

MONEY GUY

THE NEW NEED TO MEASURE EVERYTHING

by Harold Montgomery



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It's a new era in the ISO part of the merchant acquiring business. Readers of this column are probably tired of hearing me talk about margin decline and its twin sister, Negative Margin Substitution (that's replacing older, higher margin merchants with newer low margin ones.) But if you're seeing those trends in your portfolio, then it's time to move to a more analytical stance in your business, using hard data to measure everything you're doing and knowing exactly what works and how well and what doesn't.

When margins decline, it's time to get serious about measuring sales efficiency to make sure that you're spending the right amount of money on sales and not a penny more. Up until about five years ago, most merchant processing contracts came with a lease that essentially paid for the sales commissions and other sales costs. In effect, ISOs got the residual stream for free. The cost of a sale was not relevant since the merchant was paying to join in the electronic payment processing system.

When the POS terminal market became saturated and leasing revenues went away, followed closely by the wide availability of free POS terminals, a new logic quietly settled in on our industry. Circumstances dictate that ISOs pay attention to the value of a customer measured by the overall financial return on that merchant contract. You can estimate this quite simply by taking the average residual yield per month and multiplying the average life span of a typical merchant in your portfolio. If you don't know that number, use 60 months. That will tell you how much cash that merchant will produce in its lifetime as a customer.

But what did it cost to acquire that merchant? Are sales costs about \$1,000 per merchant contract activated? Is that more or less than the total amount of residuals the merchant will generate? And, if it's a positive spread, how do you pay for the cash flows since the sales costs are all up-front and the revenues are spread over 60 months?

These are the key reasons to measure everything that goes on in your sales rooms. You can't know if you're creating value in your company unless you know the spread between the cost of acquiring a merchant and the value of that merchant over time. If that's a positive spread, then you're adding value and more merchants is better. If, on the other hand, it costs more to gain a merchant than the merchant will produce, there's something wrong with the sales process. That upside down relationship between cost and value will erode the value of your business. You will need to know the key measurements throughout every stage of the sales process from lead generation to activation to make sure that you're operating as efficiently as possible.

It's not only important to measure the direct costs involved, such as the cost of buying a lead from a lead generating service, but also the total cost. For example, what about leads that don't end in closed sales? It's best to count those costs when reckoning the total cost of successful leads. Be sure to take into account costs related to sales such as phone system charges, rent and other indirect costs. These are often ignored, but to get a true picture of sales efficiency, you have to include all the costs that make it possible to be in the sales business.

Keep in mind that the point of this exercise is to build the systems and capabilities to provide the data you need and then you can measure how it changes over time. A good measurement system is crucial and will need to be able to pick up data from operating and financial sources in order to create a comprehensive picture of what's going on. When you set things up, err on the side of capturing more information, not less. You never know when a piece of data will come in handy later as your understanding of the process develops over time. A good process will yield more and more questions.

The most important element of this procedure is to achieve a solid enough data supply that allows you to measure the efficiency of the sales force down to the individual salesperson's results. I have often heard that a certain salesperson is the top producer as measured by the number of deals closed in a month or the overall compensation. But in this new era, I think we're likely to start measuring salespeople by how efficient they are with the resources they have. Instead of measuring sales by the gross number of deals, why not measure by the lowest cost per sale? Better yet, how about the lowest ratio of cost to yield – an equity contribution ratio? Wouldn't that be a better indicator of whether or not a salesperson is actually building value in the company? ■