The Pay-per-Lead Disaster-in-Waiting

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If you need qualified sales leads, a performance-based service (e.g. pay-per-lead, pay-per-appointment, commission-based, etc.,) probably sounds like an attractive way to go. There are literally thousands of independent telemarketers and call centers that offer the option. And depending on the vendor, you can theoretically avoid most, if not all, of your up-front costs. So it seems to eliminate virtually all of your financial and market risk. Then why doesn't it work?

While pay-per-lead may eliminate your up-front investment (assuming that there's no set-up charge, and assuming you don't have to pre-pay for the leads), it does not eliminate all of your *risk*. Ignoring those cases where the offer itself is unfulfilled (e.g. a promise to do work that just doesn't get done), in practice performance-based approaches simply defer the costs, in most cases amplifying them significantly. And, more importantly, they significantly increase the risk of failure – sometimes well beyond reason, and often catastrophically.

In this analysis, we'll discuss why this happens, and show how it can impact your business.

Background

Given today's economic situation, a good metaphor for a pay-for-performance campaign is an Adjustable Rate Mortgage with a 0% teaser rate and no money down. Except in this case you might lose your business instead of just your house. But while analogies are easy, let's take a look at what happens in a real-world pay-for-performance campaign, and how it can cost you a lot more than you think, and maybe cost you your entire business.

Typically, a pay-for-performance program stipulates a set of "lead qualification criteria," and a price that will be paid for qualified leads, While it may seem either high or low to you, (and, by the way, it doesn't much matter which it is,) it would certainly be an acceptable price if the leads are good. There might even be a formal contract so everyone agrees on what counts as a lead, and under what conditions the payment is due. So far so good – as far as you, the client, are concerned.

Now let's look at it from the vendor's perspective. You'd like to think that the vendor should be willing to bet his own money on his ability to produce leads for you because he's so confident in his abilities. But is that really rational? Why should a vendor put his efforts (and his money, in some cases) into promoting *your* business, and not into one of the hundred other prospects that call each week wanting pay-for-performance programs? Surely your opportunity can't really be better than all of them, can it?

In fact, why shouldn't he just put his efforts into promoting his own business, and convert to a fee-based arrangement where he's sure to get paid? That is, if he's good enough to sell your products, shouldn't he be at least good enough to sell his own, instead of giving them away for free?

Another question to consider is how does he really know that he can produce good leads for you, and what it will cost him to generate them? Certainly he'll tell you that he's done it before, and that he knows roughly what it will cost. But if he really knew what your cost-per-lead is going to be, (along with the expected close rate and margin in your market, which he would need to know in order to set a compensatory price-per-lead) why is he in the telemarketing business in the first place? He's obviously an entrepreneur; and if he knows these costs, then he should be in *your* business. You can't use the excuse that he's invested in a telemarketing company because the investment is – frankly – very low. (In fact, he may be a one-man-shop.) But more to the point, if he really knew what it would cost to find new sales opportunities for your business, he could easily borrow the money from the bank to get into your business - more easily even than you could - because you evidently have a lead generation problem.

In fact, if he actually knew what it would cost to generate leads for your business, and really knew how to do it, he could easily just generate the leads himself and broker them, or sell them to the highest bidder. In other words, what does he really need you for?

In reality, he really doesn't know these costs, because he *can't* know them. He's just setting a price based on what he thinks you're willing to pay. He's not betting on his ability to produce leads for you; he's betting on something else entirely. That is, he really doesn't care whether he can produce good leads for you or not. It's simply not an issue for him.

If pushed, by the way, he might tell you that he's playing the "probability game" where he's got multiple projects going, and if one makes money, he wins. (The one-man-shop would have a hard time making this case, of course.) He might even tell you that having multiple projects allows him to offer you a lower price because he's spreading his risk. From a mathematical perspective, that should actually lead him to demand a *higher* price because he needs to compensate for losses on his failed projects. But a discount off of a meaningless number (i.e. some projected cost-per-lead,) is still a meaningless number. And there is no probability that he will succeed, although it obviously doesn't do you any good if he fails.

You may respond that, if he fails, it will not have cost you anything. But a review of dozens of cases has shown that it really will cost you quite a bit, including time, expectations, reputation, money, material, and potentially any salespeople that you have. Again, the fact is that the pay-per-lead (PPL) vendor doesn't care whether he can produce leads for you or not, good or otherwise, and no matter the cost. He doesn't care whether they're any good or not, or what they cost, or what the probability of success is. His business model just needs to set a price-per-lead that you're willing to pay. And it doesn't matter what that price is, as you'll see.

When entering into a performance-based arrangement, you need to ask yourself: Why should the vendor care about results? Should he care because he's a good guy? (Not likely. You'll never meet, will you?) Should he care because he likes to gamble? (A real businessperson, if he were taking all the risk, would demand a *much* higher price, or even equity, than what you're willing to pay for a qualified lead.) Should he care because he's desperate for the business? (He may be desperate for money, but he's certainly not desperate for you to succeed.) Should he care because he wants a reference? (Does he really need one if he's "giving away" his services? In fact, did you even bother asking him for references when you hired him, and did he provide them? Doubtful – because, after all, it wasn't going to cost you anything unless he delivered results, right? So why bother with a reference?) The fact again is that he doesn't care about results because he's not selling leads. He's selling something else entirely. He's selling hope. And you will be hoist by your own petard if you buy it.

If the logic doesn't make you nervous, let's look at how the PPL vendor runs his business (assuming he even has one,) to see what's actually going on.

The Pay-for-Performance Models

There are two approaches companies take to providing a pay-for-performance service. One is where the employees are paid hourly; the other is where they are paid on a performance basis. Let's look at how the performance-based payroll looks first.

In the case where the employees are paid on a performance basis, ask yourself if you think it would be reasonable for a truly good telemarketer (i.e. someone who's trying to put his kids through college, and who can sell well enough ring your cash register to risk his family's welfare on your business. Is it realistic to think that someone who is that good would be willing to gamble that you're going to agree that the leads are qualified, and that you're going to pay for them (and that his boss is going to pay him)? You've already proven (to him, at least,) that you're in "short pants" because you're looking for pay-per-lead in the first place. (We "know" the real reason is that you've been burned by telemarketing firms before, and you don't want to throw good money after bad. But that's your concern, not his.) But do you really think that someone who knows what they're doing is going to wait to see if you'll keep your word, especially if the sell-cycle is a couple of months? This isn't to imply that you're not honest, and willing to pay for the leads that are good; but what about the gray areas? What about the honest disagreement where the vendor or the telemarketer says that the lead is good, and you say it's not. Will that ever happen? (It does. In fact, it happens over 80% of the time.) Do you really think that a good telemarketer is going to stick around if you disagree more than once? Not likely. In fact, *no good telemarketer will work on a performance basis unless it has a proven process, and a proven cost* (in other words, the leads are "gimmee's"). And if the process has been proven, and the cost-per-lead is known, what difference is it to you whether you pay per-lead or per-hour? The short answer is that if the vendor is paying their people by the lead, they can't be using good people, in which case you're not going to get any good leads.

But even if you don't care about the quality of his people (which you should), to the vendor it doesn't matter – because, again, that's not what he's selling anyway.

In the case where the employees are paid by the hour, it should be clear that the vendor has now *increased* his out-of-pocket costs, and risks. That is, not only is he taking a risk that you will pay for the leads, but he's now taking a risk that his people will actually generate some. Not that any raional businessperson would do that, but let's look at the numbers.

Let's say that he pays his people $10/hour, and charges you $250 per appointment. (Pick any number; it doesn't matter what it is.) He may even pay his people (or maybe just tell you that he's paying them) a per-appointment bonus to motivate them. Assuming that they can generate a lead in less than 25 hours of calling (again, the actual numbers don't matter,) he makes money, right? Sounds like a win-win: The telemarketer makes money, you make money, and the vendor makes money. But what kind of a business model is it where you might disagree about whether a lead is qualified or not? Do you really want to be debating every lead? And what if you win the argument? What do you think the vendor is going to do the next time? Keep generating leads that you're going to argue about? Don't bet on it. Today you might feel comforted by the fact that you can control your costs with the acceptance process, but it is that very comfort that only serves to draw you into the trap.

The Game

By now you should begin to see the game he's playing. The fact is that he's not betting that he can generate sales leads for you. Of course he can generate leads for you, even if he has to make them up. He's betting that he can get you to pay for them. That's the game.

The truth is that most people who run performance-based telemarketing programs are pretty good at sales. And he's in it to make money for himself, not you. He's betting that between the creative writing of the "lead qualification criteria," the acceptance process, and your desperation to increase your sales, he can win enough times to make money. Specifically, he's betting that you will give him the benefit of the doubt on the first few leads so that he can cover his marketing costs, or even make a few dollars. And he's betting that he'll be ahead of the game before you get tired of arguing about it.

Think about it, wouldn't you give him the benefit of the doubt on the first few leads - if for no other reason than to motivate him the stay with it? And once you pay, you've lost.

Ask yourself: What's he really selling? Leads? Or getting you to pay for them?

In other words: He's not your partner. You're simply a customer for whom satisfaction is unwarranted.

The only thing that matters to the pay-for-performance vendor is that you pay for the leads. He doesn't care whether they're qualified or not, or whether they close or not. How could he? Regardless of what he does, or of the quality of the lead in his view, he knows that ultimately he has no control over whether they're qualified and paid for - since you're the judge, the jury and the executioner. That, after all, is your declared (albeit self-destructive) strategy.

One could argue that he should care because if he generates good leads, you'll pay for them; or that the criteria are clear, and all he has to do is meet them. But he knows that - when push comes to shove - you WILL push back. This is because you're only human, and you're running a business for a profit; and therefore you will resist paying for unworthy service. He "knows" this (whether it's true or not) because you've already proven it by opting for pay-per-lead in the first place. Why should he think you'd change all of a sudden?

He also knows that if the survival of his business depends on your integrity and good will, *based on what you've already done* (in opting for pay-per-lead,) he will lose. And so he simply will not play that game. He knows that instead of worrying about generating leads, he really needs to spend his time and energy getting you to pay for them. And that, in actuality, is his business model.

As a result, in your desire to reduce your risk, you have made yourself a victim.

Impacts

So let's now talk about what this does to your business, because it will have an impact. There are a number of situations that we've seen in the market, but here are some of the typical ones.

<u>Case 1</u>

Although the rarer of the cases, some PPL vendors will start out by giving you a few leads, and some of these leads will be good, although most will be bad. Because it's the first batch, you agree to pay for all of them though. Your salespeople go out on the appointments, and maybe one turns into business, or maybe not. But you're happy because you either made some money (unlikely in the near term,) or you think you're going to make money later on. So you keep going with the program. (By the way, the vendor has now made a profit.)

Now you get a bunch more leads, and again some are good, and some are bad. But now you don't want to pay for the bad ones anymore. Why should you? They're bad - obviously so; and you can't keep being a nice guy forever. So you debate with the vendor, and because you have the checkbook, you win the debate.

Now the vendor does one of two things depending on how you handled the debate. If he thinks you're a soft touch, he'll start showering you with leads, hoping to make up in volume for your cutting down his list. If he thinks you're hard-nosed, he'll just walk away. In the first case you'll end up with a lot of junk to chase, and waste a lot of time and money. In the second case you'll end up with nothing, and just waste a little time and money. Either way, you lose.

And, by the way, he's already made money.

Now ask yourself: What is the impact of having too many leads, as will happen if he thinks you're soft? Well, how do your salespeople feel about going on a lot of wasted calls, and what does that do to your field sales budget? And how much time do you want to spend arguing with the vendor about which leads are good, and which are bad? Again, you lose.

In the other case where he thinks you're hard-nosed right from the start, what is the impact of the vendor walking away? Ask yourself what you could have done with the time you wasted. More importantly, ask what the PPL vendor said to the 500 people per week they pitched while you were arguing with him about the payment. And so once again, you lose.

<u>Case 2</u>

Most other PPL vendors will simply shower you with leads from the get-go, figuring to throw a bunch of stuff against the wall and see if anything sticks. They know that's what you want anyway – because you probably told them "the more leads you can produce, the better." Did you tell him that you currently close 35%, or 50% or 80% of the leads you get now (as a way to brag, or motivate him)? Why not just give him your wallet now, and put yourself out of your misery?

This is because now you're getting 25 leads a week, and your salespeople are running all over creation following up on bogus leads. How much does a field sales call cost you? $50? $100? $200? $300? Multiply that by 25, plus the cost of the lead. How long before your salespeople are so angry that they revolt or quit? Ask yourself: Do you really want to work with a vendor who makes more money the more he runs your salespeople around, regardless of the outcome?

Even if the quality were acceptable in 50% of the cases, which is an impossibly high rate, by the way - do you really think your salespeople will tolerate a 50% rate of tire-kickers? Could you really afford it? And, in fact, when you pay on a per-lead basis, the percentage of good leads is usually in the low single digits. What does that do to your business model?

So now let's add insult to injury: What caliber of telemarketer, in either case, do you think he actually has on the phones calling for you? Do you really want someone making minimum wage representing you? What do you think the telemarketer was telling all your prospects about your company while he was trying to generate those leads? After all, you didn't want to pay for a proper set-up and training. And you certainly weren't willing to gamble on his talents. So what do you think he was saying – anything good?

You will, of course, argue that he had a script. Really? If you were a busy decision maker and someone called you with that script, what would you do? Now multiply that reaction by 500 prospects per week, and you can imagine what just happened to your perception in the market.

Congratulations. And enjoy re-naming your company.

<u>Case 3</u>

Both of these cases, of course, can occur where the vendor is a company and where it is an individual. But the latter also is a special case.

If you pay an individual on a pay-per-lead basis, do you think his self-interest will be stronger or weaker than a corporate vendor? In general, it will be stronger; and they will therefore bail out faster because they're less adept at the debate, and have less staying power. But you can now understand why the turnover and failure rates are so high with individuals.

Ironically, though, you're likely to treat the individual with more sympathy. And, in general, PPL clients who work with individual telemarketers are extremely forgiving. They try to motivate the telemarketer with encouragement, and pay for more leads than they would otherwise. The question is: How long will you tolerate failure before you just decide to cut your losses?

The average is eight months – which is an incredibly long time. And you may well run out of year before you've made your number.

Is it possible to find an individual who is willing to work on straight commission or PPL that works out? Yes. But our data show that it happens about 5% of the time. How would that impact your risk calculation?

Those PPL clients who are hard-nosed, by the way, and who hire individuals have an even greater problem. They simply end up spending all their time recruiting, because the individuals quit sooner. But again, you lose.

Case 4

There's one other version of the pay-per-lead model that is worth noting, and that is the case where you have to pay up-front for a certain number of leads. The guarantee is that, if the vendor doesn't provide the agreed number and quality of leads, you get some of the money back. While this is not truly a pay-for-performance model, it is disguised as one, and it does exhibit many of the same characteristics.

In this case, if your goal is to avoid up-front costs, this clearly does not achieve that goal - because the vendor is holding the money. But the issue here is that the vendor already has your money, and now you have to argue (in this case on a lead-by-lead basis,) to get it back. Is this how you want to run your business?

Discussion

Pay-for-performance is – charitably – a classic case of "the law of unintended consequences." Less charitably, and occasionally, it's a hustle where the vendor keeps raising the ante – forcing you to compromise on the acceptance criteria - until you realize that nothing's happening, and you end the game broke.

The PPL vendor is simply taking advantage of your *self-declared* risk aversion, ignorance, and lack of funds, whether he wants to or not. By your asking for a performance-based model, you have *by definition* positioned yourself to become a victim of your risk-aversion. And the vendor – who may, in real life, be a perfectly honorable person – will have no choice but to take advantage of it. It is human nature, of course, but it is also because of another "law," the law that says "you can't get something for nothing."

Because of your desire to only pay on a performance-based compensation plan, vendors of this type of service understand that they are not principally selling you leads anymore. They know that you *want* leads, and that's what draws you in. But they know that, more than wanting to get leads, you want to avoid risk. They know that you absolutely don't want to take a chance that the program might not work; but that you're probably a nice guy and would repay his willingness to take a chance on you by giving him the benefit of the doubt when it comes time to pay - at least for a while. That's what makes you a target for the con. So he sells you the promise of good leads for no up-front cost or risk. And, of course, that's what you've bought: The comfort of a promise. But like cheap insurance, it's there until you need to make a claim.

And the funny thing is: You probably offered to pay him whatever he wanted.

What If You Don't Have the Money?

Given this bleak assessment, the question often comes up regarding what to do if you can't afford, but need, lead generation. Certainly, lead generation needs to be in your business plan; so if it isn't, then the plan itself is flawed – and needs to be re-worked to include it.

Options exist, though, for companies that have very little money, mostly in-house solutions. These require that you know how to recruit and hire a good telemarketer, and that you're willing to pay some up-front wage. But this is far less expensive and less risky than what you'll pay with a PPL approach.

You can also contract with a fee-based firm to do a pilot program, and if it is successful then convert over to a performance-based model. This is possible because the pilot program lets you figure out exactly what the cost-per-lead is, which can be used to set a performance model later on.

Conclusion

We've been in this business for a long time, and the irony of companies trying to lay off their marketing risk onto a vendor never ceases to amaze us. Is it really rational to think that someone would, or should, take a bigger risk on your business than you without an equity stake? Does it make sense that you can get the type of talent it would take to generate qualified leads for your business for free?

The reality is that when you tell the vendor that "if you take the risk, you will get the reward," they know that you are the one taking the risk; you just don't know it yet. Looked at more cynically (if it were possible,) when you use a pay-per-appointment service you are trying to get something for nothing - and so you will get what you deserve. If you do get any good leads, you will overpay grossly for them; but it is far more likely that the endeavor will simply trash your market, destroy your sales team, and waste an enormous amount of money and time.

And for what? Because you don't have the money for a pilot program? If that's the case, better to run an ad in the local paper and hire an in-house telemarketer. Train them well, coach them carefully, and fire them early for failure.

So now we come to the proof. While as logical and obvious as the argument above may seem, at least, the desire to rationalize performance-based lead generation programs is strong. And the fact is that pre-paid programs don't work 100% of the time either (although their costs and risk are much lower.) And so there clearly is some risk involved, no matter what you do.

But a recent study by the Aberdeen Research Group on the B2B Teleservices industry demonstrated unequivocally that pay-per-lead approaches produced far fewer qualified leads, had a far lower ROI, and failed miserably in the vast majority of cases – just as described above. You can buy the study for around $5,000 - about the same amount as a decent pilot program, by the way.

Or you can simply ask yourself, what's really going on here?