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Give salespeople free range, but bound them by perimeters…prized herds and flocks roam within the fence line

By Harry Gray and Chad Greenway

The business world teems with a myriad of opinions regarding the best way to manage salespeople; yet, investors and managers essentially agree that individual agendas are impossible to eliminate in the world of sales management. Often salespeople conduct their business segregated from the core management team; this isolation can afford an opportunity to focus on accomplishing individual goals rather than on making the company successful. These situations may drive near-term gains, but almost always lead to longer-term profit margin erosion. From our experiences, one of the primary culprits for such misalignment is the sales commissions program. Used improperly, commissions are likely to undermine any sense of unity and common purpose in a business, often resulting in animosity, resentment and conflicts.

There are many successful salary-only sales programs, but commissions are the norm in most industries; and, for most salespeople they are a primary motivator. However, this incentive framework can sometimes sway salespeople to be in business for themselves. Unfortunately, many salespeople do not recognize the long-term threat of these conditions, but savvy sales managers and senior executives must not only design commission plans that drive sales, but also foster a team spirit and commitment to the company. Executives who establish and oversee the commission package for a company's sales force must balance numerous components to create a plan that both fairly compensates and adequately motivates the sales force. Ultimately, a plan should keep salespeople happy while supporting and advancing company goals. Alas, this fundamental is something not taught in college or business school. How does a company implement effective commission plans to secure one stable fence post in the perimeter used to bound and manage salespeople, while assimilating them with the core management goals of the enterprise? Generically speaking, whether a company delivers long-term contracted services or pushes high-volume, low-cost products, we have found a number of sound approaches and salient attributes commonly associated with robust commissions plan and the practices of its beneficiaries, including:

- **Firstly, if a fresh start is practical, engineer a mechanism with rules of engagement that drive behavior.** In the middle market, many plans fail due to issues such as territory imbalance, quota structures that do not plot well along a standard bell curve, and incongruence between performance and commission earnings. Whether the plan’s permutation is commission only, commission plus salary, commission plus bonus, or commission plus salary and bonus, certain ground rules cut across industries and provide a framework for engineering an effective incentive package. While the methods for creating a compensation plan vary widely and often reflect industry-specific standards, the more important rules include starting with the outcomes and behaviors the company wants to foster, as well as the prioritization of these behaviors. It is difficult to keep the incentives flexible so that they can evolve along with a company's goals, but in all instances the compensation plan must be understandable to everyone. Naturally, benchmarking competition should be a regular test for relevance. Universally, however, best practices in sales compensation plan design include, at a minimum, alignment with company goals (i.e., tailored focus on revenue, profit, new product introduction, new customer acquisition), definition of sales roles and a customer's buying process (i.e., hunter and farmer roles), and appropriate fixed/at-risk pay ratios for each role like territory rep, account manager, channel manager, and telesales rep, each position typically requiring its own compensation plan.

- **Step back, widen the lens and evaluate the full sales incentive plan.** At first blush, sales incentive plans (SIPs) are analogous to commission plans. More precisely, SIPs also incorporate sales metrics other than value of goods sold, which is traditionally how a commission plan is derived; a well-constructed SIP is a comprehensive business tool that aims to motivate and compensate salespeople to meet goals or metrics over a specific period of time, including quotas, new business opportunities and other objectives. SIPs govern incentives for salespeople where total dollars sold is not a precise measure of sales productivity, especially when the complexity or length of the sales process is noteworthy or where a sale is completed not by an individual but by a team of people. The SIP approach works well to encourage and compensate each member of the sales team as he or she contributes to the team's ability to sell, especially where the members of such teams are located in different physical locations and when product introduction occurs in one location and the purchase of such a product occurs in another location.

- **Offer a rich menu of tasty carrots…but be willing to use a stick.** Naturally, to retain top-level salespeople, the plan needs to be competitive and perceived better than that of the competition. Fortunately, numerous sources provide compensation intelligence. When people and resources are both scarce and expensive, every investment in salespeople must count. The sales force is a major growth engine for a company, as well as a critical source of market feedback, yet it is also a substantial investment—and one that can rapidly grow out of control. Stimulating the sales force while simultaneously controlling costs is the balance a company must achieve. Cost control is possible through applied disciplines such as analysis of sales calls, territory realignment, managing shifting product or market emphasis, reallocating salesperson time, and adjusting sales force size. Because a company must "pay up" for a competitive program, it must be selective on who participates over the long term.

- **Eliminate sales de-motivators…but embrace dashboards.** Par for the course in sales is that salespeople contend with numerous multi-directional pressure points thrust from the company, customers, personal lives, and ego. A positive attitude is essential to successful selling. Commissions seize upon Pavlovian instincts, so a compensation system that provides positive reinforcement must also yield reward immediacy—faster rewards yield faster repeat behavior. Furthermore, a company must be wary of structures that remove income for failure to produce, as these tend to foster fear as a short-lived motivator. While we prescribe efforts to remove environmental de-motivators, we strongly advocate the dissemination of dashboards that rank individual performances and incubate competitiveness. We have found that broadcasting individual and divisional performance through dashboards preys well on performance instinct, ramps the hustle factor, and elevates a team's aggregate success.

- **Implement a robust lead capture and dissemination program.** We recently launched an article on the importance of lead capture to eliminate sales leakage (see www.verto-partners.com to download). Notwithstanding this virtue, the design and implementation of an effective lead capture processes will also facilitate mediation between departments and resolution of common intra-sales disputes such as territory and customer allocations.

- **Salespeople…not production…should "own" the inventory.** Long ago, GAAP concluded that inventory is an "asset"; at times, this accounting interpretation proves to be a non sequitur. For instance, in manufacturing environments, management teams can generate "profit" by producing inventory and generating favorable manufacturing variances. In these instances, EBITDA looks good while finished goods stockpile…and inventory becomes a liability. A classic knee jerk is to hold production accountable for the resulting working capital imbalance. In these circumstances, while many hands are culpable, we believe that in most circumstances salespeople should "own" the inventory and be held accountable. After all, who submitted the budget that drove production?

- **To depersonalize the sale, evaluate down-streaming customer relationships and phased commissions bleed out.** For salespeople on commission, the customer represents security, promoting self-preservation that drives salespeople to embrace and nurture the personal nature of the sale process. When the customer base is highly concentrated, in particular, coziness between salespeople and customers can risk the integrity of the company-customer relationship. In the extreme, a departure could also result in a lost customer. One protective approach to lessen this grip is to have the salesperson and customer service representative share the management of the customer account. Another technique that can be deployed is the reduction of commissions over time, although tools should be in place to sustain high motivation to retain customers.

- **Leverage the power of perception by paying all employees the same way…but not the same amount.** Because of the role they play and the difficulty of the work they do, as they should, salespeople will always earn more than most other employees. Granted, however, many companies may want to reward members of the sales support team disproportionately through higher base salaries for length of service, experience or stellar performance. Notwithstanding the nuances of particular sales compensation, one subtle step toward getting all hands on the same team is to pay everybody the same way. This does not imply the same amount. Rather, this means establishing some link to an enterprise-wide compensation system. For sales, this means professionals receive a salary that is reviewed and adjusted annually, based on the performance of the company and the contributions of the individual depending on his or her responsibilities. If a company also pays bonuses, it needs to determine not only the percentage, but also if the bonuses are based on company-wide goals, individual goals or both. In any event, for at least one or two tranches of the sales force's compensation structure, this alignment with both the rest of the employees and the common enterprise-wide goals yields long-term dividends.

- **Limit field activities with ironclad pricing grids…and monitor backlog that is meaningful.** Pricing grids are authority guidelines that protect profits. Deviations from the grid, such as intentional loss leaders, should require specific senior management sign off. For simplicity's sake, most commission plans are calculated from a revenue base. In these instances, the grid is essential for reinforcing lower boundaries on promises to prospective customers. At the same time, smart multi-dimensional grids can drive the interim goals of the company, such as steering commissions at a different rate for third-party products, promoting services rather than products, or quoting from different hurdle rates ranging from contribution margins to fully-loaded SG&A-plus costing. Finally, if practical, monitor and manage to gross margin-based backlog. Where cash is king revenue growth is irrelevant when profits are lost? Unfortunately, revenue backlog can be replete with imperfections when costing or pricing controls are weak.

- **Properly onboard sales people.** Too few companies properly onboard new sales staff. Properly done, recruits (both rookies and seasoned pros) should undergo brief structured sabbatical time in other departments. Typically, companies locate salespeople in separate offices, hold separate meetings for them off-site, and treat them far more gingerly than other employees at performance review time. This venue is catalytic for festering of age-old finger pointing...the accounting people complain that the salespeople make special deals with customers, but do not inform the people who do the billing; meanwhile, the operations people complain that the salespeople make unreasonable demands, and so on. Because sustaining a physical connection to the corporation is difficult, these early cross-departmental indoctrinations prior to actual selling can be helpful in building inter-departmental goodwill and a connection to the enterprise.

- **Consider MBOs to drive enterprise-wide success incentives.** Even for salespeople, establishing management by objectives (MBOs) tied to the company's larger goals can help align the corporate interests with individual interests. To this end, as a discrete good measure, consider reprinting corporate goals in sales agreements to underscore a unity of purpose, sometimes including work objectives for additional clarity. Logically, we want them to focus on doing what is best for the company whether that means selling or working with other employees to solve a customer's problem or helping with collections or spending time on important projects that do not necessarily result in immediate sales. The end game is for salespeople, like other employees, to be rewarded both for the company's success and for their own contributions to it. On the softer side, salespeople can enjoy more personal time if they feel they can leave customers unattended while someone else on the team will handle any problems. In the right culture, they will enjoy the satisfaction of being part of a thriving company and the security of team coverage.

- **Revenues do not pay the bills, so disburse commissions as cash is collected.** Our team has actually worked with commission programs that pay upfront and in full for estimated total-contract-life revenues. As one can imagine, such a perverse incentive does not generally comport with other enterprise-wide best practices and fosters a "close the deal at any price" attitude. This can be catastrophic when increasing customer commitments dovetail with declining margin sales. In general, we advocate gap management that streamlines the commission stream with the accounts receivable and collections process.

- **Be wary of the double-edged quota sword.** It is natural for salespeople to want reasonable certainty that once the reward has been earned, no outside factor can keep it out of his or her pocket; this includes changes in the rules of the system, fluctuations in market conditions after the sale, and, most of all, subjective decisions by company management. A frequently-encountered commission system with potential to violate all of these rules is one basing the commission rate on achievement of a budget or quota set by management, rather than the sales person. When management has to persuade the sales force to "buy into" a quota, suspicions of surreptitiousness will arise; inevitably, perceptions that justly-earned income will not be realized, if they fail to achieve the quota, will surface. Trust will evaporate if the salespeople believe the company desired to increase profits by decreasing commissions. Moreover, this approach may correlate poorly with salesperson morale, since they must wait until the end of the quota-producing period to learn what they have earned for each sale. The longer the period—which frequently lasts three months or even a year—the greater the time between the salesperson's action and the reward for that behavior. Simply stated, delayed gratification de-motivates salespeople, as they are energized by the immediate fulfillment of selling, positive customer feedback, definitive completion of a long selling process, and closing the sale. Sometimes, in effort to smooth sales, management rolls out mid-period quota targets. In services industries, for example, the logic is to provide sales incentive to renew contracts well before expiration. Shortening the quota period to move the reward closer to the sale would seem to be the logical answer to this problem, but since it is impossible to figure out what an individual sale earns before the sales person works on it, the commission plan tends not to have a positive effect on their efforts. The other major disadvantage to interim period (we have seen monthly and weekly) quotas is that they tend to encourage quick-fix sales, which erode pricing standards. Even worse for many companies, short quota periods may discourage development of long-term relationships with larger accounts, which necessarily take effort over an extended period to achieve. Frankly, it is extremely difficult to focus a sales team on long-term goals when the size of the week's paycheck is set by today's sales. Finally, quota-based commission plans are almost never simple and they are invariably subject to forces outside the sales person's control. Plans such as these are strong de-motivators to the salesperson who misses the company-imposed deadline by a day or the quota by a dollar. The negative feelings are compounded when the shortfall is due to events like charge-backs or shipping delays, which are beyond the salesperson's responsibility. We understand that some selling environments necessitate quota programs, so management and investors should address these cautiously.

- **Test, document and automate the program**. Sales compensation plans are a combination of measures, mechanics, and policies. Management should set approximately three to four easily understood individual and/or team-based measures as appropriate for each role, and they should align selling practices with corporate sales goals related to margin, profitability, new customer acquisition and new product introduction. Too much complexity will be ineffective, and may even indicate the need to define yet another sales role. The mechanics determine how the measures are used in calculating commissions. Whether management designs rates that are flat, ramped or variable, the desired outcome must calculate intuitively even as performance thresholds, multipliers, and accelerators that may be applied as quota attainment increases enter the equation. The company should model its plans to evaluate the impact at both the macro (plan cost) level and the micro (individual earnings) level. It should also be confident that the plans fit within budget parameters and adequately reward top performers. Naturally, the underlying framework should be governed through clear and absolute policies for crediting, adjustments, liabilities and windfalls. To avoid surprises, scenario testing should be conducted by both the plan designers and the sales team. The plan must be easily understood and testing should yield the same numbers, regardless of the testing individual. The plan document will state the terms and conditions of the plan, but scenario testing of illustrative examples will demonstrate the science that went into designing the plan to the team. This cooperative effort will prove to salespeople that the plans are realistic, fair, and attainable. By all means, the company should maintain and centralize electronic and hard-copy records of each salesperson's signed acceptance of the plan document. Even in this modern era, it seems that spreadsheets are still overwhelmingly used in the calculating of sales commissions in most businesses. This is even more acute in small and mid-market businesses who cannot afford to build more robust systems. If possible, the company should automate plans with an affordable on-demand sales compensation management solution. These solutions eliminate spreadsheets and the errors associated with them, provide real-time visibility into attainment and earnings information for sales team, and provide finance with one centralized and secure solution for commission accounting. Quality plan design, coupled with efficient automation and frequent communication, will help the company attract, retain, and motivate the best salespeople. It will also provide the best path to optimizing sales effectiveness and performance with a balanced ratio of revenue to cost.

- **Only after performance is proven, explore the pros and cons of a "commission buyout" program.** We have seen companies "buyout" commissions in an attempt to stabilize the cost of generating growth and lock-in a good team. In these instances, after new salespeople demonstrate a few years of performance, the elite performers are offered a commission buyout and a salary raise. The spirit of these packages is for salespeople to be guaranteed good pay in good years; but, if the economy goes bad and they have some down years, they do not have to worry about a big drop in income. In effect, this is similar to a collar structure. The management pitch is that salespeople gain security because the company wants them in the game for the long haul. We believe that organizational culture must be uniquely strong for this to be most effective.

- **Finally, if growth acceleration depends on unusual efforts, align incentives with demand innovation.** Marketing should improve the selling environment and play a very important role in sales. Effective sales management often breaks down the selling process to increase the effectiveness of the discreet processes as well as the interaction between processes. The reality is that each selling opportunity at each enterprise lies on a continuum of numbers of people involved, necessary degree of face-to-face interaction, overhead, and through-put time, to name a few dimensions. When salespeople spend too much of their time preparing customer-facing deliverables and leveraging too few of the materials created by marketing, this fuels mutual perspectives that marketing is out of touch with the customer, and sales is resistant to messaging and strategy. This phenomenon exacerbates in periods of growth stagnation. To thwart stagnation, some innovative companies have successfully deployed "demand innovation" techniques to achieve new growth with the same product and the same customer by addressing the issues and hassles that surround their product, instead of investing in an improved product or finding new customers. Beginning with the strategy development process, and eventually linking to the goals and milestones of the marketing and sales plans, the company must anticipate the next-generation needs of their customer, as well as identify hidden opportunities for growth (i.e., unique customer access, technical know-how, unique window on the market, etc.). By connecting the next-generation needs of the customer with their hidden assets, demand innovation can create new value for the customer. Only a coordinated effort by both marketing and sales can catapult the company ahead of its customer's proprietary internal thought leadership process and steer them successfully toward satisfying their high-order goals. Any dysfunctional breakdown between marketing and sales must be patched. At the same time, because sales commissions can warp the incentive to build long-term strategic value, especially when growth seems impossible, management must think critically about the alignment of commissions with demand innovation as a growth strategy.

In the final assessment, keep things simple and do not fix what is not broken. A commission plan must be easy for salespeople to understand and reward the single highest-priority behavior the company wants repeated. Any one compensation system cannot reward the actions that produce very different results. To this end, be sure that the compensation system sends the exact message the company wants the salespeople to receive. Salespeople need to know--as precisely as possible--what the rewards are going to be. The compensation system, therefore, needs to be simple, clearly stated and documented. Lastly, with such a critical driver of the company's lifeblood, seeking third-party expertise in this functional niche may be money well spent, even if the byproduct is only a validation of the existing program.