



Shifting the Sales Compensation Paradigm

by Don McNamara

Executive Summary

Before us is the thorny question of how to protect cash positions while balancing the seemingly contradictory problem of keeping cost of sales under control and your sales force intact while revenues decrease. Compensating sales efforts appropriately is one solution for protecting margins, profit and cash. Solving this issue may take creating a new paradigm for sales representative compensation.

Longing For the Good Old Days

It was like a feeding frenzy when business was booming, backlogs were steadily increasing and customers were paying regularly. Just like the stock market, everyone was chirping ‘go baby go’. But times have changed; no doubt your business plan has changed too. Now how we compensate a sales force properly in these market conditions needs to be revisited also.

Sales Force Goals

What are the goals of your sales force? Maybe they have only a sales goal. Perhaps they have a sales and revenue goal, where revenue is net sales after returns, adjustments and back charges. Possibly they have a profitability goal too since your organization desires quality, not merely quantity. Regardless of times, determining how to keep sales incentives appropriate without resorting to Draconian measures that annihilate the heart of the sales organization – both literally and psychologically, is vital too.

Let The Incentive Methods Begin

Compensation on Sales Volume

The most traditional of all methods, it carries with it some in-built shortcomings. If the plan pays commission rates based on total dollar value of the orders, then the rep has little incentive to dramatically exceed the established quota. If you will, the rate is the rate, no matter what, no matter how much is sold.

Compensation Rate with Accelerators

In this plan quarterly targets accumulate to an annual quota. When these quarterly quotas are achieved, the next accelerated commission rate gets activated. This strategy does provide additional incentive over the flat commission rate plan though since the rep is striving for the next higher commission rate at all times. Shortcoming: the sales rep is only working toward the average rate.

Accelerators and Year End Bonus

Add a flat amount as a bonus when over quota attainment is reached. This will incrementally incentivize. Shortcoming: the sales force sees the bonus as paid out at plan year-end, which usually is paid after a years worth of effort and energy. It does not give them the ability to earn the bonus in the present.

Net: traditional sales compensation plans are back end loaded, i.e. a payout is awarded after successive sales hurdles are reached or as the plan year ends for over goal performance. That's wonderful if everyone makes quota every quarter, not a likely scenario – especially in this economy.

Coping with a Few Realities

All businesses, regardless of market space, are seeing declining revenues due to fewer actual orders with lower order value. The fact is cash once collected amounts to less.

We can improve margins and cash by cutting variable sales expenses. On the surface this looks like a no-brainer. However, you could be triggering call reluctance behavior. Customers being paid attention to now will be stronger customers when the economy improves. Besides you risk having your competition fill the void your sales staff is creating by fewer customer and prospect calls.

Less revenue and cash means a staff headcount reduction. Or should it? If you cut sales staff now when business improves you will need to staff up again. The knowledge base of severed employees will take time to be gained back by new sales members resulting in an unproductive learning curve for you and them.

An intelligent sales incentive program is one that compensates for achievement according to the company's business plan. And in these economic times every company in America has had to modify their business plan.

A New Paradigm

If your goals are to maximize unused plant capacity, optimize your supply chain resources and smooth the bumps in your quarterly business cycles, then the sales compensation plan that follows just might contribute to that end, and help cash flow too. It is based on measuring and compensating sales efforts quarterly.

Baseline Presumption

If your sales team is like most, 80% of the business is generated by the top 20% of your sales force. So why not compensate the star performers and overachievers well for their results every quarter.

Step 1: Take the assigned quota for each individual and break it down to assignment per quarter.

Step 2: Assign a commission rate to that quota as if it were paid at 100% achievement.

Step 3: Determine what reduced rate you would be willing to pay for achievement of quarterly quotas for 70%, 80% and 90% attainment.

Step 4: Decide what graduated commission rate you would be willing to pay for achievement over the quarterly 100% attainment for various levels, e.g. 110%, 120%, etc.

Step 5: Watch the results come in for the first quarter this is implemented.

Step 6: Those sales persons achieving 70% of their quarterly quota, will receive the 70% rate; those at 80%, the 80% rate; those at 90% the 90% rate; those at 100% the 100% rate.

Step 7: Those exceeding 100% in any quarter, receive the effective rate of overachievement.

Why a Floating Commission Plan Works

1. A Floating Compensation Plan can be accommodated to fit any of the ways you measure sales person goal attainment; sales, revenue, sales and revenue or profit.
2. Regardless of the economic fortunes of the enterprise, you keep incentive compensation proportional to measurables like sales, revenue or profits.
3. You conserve outlays of cash; you compensate those contributing higher value to the enterprise by compensating them proportionally higher. To prove the point, investigate your mean sales dollar of revenue and profit for all orders by quarter for the last year. Then contrast the mean percentage rate of commission payout for the entire sales force. You will see that higher commission rates are paid to sales persons that contribute less to the business.
4. You install a measurement mentality in the sales team that is based on quarterly performance, probably the same way you are compensated.
5. You want to keep sales force self-motivation always at peak levels. They will see, especially the 20% mentioned above, that they maximize their income by exceeding quota every quarter. Getting paid in the near term is an incentive too good to ignore.
6. The top 20% rightly will conclude they are being compensated at higher levels than the average and ordinary in the sales force.
7. Psychologically paying immediately following achievement has great motivating effect, especially if your sales force is highly driven for financial reward with near in gratification for their successes.

There are numerous variants, mutations and perturbations to this concept. While we cannot cover all of them here, nonetheless our purpose was to expose a very viable alternative in sales compensation that can be used to drive the sales behavior you wish. It is purely enterprise and situational dependent.

So the real question is can you use it? Before you try it, analyze the financial impact of the new paradigm, or for that matter any new sales compensation would have on the results of the enterprise. Determine if in modifying the plan you influence the type of sales behavior that contributes to your goals and objectives. Simply stated, at the end of the day, this plan or any other must coincide and contribute to the business goals of your organization.

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