cost due to changed conditions, assuming standard performance on the part of sales person.
  - Give allowances to take care of variation of "individual performance" against "standard performance."
- Standard costs method is easily applied in production activities. However, 'standard cost' for various sales and distribution activities are not fully developed.

Use of Break-even Analysis in Sales Expenses

- In this method the sales expenses are listed down under two broad heading viz.
  1) Fixed Expense :Rent, salaries, fixed taxes, essential travel: deprecia-tion of fixed assets, maintenance of vehicles etc.
  2) Variable Expense: Incentive pays (bonus/commission), postages, shipping costs, variable taxes, optional travel, optional entertainment, advertising, packaging, and production.
- Having arranged these, a Break-Even Chart is drawn in the standard manner.

Break-even Analysis

- Break-Even Analysis is a useful tool for management in taking important decisions preparing sales budgets.
  1. What volume of sales gives reasonable profit?
  2. What is the cut-off sales volume when profits disappear?
  3. What should be the safety margin of sales volume?
  4. Impact of unit price variations on income, safety margin and breakdown volume of sales.
  5. Effect of rise of salary and sales commission on overall income and profit
  6. Product mix and their individual contribution on income and profit.
  7. B.E. chart also assist in preparing two sets of budgetary proposals to suit the "low volume" and "high volume" sales forecasts.

Sales Budgeting-Importance

- Company budgeting starts with sales budget.
- Input from sales budget is essential for marketing department to prepare their budget.
- Production department needs the expected sales to work out their manufacturing budgets consisting of estimating inputs like manpower, raw materials inventory and production schedules.
- Finance department needs sales budget in preparing the following: (a) Operating budget (like production budget, purchase budget etc.), (b) Financial budget (like fund flow, cash flow) and (c) Capital budget. Similarly sales budget is also an important input in preparing unit/divisional/corporate budgets.

Budgeting Approach-1

- Top-Down Approach
  - Here top management sets the objective in sales in terms of product mix, sales volume and profit.
  - Head of each organisational unit (district/divisional/regional sales manager as the case may be) receives his sales objective from his superior.
  - Based on this objective, he prepares a plan indicating expected sales volume, sales expenses and net profit.

Budgeting Approach-2

- *Bottom-Up Approach*: In this approach, head of each organisation unit or section including even an individual salesman prepares a sales objective and a plan to meet such objective given in terms of sales volume, sales expense and possible net profit.
- This approach has following advantages.
  - Assumptions are more realistic since these are made on the basis of actual field experience.
  - Improve participation in planning.
  - Better chances of implementation since persons implementing the plans are themselves involved in preparing the same.
  - Improve motivation due to mutual trust, commitment and sense of belongingness.

Sales Budgeting-Approach

- The procedure and steps in preparing sales budgets based on bottom-up approach
  1. Lowest "profit center" say District Sales Manager, estimate district sales volume, direct sales expenses, sales overheads and expected net profit for a future period
  2. District budget is submitted to the Regional Office. Regional Manager add his overhead expenses and budgets received from District Managers and combine them together and present as the "Regional Sales Budget“ for a given product mix or market group.
  3. Divisional Manager combines all Regional/District budgets along with divisional overhead expenses and presents a combined "Budget for the Division"

Sales Budgeting-Approach

4. Other departments like Production Department, R&D Department, Personnel Department etc. also compile their budgets for the same period, as the sales budgets taking the cue from the sales budgets on "scale of operation" in terms of sales turnover in quantity and value terms.
5. At each higher level budget, the focus is made on a few essential policy aspects like global sales and turnover product-wise, total expenses and gross/net profit, leaving other details to be dealt by at each of the respective lower levels budgets.

Capital Rationing within Marketing Department

- Marketing Department combines budgets received from all its constituents departments like sales, advertisement, customer service, public relations and others.
- The head of Marketing Department selects those proposals which are realistic and having highest benefit potential to the firm and combines them as "Budget for Marketing Department”
- Head of Marketing Department allots the funds to each of his subordinate departments, based on the value and priority of their respective proposals.
- This is called capital rationing.

"Selling" Sales Budget to C.E.O.

- Head of Sales Department assisted by Head of Marketing must convince the CEO/Top Management of their budgetary proposals.
- This is called the "selling process" of convincing top management and must take into consideration the following:
  - Necessity to appraise real field situation.
  - Appreciate top management view point of priority of needs and wants.
  - Preoccupation of top management on long term gain of firm.
  - Scarcity of funds and need for pruning proposals received from different departments.

Budget is a Plan

- Budget is the financial plan of sales activities which are identified in terms of quantity and value.
- Once the sales budget is approved, each and every sales activity there in, is defined in terms of "time-frame" and "cost--frame" by the top management.
- It is now left to the sales departmental persons to implement their plan, in letter and spirit, within the time frame and cost frame envisaged.
- Thus, sales budget serves as a "standard" or "quota" of the various activities of sales department.
- Having set the plan by budget, the next logical step is to implement the plan.

Budget for Managerial Control of Activities

- By fixing the standard of "time frame" and "cost frame" of various sales activities, the budget now provides the guidelines for individual managers to act.
- It also provides them with a useful "control" mechanism when activities are initiated and implemented.
- Wherever time or cost overrun in noticed on any budgetary activity, the laid-down standard serves as a useful "alarm signal", for initiating corrective actions.
- Assist Manager to become "self controlled" and "self directed."

Budget for Top Management Control and Performance Evaluation

- Having laid down "standards" and "quotas" of individuals and sections, budget assists control through effective MIS.
- MIS is introduced on these data so that higher level managers are appraised on performance, on sales and expenses at regular intervals, say, in every week/month.
- When performance shows short fall in case of budgetary sales or cost overrun in terms of budgetary expenses, necessary control mechanism is initiated.
- Target of sales and expenditure envisaged in budgetary plans are achieved.

Correction on Errors in Budgets

- Budget is prepared based on a number of assumptions and when actual situation/figures differ significantly from the budgeted assumptions, these are called as errors in budget.
- Such errors are due to

  (1) Avoidable causes or

  (2) Unavoidable causes
- In order to overcome these problems some management resort to the following steps:
  - Alternative Budgets
  - Flexible Budgets
  - Variable Budgets

Budgeting Variations

- ***Alternative Budgeting:*** When wide variations of sales volume is expected, some firms use "low volume" and "high volume" forecast of sales preparation of alternative budgets on either cases.
- ***Flexible Budgeting:*** Here different budgets are made to cater for different levels of operations based on a wide range of probabilities of sales figures. Too much flexibility is too bad which leads to complacency and inbuilt excuses for non-performance by lazy managers.
- ***Variable Budgeting:*** When budgeting errors are noticed the common method is to alter estimate by applying standard ratios of costs to adjust the sales volume. This system, known as variable budgeting is used by most firms.

Sales Quota-the Concept

- Sales quota is defined in the following words:

1) "A quota is a standard established to measure achievement and used in organizing, programming, budgeting, and controlling company activities concerned with sales."
2) "For sales manager, quotas are keys, to measure in planning, control and evaluation of sales activity to increase selling efficiency of the company."
3) "Quotas are quantitative objectives of sales performance assigned to sales units like District Sales Manager, individual sales persons and middle men like, agents, wholesalers and retailers."
4) "Quotas specify desired performance levels for sales volume, sales expenses, net profit and return on investment."

Nature and Scope of Sales Quota

- The nature and scope of sales quota is

  (a) It is a standard set by management, on sales activities.

  (b) Quotas are useful in preparing sales planning, sales control and evaluation of sales performance of individuals, organisations units and middlemen like agents, wholesalers and dealers.

  (c) Quota assists in increased selling efficiency of organisation.

  (d) Quotas are performance targets of sales volume, expenses, net profit and/or return on investment

Objectives of Sales Quota

(a) Provide Quantitative Standard of *Sales Performance*: These are quantitative targets of sales volume, sales expenses and/or not profit.

(b) Provide Objective Control Mechanism: This serves as a planning tool for sales persons as well as superiors for introducing pro-active control mechanism

c) Motivate Sales Persons: Quotas generate healthy competition between sales persons and provides them with necessary motivation.

(d) Competitive Advantage: Quotas help the organisation not only to improve sales but also reduce costs. This assists achieving competitive advantage.

Sales Quota-an Integrating Force Between Marketing, Production & Finance

- To understand the procedure for fixing sales quota, it is necessary we understand the relationship between sales forecast, sales budget and sales quota.
- Greater the integration among Sales Forecast, Sales Budget and Sales Quota, more effective the quotas become as devices for controlling sales efforts.
- Sales budget need sales volume objective for each territory which is derived from sales forecast.
- Budget also needs sales expenses based on which the net profit is estimated.
- Quotas, derived from sales budget also need information on contribution and sales expenses of each territory.
- These information make, quota an effective device for controlling sales efforts sales expenses and evaluating sales performance

Procedure in Preparing Quota

- Sales forecast is made by marketing research. which is used by sales department to determine the sales potential.
- Information obtained through scanning of both "micro" and "macro" environment, enable sales department to convert sales potential to "sales volume objective" of each territory.
- From sales volume objective we estimate gross profit contribution. From historical data we also estimate the sales expenses.
- From these two data we derive territory-wise net profit objective. Net profit objective and sales expenses form the basic data required for preparing sales budget and sales quota.
- Sales quota assist control and evaluation of sales performance of various agencies involved in sales, like sales force, regional/district sales office and middlemen/agents.

Conclusion

- Sales quota is derived from sales forecast.
- Sales forecast fix the scope and scale of operation of the firm such as :
  - The plant capacity
  - Production quantity
  - Number of persons required in various areas like production, marketing, sales etc.
  - The requirement of funds both for fixed capital and working capital.
- In other words "Sales quota becomes the basis of planning production, work force size and financial requirement".

Types Of Sales Quota

- Quotas are classified under the following four types:
  - Sales Volume Quota
  - Budget Quota
  - Activity Quota and
  - Combination Quota

Sales Volume Quota

- This is the oldest and most common type of quota.
- Quotas are fixed product-wise, territory-wise, period wise and customer account-wise. Sales volume quota is easy to understand, identify and operate on.
- Following variations are available on sales- volume quotas.

  i. *Sales Volume Quota in Terms of Money*: Use full where product varieties are very many.

  ii. *Sales Volume Quota in Terms of Unit Quantities:* Useful where product range in small, prices are stable.

  iii. *Sales Volume Quota in Terms of Point Sales*: This is a combination of *(i)* and *(ii)* above.

Methods of Setting Up Sales-Volume Quotas

1. ***Derived from Territorial Sales Potential:*** Based on opportunities and threats of external environment and strength and weakness of our own firm, we fix "sales-volume-objective" of each territory.
2. ***Derived from Total Market Estimates:*** Where the planning is made on "top-down-approach," the forecast of sales of whole firm, obtained from consultant experts in the firm, are broken down into various territories based on indexes indicating relative opportunities in each of such territories.
3. ***Quota based on Field Sales Force Views***

Methods of Setting Up Sales-Volume Quotas

4. ***Quota based on Historical Data:*** Some firms follow a very approximate method fixing quota in each territory based on past sales, added with certain percentages for current/future period to take care of increase in population.
5. ***Quota based on Executive Judgement***
6. ***Quota based on Compensation Plan:*** Here the quota is not based on territorial sales potential, total sales or past sales but is fixed arbitrarily on compensation.

Budget Quotas

- Budget quotas convey the message to the sales persons that their job is not merely to get sales orders but also to promote sales which improve company profits.
- In Budget quotas, following are specified:
  i. *Expense Quotas*: This will ensure better co-ordination between sales volume and sales expenses.
  ii. *Gross Margin Quotas*: This 'will emphasise optimisation of sales efforts to minimise sales expenses.
  iii. *Net-Profit Quotas*: Emphasise discretionary sales strategy and promoting "sales accounts" which are more beneficial to the company.
- This will avoid, "sales volume-at-any-cost-approach."

Activity Quotas

- Sales Budget consists of identifying Sales Management activities and fixing standards in terms of "time-frame" and "cost-frame" for such activities.
- Thus activity quotas are setting standard of each and every activity such as the following:
  - Number of sales-call
  - Time period of each call
  - Frequency of call
  - Number of new accounts per each period say per month
  - Time and expense for each demonstration/seminar and such other non-selling activities
- This is found useful to set norms and standards for non-selling activities although it may go against intrinsic motivation of sales persons.

Combination Quota-Point System

- Performances of selling and non-selling activities are assessed against quotas and measured in percentages which are known as "points."
- This system overcomes difficulty of using different measurement units to appraise different aspects of sales performance.
- This system has two variations which are given below.
  - Overall Point Score Quota System
  - Product Line Point Score Quota System.

Combination Quota System

- Combination quota, control performance of both selling and non-selling activities.
- Broadly there are two types of combination quotas *viz.*

1. Overall Point Score Quota System
2. Product Line Point Score Quota System

Overall Point Score Quota System of Performance Evaluation

Sr	Items			Salesman-A				Salesman-B		
No		Weighted	Quota	Actual	Points	Weighted	Quota	Actual	Points	Weighted
		Score	(Rs.)	(Rs.)	Score	Score	(Rs.)	(Rs.)	Score	Score
1	Sales Volume	4	1,00,000	90,000	90	360	80,000	60,000	75	300
2	New Accounts	3	50	40	80	240	40	36	90	270
3	No. of Calls	2	100	60	60	120	150	90	60	120
4	No .of Demons/Sem.	1	20	16	80	80	30	15	50	50
Total		10	-	-	-	800	-	-	-	740
Point Score						80				74

Product Line Point Score Quota System

- In overall point score quota system individual performance of salesmen are determined based on selling and non-selling efforts in an overall manner.
- However, in practice sales efforts vary with different types of product line.
- In product mix all products do not require same amount of sales efforts.
- Secondly, depending on sales margin and competitive position, company expects a salesman to apply his discretion in distributing his efforts; the ultimate objectives being the maximisation of profit.
- In product line this discrimination of efforts between the products is essential.

Product Line Point Score Quota System

Sr				Salesman-A				Salesman-B		
No	Product Mix	Weighted	Quota	Actual	Points	Weighted	Quota	Actual	Points	Weighted
		Score	(Rs.)	(Rs.)	Score	Score	(Rs.)	(Rs.)	Score	Score
1	Product I	1	2,00,000	2,00,000	100	100	2,00,000	1,00,000	100	100
2	Product II	2	1,00,000	1,00,000	75	150	1,00,000	1,00,000	100	200
3	Product III	3	50,000	40,000	80	240	50,000	20,000	40	120
Total		6	-	-	-	490	-	-	-	420
Point Score						81.5				70

Administration Of Quota System

- Quota is a control mechanism.
- It is the psychological tendency of every human being to resist control mechanism of any kind.
- Quota is therefore, naturally resisted by sales persons.
- The emotional objections can be to a great extent overcome by better leadership, training and participation.
- However, in addition to emotional objections there could be rational objections to quota if these are not scientifically evolved and fairly applied.
- Thus we see efficient administration of quota is possible when these are rationally conceived and innovatively implemented with participation and support of the sales force.

Rational Consideration Realistic Quota

- First of all the target fixed by quota must be realistic.
- Individual sales persons differ from each other in their competence level.
- Secondly each territory is unique. In addition, each product line needs different level of efforts depending on market editions, competitors' strategy and customer attitude.
- Great care must be taken not to follow "rule book mentality" when quota is finalised.
- Sound judgement is important to take care of aspects like territory, product line and personality to design realistic and attainable goals (quota).

Rational Consideration Accurate

- Every effort is made to gather reliable field data through market research.
- However, there are possible errors in estimating territorial sales potential through sales forecast. Secondly, in estimating expenses, we rely on past records.
- Lot of errors can creep in such data due to many reasons like personal tendency to project higher figures, in accurate records and escalations.
- Sales volume and sales expenses form the basis of sales quota.
- Errors on these can make quota inaccurate and unreliable.

Rational Consideration
Fairness

- Performance appraisal must be fair. Reasons why a sales person fails to meet his quota must be thoroughly examined under the following:
  - Due to avoidable reasons
  - Due to unavoidable reasons.
- Sales persons must not be penalized on shortfall due to unavoidable reasons. Secondly management must "not only be fair but appear to be fair."
- Proper allowances must be given to take care of field problems due to type of product line, customer class and other unique problems of territory.
- Allowances need to take care of variation in ability and competence level of individual sales persons.

Emotional Support and Motivation

- Any programme "well begun is half done."
- Regarding sales quota, the first and foremost thing is that the sales persons should understand the concept, be convinced of its merits and accept the same.
- Following steps assist these aspects:
  - Participation
  - Pro-active control
  - Continuous feedback and
  - Incentive systems.

Participation

- Participation assists transparency of operation, education and training of sales persons, and implementation of quota system.
- Management's efforts to make the quota realistic, accurate and fair are laudable.
- Role of transparency of transaction helps.
- Participation will assist sales persons to gain knowledge and skill in the planning process and make them familiar with the procedure and process of setting standards.
- Sales person's participation will assist management to get better knowledge and first hand information in regards to field conditions.
- Chances of implementation of sales programme by the sales persons are better, if such programmes are conceived and designed by the same persons.

Pro-active Control

- In quota administrations, effective control of management is essential.
- Necessary proactive MIS be designed so that data and information are exchanged with minimum time delay and distortion.
- In proactive system of control sufficient time is given to the field force to set things right on selective basis, where deviations of performance has gone beyond the acceptable limits.
- Here control is based on the "principle of management by exceptions."

Continuous Feedback

- It is a well known fact that feedback of performance serves as a motive factor.
- In effective quota administration system, managers must keep salesmen informed of their performance in relation to their quotas.
- This assists sales persons to identify their shortfalls and correct mistakes.
- Feedback should be positive.
- Wherever possible the sales persons be encouraged, advised, guided and supported to meet their quota with mild warning if inescapable.

Incentive System

- Incentives are positive motivators.
- According to Vroom's motivation theory, perception matters a lot.
- The sales persons must have confidence in their capability of meeting the quota.
- In addition, they must believe that good efforts will lead to rewards.
- Lastly they must also be convinced that the rewards are worth getting.
- The incentive schemes of achieving the quotas must be designed to meet the above expectations of sales persons.
- This will contribute towards increasing their motivation levels.