Building Your B2B Pipeline – It's a Matter of Math

In our paper, "**7 Situations Where Start-Ups Hire Biz Dev Teams Too Early**," we spoke about the costly risks of recruiting a traditional marketing and sales team too early. While there are exceptions, new ventures should ensure a number of key milestones are accomplished before expanding the payroll:

- Has a minimum viable product and value proposition been validated by a small book of anchor clients?
- Do a percentage of these early-adopting anchor clients represent one or more consistent target markets?
- Could these target markets be large enough to serve as the basis for an extended sales campaign?
- And have you been able to price your offering such that you can consistently depend on a sizable cash return and net contribution for each sale across these markets? In other words, do you anticipate these markets will be lucrative enough to break-even, if not propel your profits?

Even if the answer is "yes," to these questions, you still haven't determined whether you're ready to hire a full-time sales and marketing team; or how many sales agents you need to hire. Why? Because as a founding member of your venture start-up, you need to understand the mathematics behind a reliable, well-built B2B pipeline.

Don't Hire "Closers" Until You Can Guarantee A Consistent Volume of Leads.
And Don't Recruit a Lead Generator Until You Understand Your Pipeline Metrics.

It's Simple Math – And Rarely Done

Building a consistent and reliable pipeline is a matter of math. It's straight numbers and probabilities. But our experience has shown us, whether dealing with start-ups or established firms, that many businesses often ignore the math – and much to their detriment. Now, to be clear, it's not an exact science. And pipeline metrics change over time. But like all aspects of a well-managed business, a pipeline should be quantified and benchmarked at the start so that key performance indicators (KPI's) can be established, and sales outcomes properly evaluated at even the earliest stages of a fiscal cycle.

So let's explore the math through a hypothetical illustration. Company ABC Inc. sells industrial devices, you're attempting lift-off, and you've established an objective to break-even in 12 month's time. Estimating your pipeline metrics will approximate the following steps:

<u>Step 1 – TARGET SALES VOLUME</u>

First, you need to estimate your break-even sales volume target. To do this, you need three key elements:

1. Fixed Operating Expense (or your annual "Burn")
2. Average Deal Valuation for a Single Sale
3. Contribution Margin per Deal

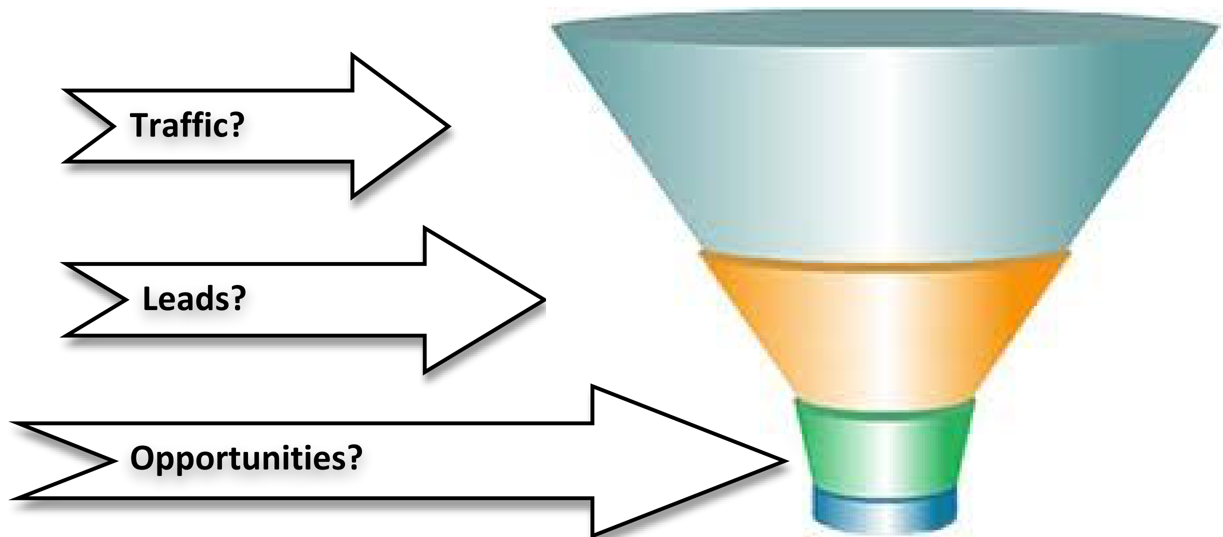
For the sake of this scenario, let's assume the following figures:

Fixed Operating Expenses = $1.8 million / Year
Average Deal Valuation = $10,000 / Unit Sale
Contribution Margin = 60% / Unit Sale (or $6,000 gross)

With these figures, your target sales volume to break-even is:

$1.8 million Fixed Costs / $6,000 Contribution per Sale = 300 unit sales

You've now determined you need to sell $3 million worth of product consistently each year to be self-sufficient. (Any complexities related to delayed payments and minimum operating cash flows are set aside for the purpose of this example.)



TARGET: 300 Sales = $3 million

From this point forward you need to quantify the preceding segments of your overall sales funnel. Various sales models use different terminology. Traffic. Leads. Qualified Leads. Prospects. Opportunities. And criteria for "qualification" can also vary by name, if not by nature. But really, it all boils down to the same thing. We encourage you to keep your terminology simple. Working from your total target sales volume, you need to ensure your pipeline is maintaining a consistent flow-through and quantify of:

- **Traffic** (Eye-Balls)
- **Leads** (Pre-Qualified Interest)
- **Opportunities** (Qualified Lead – Need, Budget, Urgency, Decision-Maker)

Now putting exact numbers to these funnel segments will be difficult at the start without any pre-existing sales history. Instead, you will have to begin with a combination of industry comparables and common sense. When you start closing deals, you can adjust and refine your assumptions based on actual outcomes. For now, let's move on to the next step.

Step 2 – QUALIFIED OPPORTUNITIES and your CONVERSION RATIO

You've determined you need to sell 300 units to break-even. For ease of argument, let's assume that every deal will only average a single unit sale, and not multiples. So how many opportunities do you need to harvest over the course of a year to reach this minimum annual 300 unit sales target?

There is no hard and fast rule when first estimating a minimum target conversion ratio of "Opportunities-to-Deals." However, it's not simply a matter of arbitrarily setting a goal that you want or insist your sales function must achieve. An early-stage conversion ratio has to be grounded in your own business realities, and the realities of the current market. Moreover, the target ratio needs to take into account a number of variables that have to be either measured or estimated. They include:

- Addressable Market Size (How Many Comparable Products Are Purchased Each Year?)

- Competitors in the Market
- Average Deal Size / Contribution Margin
- Estimated Effort required to Close a Single Deal (# of calls / # of hours including admin)
- Total # of Sales Staff

I. Target Conversion Based on Competition

One way to project a potential conversion ratio in your early days is simply to count the number of close competitors in the market. If there are 3 other competing firms alongside your Company ABC Inc., then you could start with a straight-line average of 4:1 conversion. In other words, you could assume that, all else being equal, each competitor will capture 25% of the market. But in reality the incumbents have a much more recognizable brand, you're new to the market with an unknown/unproven product, and while you may have a superior offering, it will take time for the market to accept change. With all these other intangibles taken into account, you may want to target for a 5:1 or 6:1 conversion ratio at the start.

II. Target Conversion Based on Capacity

On the flipside, you also need to benchmark what is an ***unacceptable conversion ratio***, both for the company and for the individual sales agent. So how could this be estimated from the very start without historic evidence? Exploring a single agent's maximum capacity is another approach. Again, let's illustrate through an example.

Assume a standard 9am-5pm work-year, less 4 weeks for vacation, illness, and seasonal slow-downs, translates into 1,800 selling hours per sales agent. Now further assume that approximately 1 hour each day is lost to internal meetings, training, performance reviews, reporting, general administration, etc. Each sales agent is left with 1,560 hrs to sell over the course of a full year. And that's working like a machine.

So now let's consider a scenario where it takes a sales agent 4.5 hrs to close a deal and they're currently converting at 7:1. (The 4.5 hrs is spent between emails, calls, demos, quotes, and contract negotiations.) With a 7:1 conversion, how many deals would a single sales agent win towards the total goal of 300 units?

= 1,560 selling hrs / 4.5 hrs per deal / 7:1 conversion ratio = <u>49.5 units sold</u> by year's end

So what does that tell us? At an average conversion ratio of 7:1, Company ABC Inc. would need a full-time sales team of **6 agents** to reach the target goal of 300 unit sales. And then you would need to ask yourself:

1. Does your fixed operating expense of $1.8 million include the base salaries of 6 sales agents? (If not, you'll have to re-set and re-calculate.)
2. Do you have separate marketing personnel generating and qualifying leads? Are they also accounted for in your $1.8 million fixed operating expense?
3. What If you targeted for a 6:1 conversion ratio? (You only need 5 sales agents.)
4. What if you targeted for a 5:1 conversion ratio? (Now you're down to almost 4 sales agents.)
5. What if you could reduce a sales agents selling time to only 4 hrs / deal on average? Etc…

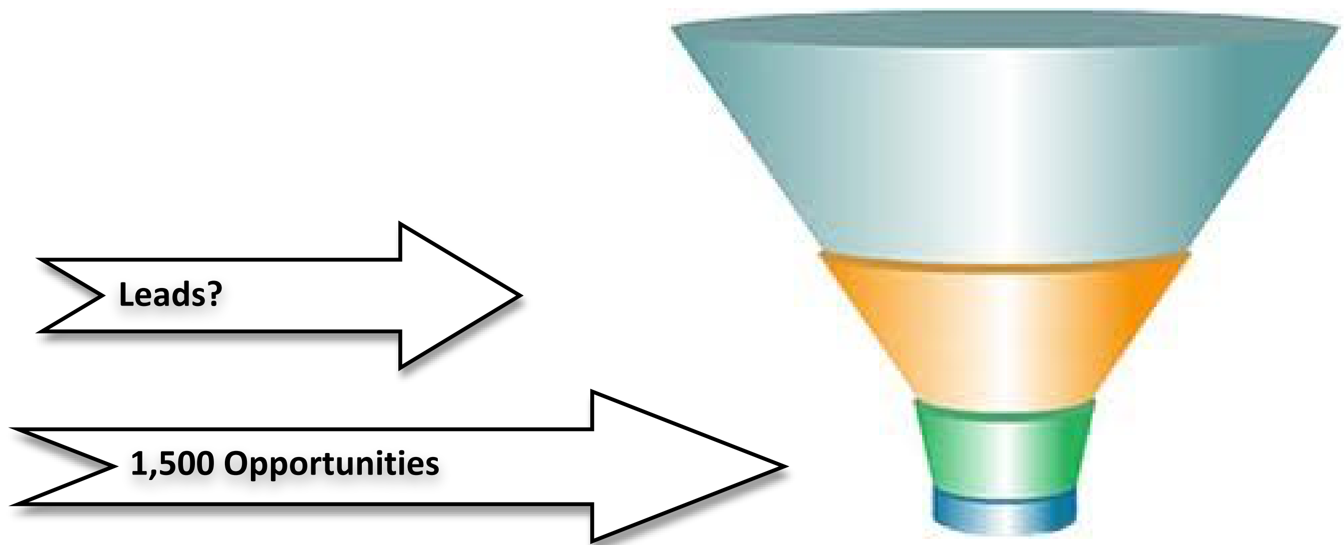
In short, you have a range of "levers" you need to quantify and benchmark to determine how many sales agents you need, how many sales agents you can afford, and your minimum viable conversion ratio. There is no hard and fast rule. But you must set an initial objective and then track actual outcomes. If you're not achieving the target conversion ratio, then you need to immediately evaluate how to increase conversion. That could be accomplished in a number of ways:

- Revisit product-price mix
- Revisit source and quality of leads
- Revisit qualification criteria used to transition a lead into an opportunity
- Revisit individual performance of your sales agents (i.e. hire, fire, re-train, etc…)

And remember that we're talking about a conversion ratio for an early-stage B2B start-up that's simply trying to make an initial name for itself in the market. If your objective is to dominate the market, and your mandate is to eventually win 66% of all business, then you need to achieve a minimum conversion ratio of 3:2 (opportunities-to-deals). But no matter what your ongoing objectives, you have to begin by putting measurements and benchmarks to your pipeline.

In reality, B2B companies understand the chance of long-term survival is slim without targeting for a minimum 5:1 conversion ratio at the start. The end game is typically to accomplish at 3:1 conversion or better.

By applying a 5:1 ratio in this particular example, Company ABC Inc. needs to ensure there are a total of **1,500 bona fide opportunities** in the pipeline to achieve 300 unit sales and $3 million in target revenues. That works out to roughly 1.75 unique opportunities per sales rep each day across a more modest team of 4 agents working an average of 48 weeks. (Remember, these agents are spending 4.5 hrs per opportunity over the course of an extended sales engagement with a given prospect.)



TARGET: 300 Sales = $3 million

Step 3 – TARGET VOLUME of "INTERESTED LEADS"

So how many leads do you need to generate 1,500 Opportunities? Once again, there's no fixed formula. And the only way to really learn is to test the market. However, barring any historic information, you should assume you will need to apply a minimum **4X multiplier**: "interested leads"-to-opportunities. An "interested lead" is a contact that in some way has demonstrated a potential appetite for your product or service. They are not fully qualified as an opportunity where "Need, Budget, Urgency, and Decision-Maker" have been confirmed. But there is a meaningful probability that they could be in the mix for a purchase.

Given a 4X multiplier, it then means ABC Company Inc. needs to generate 6,000 leads during the course of the year. Or 500 leads per month. ***Or roughly 20-25 leads per business day***.

300 unit sales → 1,500 Opportunities → 6,000 Leads

Note that, in this scenario, we're assuming 5% of your early-stage or "interested leads" will ultimately convert into a final sale. (300 sales / 6,000 leads.) Is this realistic? It's uncertain until you've tested the market. But it represents a benchmark that you now must use to measure the effectiveness of your marketing and lead-generation engine.

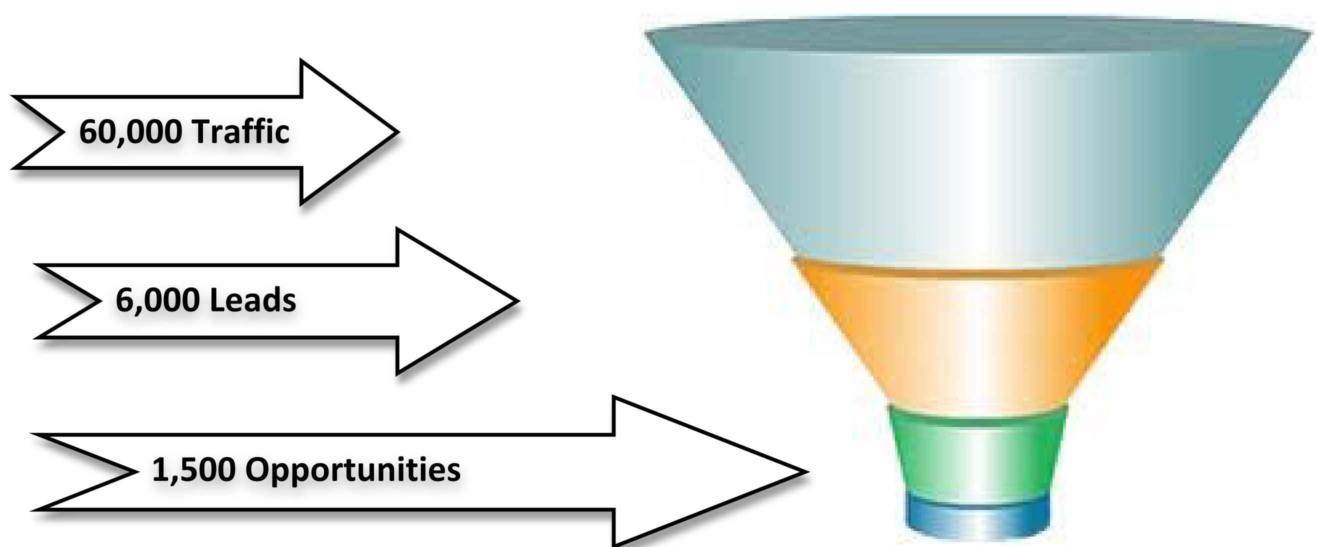
Where do these leads come from? Here's where you also must test a range of tactics, the success of which will vary based on your industry and the behavior of your target audience:

- Digital / On-Line Marketing
- Social / Professional Network Media Marketing
- Referral Marketing
- Blogs, Forums, Smart Papers, Webinars
- Direct Email Campaigns (outbound)
- Direct Call Campaigns (outbound)
- Trade Shows, Etc…

Step 4 – QUANTIFYING TRAFFIC

The top-end of your pipeline is as much about brand awareness as it is about securing leads. In short, you need to be seen and heard at eye-level by your target audience before you can begin to trigger genuine interest. As a result, it's critical you find ways to quantify how many times you're making impressions on your target audience about your brand, your company, and your product offerings. Again, there is no hard and fast rule. And many of these metrics depend entirely on the size of your overall addressable market.

For the sake of this exercise, let's assume that you will need to create an impression with at least 10 contacts for every individual who becomes an "interested lead." That means you need to ensure your print advertising, digital marketing, blogs, tweets, newsletters, smart papers, webinars, etc, reach a minimum 60,000 contacts who fit the overall profile of your target market and target purchaser, whether or not they are ready to buy.



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Your Sales Cycle – Time is of the Essence

An additional note – throughout this illustration we have ignored the importance of quantifying the length of your typical sales cycle. The pipeline numbers illustrated so far in this paper assume that ABC Company's sales cycle is relatively short (less than a month) and that leads, opportunities, and deals occur continuously.

In reality, however, a $10,000 purchase might require upwards of 2-3 months to close. Larger deal valuations could easily take 6-12 months or longer. Or you could be selling into a target market where final approvals are typically slower to come (e.g. the government sector). And so a lengthier sales cycle must be taken into account when quantifying the number of viable leads and opportunities in the pipeline that could contribute to this year's break-even objective of $3 million in sales. In fact, if ABC Company's sales cycle averages 3 months, then none of the opportunities that enter the pipeline in the last fiscal quarter of the year can be expected to close in time to help accomplish the year end objective. Rather, it will be opportunities initially cultivated in the fourth quarter of the previous year that are likely to translate into closed deals contributing to this year's 300 unit sales target.

Building Your Sales Engine

So you've attempted to quantify your pipeline. It won't be accurate. But it now forces you to ask some mission critical questions that will dictate when and how you start to build and recruit for your sales engine:

- What's the minimum traffic required to trigger interest in my product?
- How many direct leads must I ensure I generate from this traffic?
- What's the process and criteria required to transition leads into opportunities?
- How many sales agents do I require to convert opportunities into closed deals?
- Do I have a system in place that tracks conversion rates and sales cycles of all leads and opportunities?

Distant Early Warnings

Missing a critical pipeline benchmark even in the first month will indicate whether your sales engine is already under-performing, and whether you even have a chance of achieving year-end targets. (Remember, setting aside "seasonality" or "cyclical" considerations, you already know in our example above that you need to source 500 leads per month to reach your goals. If you only source 200 leads in your first month while maintaining all other target conversion ratios, you've already identified a problem in the upstream portion of your pipeline.) Discovering a missed metric like target leads in month #1 should have you re-evaluating your marketing and sales operations well ahead of your Q1 revenue report. In turn, these early alerts enable you to revisit tactics, seek advice, and/or revise expectations long before you need to have a very challenging conversation with your investors and board by the 3rd or 4th fiscal quarter.

Pipelines. It's a simple exercise in math. It drives a wide range of critical operational decisions. We encourage you to embrace the metrics. Track your KPI's and benchmarks. But, whatever you do, don't dodge the numbers.

Need further insight?

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