The 5 Essential Drivers of Successful Sales Compensation Plans

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Consider this story:

> A sales person arrives in a small foreign country that is a new market for their shoes. Soon after arriving, he calls the office and says, "I'm returning home, there is no market here. No one wears shoes." Another sales person from a competing company arrives in the same country. After a brief time period, she calls her office to say, "Get ready for some big orders. The prospects are incredible. No one here wears shoes!"

There are many different perspectives of these two sales people. Some sales executives believe that the differences are because the sales incentive plan is not effective and needs to be redesigned. Other sales executives believe that it's all about sales skills, so hiring and training are key to success. And other executives believe the answer is in the sales strategy and organization. Each executive, faced with the situation outlined above would respond differently and none of them would be right, totally. The answer to an effective sales compensation plan exists in the interplay between the forces that influence sales behaviors.

This article will examine these perspectives with data from surveys the Wilson Group has conducted on sales compensation plans over the last several years. We collected data on the design of sales incentive plans from across several industries over several years, and have distilled the data to identify the best practices. Further, based on this data and our experiences in the assessment and design of hundreds of sales compensation plans, we have developed what we believe are the five (5) key elements of success. While the design factors may sound like common sense, they are seldom "common practice". Hence, it is very important for a growth oriented company to understand what best drives their growth and reinforce those elements that make a real difference on the actions of their sales people.

The drivers that make sales compensation plans work are the following:

1. **The sales compensation plan should fit with the business strategy and priorities.**
   Most companies want more revenue especially in high growth markets. The key question is "how" will growth be achieved? In our experience and survey analysis, we find that successful companies are pursuing a focused growth strategy that includes one or more of the following:
   (1) Increase the number of customers we have
   (2) Expand the revenues we receive from current customers
   (3) Introduce new or next generation products into the market
   (4) Secure alliances and strategic partnerships that leverage our capabilities

There are important implications for the measures and incentives one uses in these growth strategies. Further, the sales process, the steps needed to achieve the desired growth in sales, will differ fundamentally by the strategy the company pursues. Consequently, the sales compensation plan should be aligned with the strategy one pursues and the behaviors associated with its implementation.

Measures are the manifestation of the sales strategy and translate the strategy into action. For the different strategic imperatives outlined above, the following measure were found to be most effective:

Increase customers:	Revenues from new customers
Expand current customers:	Revenues and renewal rates from current customers
Introduce new products:	Revenues from new products/services
Secure partnerships:	Revenues from distributors, channels

2. **The sales compensation plan should attract the kind of people you need and reinforce the behaviors you want.**
   In this driver, we are concerned about the competencies of the sales person and the behaviors that are encouraged and reinforced. The compensation plan should enable you to attract the kind of talent you need/want not just by the amount of money but by how it is structured. The requirements for the sales person will be fundamentally different depending on the sales strategy. Our research shows an effective plan will have these requirements:

   - When the strategy calls to <u>increase the customer base</u>, you need “hunters”, those that are driven by building their referrals, pursuing new relationships and opportunities, and bringing the company’s products and services to as many people as possible. Depending on the sales cycle, complexity of the sale, a commission plan that is based on revenue growth from new customers, potentially with a bonus or bounty for number or type of customers acquired is the most effective model for this sales strategy.
   - When the strategy calls for <u>increasing the revenues from current customers</u>, you are looking for “farmers” that are highly effective in understanding and embedding themselves in the customer’s organization, so the customer sees your company as the primary source for what they need. The compensation plan should focus on increasing revenues from existing customers and/or the renewal of contracts that are revenue focused. If commissions or bonuses are used, the sales people should have clear customer centric goals.
   - When the strategy is based on <u>expanding products</u>, you are looking for “experts” who are deeply knowledgeable about the products and are looking for applications where your products or services can add significant value to the customer. The compensation plan is most likely a bonus plan that is tied to working with direct sales in the introduction and sale of one’s assigned products. Or, if you use general sales staff, the

plan should provide for bonuses, accelerators to commission rates or bounties for selling new products/services.

- When the strategy engages strategic alliances, you are looking for "network builders" who have business development capabilities. They see the strategic value of the alliance relationships and can effectively define the business synergy for both companies, and secure long-term contracts with your customers. The compensation plan may be a small commission on a large volume to distributor sales or a bonus plan tied to performance expectations of the vendor, distributor or channel partners.

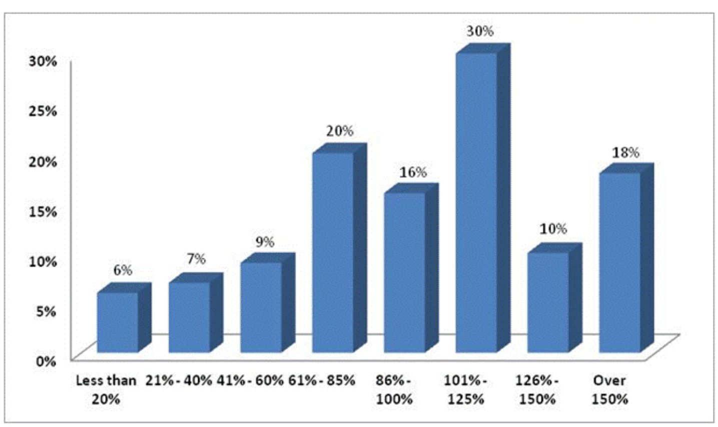
The important point here is the sales compensation plan should attract the kind of sales person that wants to earn their income or bring out the desired skills of current sales people consistent with the particular sales strategy.

3. **The sales goals should be challenging <u>and</u> achievable.**

There is much research documenting the relationship between goals and individual performance. Individuals who naturally seek to utilize and meet/exceed goals are more likely to be achievement oriented than individuals more focused on relationships, power or creative pursuits. Further, similar research shows that if people believe the goals are unattainable, they will ignore what goals the business sets and establish their own goals. Goals that are too easy are similarly not motivational. The key task is to find the right balance between goals that are challenging and achievable.

To understand the degree of stretch in your goals, examine the distribution of actual performance to the goals. In our survey research, most firms show that 60% of the sales people achieve at or above their goals. Further, only 20% of the sales people had performance that was well below the performance goals and approximately 20% were well above. If people are not achieving the desired goals, find out the root cause.

The following table shows the actual performance to sales goals/quotas:



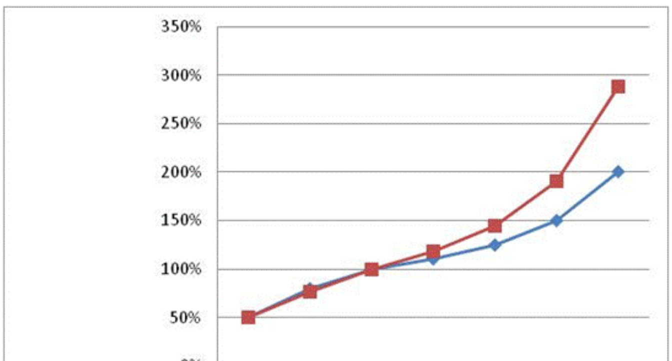
Source: Wilson Group 2013-2014 Survey Report on Sales Compensation Practices

4. **Payouts should be meaningful from both the company and the individual's perspective.**
The conflicts between the Sales and the Finance organizations are legendary. Sales executives usually seek to reward their top performers and retain their critical staff. Finance is concerned about protecting the company's margin and making sure sales people are paid appropriately for their performance. It is important that when senior management reviews the performance and pay of their sales staff, they believe they are getting a fair "return on investment". This means that if sales people had not been paid these compensation levels, the company would not have achieved the revenues. Concomitantly, the sales person needs to believe he or she is receiving an appropriate ROE – "Return on Effort." They need to believe they are receiving and will receive a payout that is fair relative to their sales effort and results. Our research shows that this perception of fairness is due in a major way to the mix of pay between salary and incentive.

The mix of the payout, between base salary and incentive opportunity, is the primary measure to determine the desired return on the investment. The table below shows the customary mix of sales compensation between the roles defined earlier.

Sales Role	% of Base Salary	% of Variable Pay
Hunter – Direct sales	0% - 50%	50% - 100%
Farmer – Account manager	40% - 60%	60% - 40%
Expert – Product sales	60% - 80%	20% - 40%
Developer – Channel manager	80% - 90%	10% - 20%

In addition, the use of sales commission accelerators is often a very important and powerful motivator of sales performance. Effective plan design principles and experience understand the relationship between the performance and the payouts or the "pay and performance ratio." In many companies, below quota or goal performance results in payouts that are similarly well below the target payout. Above target performance (from 125% to 200% of goal or quota) may result in payouts that are 2x or 3x higher that the target payout. The relationship in pay to performance should reflect what is meaningful to your sales people in relation to what challenges they face to achieve desired goals. This pay and performance relationship is depicted in the chart below.



	1	2	3	4	5	6	7
% of Sales Target	50%	80%	100%	110%	125%	150%	200%
% of Target Payout	50%	77%	100%	118%	144%	191%	288%

Source: Wilson Group 2013-2014 Survey Report on Sales Compensation Practices

Finally, most effective sales compensation plans do not have a cap on the earning potential. However, there is usually a “decision point” where the sales or company management is involved to determine whether the performance truly justifies a very large payout. These policies protect the company from overpaying someone for an order that was not truly of their making and yet enables the sales person to be rewarded extremely well when the results are exceptional. That number is usually between 150% and 300% of the sales target.

5. **The plan should be simple but not simplistic.**
   Companies in our survey research believe that one of the most important elements of the effectiveness of their sales compensation plans is how simple is the plan. They believe that the sales person should know exactly how they are paid and be able to calculate the potential income for signing a particular sales contract. This means that the measures are clear, track-able, and translatable into one’s payouts. It may take one or two years before a new plan is fully integrated into the sales process. It is clear that for a new sales plan, people do not tend to fully believe or understand the program until they receive their first pay check under the plan.

   The factors that create clarity are:
   (1) The level of communication one receives about the plan
   (2) How well they are able to receive feedback during the performance period
   (3) The ability to calculate their payout

   “Simple” is not based on some abstract or generally applicable set of standards, but in relation to what the sales person in the company or industry see as common practices. A “simplistic” plan is usually easy to understand but ineffective in encouraging and rewarding the desired behaviors or results; simple means that people understand and trust the plan. The best practice here is to have a plan where sales people have confidence that they will be appropriately compensated for taking the desired actions and producing the desired results. In this way, the company receives the growth in revenues, profitability and market share it seeks and the sales person feels well rewarded for what they accomplish.

These five essential drivers of successful sales compensation plans are not just about the design of a pay plan. These elements include what drives the behaviors and results, the “how” and the “what” of a company’s strategy in the marketplace. One cannot create a sales compensation plan without knowing the sales strategy and roles needed to make the company successful. The critical design of each element of the sales compensation plan is thereby dependent on what actual and desired results the company seeks to accomplish. A plan cannot be successful if people do not understand the plan or see how it aligns with their expectations for their own performance. Further, an organization with a clear strategy and highly talented people in the sales organization needs to have a mechanism to compensate them fairly and effectively. This paper has shown what will make this “system” work to its optimal potential. As one finds in teams and organizations, the business unit is only as strong as its weakest link. Let’s make sure that the sales compensation plan is a strong link.