"Effective Sales Compensation Strategies & Programs"
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Sales compensation is "different" than compensation for other people, if you listen to most members of sales management. And that, they would tell you, is why they do not want the Human Resources/ Compensation function involved in the formulation of strategies and the design and administration of sales compensation programs.

Their rationale makes some sense, since in order for one to design sales compensation systems that fit the specific context within which they must operate, the designer must intimately understand the products (goods and/or services) offered, the customers they are offered to, the sales processes utilized, what role each sales job plays and what and how competitor organizations pay their sales people. That is a great deal to ask of an HR practitioner and indeed most do not have that kind of detailed knowledge. On the other hand, how much and how sales people are paid has an impact on the rest of the workforce… people do talk and they love to talk about how others are paid. The relationship between sales and non-sales personnel becomes even more intertwined at the management levels and it is therefore in the best interests of HR management to be concerned about what the sales function does.

It will be suggested in this paper that designing effective sales compensation programs utilizes the same principles that determine the effectiveness of non-sales personnel compensation programs, leading to the conclusion that skilled and knowledgeable HR practitioners have much to offer when sales compensation is the subject. On the other hand, it will also be acknowledged that sales programs should and do differ dramatically across industries and even across companies within the same industry… because the specific contexts within which the programs operate differ. That is, companies selling software packages may have very different approaches due to differences in market share, brand prominence, marketing niches, nature and diversity of products, customers served and the role of the sales representative in making a sale. As a result, it seems that sales management has much to offer as well. The logical conclusion is that sales management and HR should work together to develop strategies and design programs for compensating the organization's sales personnel.

Because the performance metrics associated with sales are often quantitative and easily agreed to (e.g., more sales = good performance) one would think sales compensation programs would be relatively straightforward. Yet sales compensation programs are often diabolically complex. One reason is that those designing them want to be sure every detail is considered and that no one can "beat the system." It would seem there is a suspicion that people who perform sales work have but one mission in life: to get money they did not earn. And there is an associated belief that the only thing sales people care about is money. None of this is completely true, of course, but these suspicions cause sales compensation programs to be in a continual state of revision.

This paper will explore how HR and sales management can work together, each using its own knowledge and perspective, to develop effective sales compensation strategies and programs.

Developing A Sales Compensation Strategy

The first step in creating an effective sales compensation system is to develop a strategy that is derived from the objectives of the organization and its business strategy and that is a good fit to the context within which the organization operates. The context is a function of the external environment and the organization's internal realities, which include its culture, its resources and its structure. Often the requirements for organizational success dictate the importance of sales. A monopoly with no substitutes for its products may view sales as automatic and requiring no special effort. An organization selling a product that is a commodity, with many competitors, may view sales as its primary focus… its ticket to survival. How important sales are to an organization will determine the resources committed to generating sales and the amount of attention paid to how much and how sales people are compensated.

Given these realities it is necessary to define the context within which sales activities are performed and to formulate a "good fit" sales strategy. The context is defined by a number of considerations:

1. *the nature of the product(s)* the organization has to offer in the market: the economics associated with it; its competitiveness with others providing it; the existence of substitutes; brand recognition and strength; current market share
2. *the nature of the customer:* the needs and priorities of potential buyers; the image of the product with prospects; economic ability of prospects to afford it; value of the product to customers; existing customer loyalty; significance of product relative to customers' total purchases
3. *the nature of the sales process:* typical timeframe; sales channels; role of various sales and support personnel in making the sale; points of contact in customer organization;
4. *the nature of the labor market;* how much and how competitive organizations pay; the supply of the needed knowledge/skills; the demand for critical knowledge/ skills; current and evolving competitive conditions in the industry.

While all of these are important considerations understanding the role of sales personnel is perhaps the most critical. In some instances, the "sales representatives" serve as relationship builders and conveyers of product information (e.g., pharmaceutical reps calling on doctors). In other situations the representative <u>makes</u> the sale (e.g., door-to-door encyclopedia sales personnel). With the advent of new technology many sales personnel never see the customer (e.g., outbound telemarketing reps), while others practically live with the customer over extended periods (e.g., reps selling enterprise-wide IT systems).

Given the wide range of variability in the role played by sales personnel it is typically folly to attempt to mimic what other organizations are doing with the sales plans. Certainly a program designer must be aware of the compensation levels offered by competitive organizations, to ensure the program will attract and retain the quality of personnel required for success. But 95% of getting it right is understanding the role played by sales personnel and the significance of that role. Once that is understood the organization can determine what would constitute the ideal package of behaviors and results expected of the sales personnel. And that is the true key to the design of effective sales compensation strategies and programs.

Typical activities of sales personnel normally fall into the following two categories:

Direct selling activities:

- Identifying/qualifying prospects
- Building relationships/contact networks
- Making sales calls
- Developing and presenting proposals
- Taking orders

Support activities:

- Researching market demand
- Working conventions/trade shows
- Handling inquiries and expediting orders
- Resolving customer complaints
- Presenting new products and promotions
- Training customer personnel in the use of the product

Once the role of sales personnel is fully understood it is also critical that the staffing and development strategies are appropriate, since compensation is not the sole determinant of success. If the wrong people are hired and/or if they are not developed well the best compensation program will not produce the desired results. Therefore, once the role of the sales staff is defined it is critical to identify what they do and the knowledge, skills and abilities required to do it well. Exhibit 1 incorporates the major theories about motivation and satisfaction and proposes that there are four pre-requisites for performance. They apply to both individuals and to groups, and to both sales and non-selling personnel. The exhibit also specifies the requirements for success and mandates that HR programs that must be appropriate for the context in order for people to perform well. The relative importance of these activities should be a key factor in what the sales compensation strategy will be. The degree to which the sales representative is in control of results will be the principal determinant of the mix between base pay and variable pay. The criticality of the sales force in generating the required revenues will have a major impact on how competitive the compensation package will be. The degree to which a group effort is required will influence the level at which performance is measured (individual vs. group). Finally, the economics of the sale will dictate how much of total sales can be paid out in the form of sales compensation.

Defining The Roles Within The Sales Function

The compensation strategy must fit the design of the sales function and the roles within it. For example, if all sales reps do all of the aforementioned activities one mix of base and variable may be prescribed. If the roles are split and sales reps only do direct selling activities, while others do the sales support work, a very different mix of base and variable may be prescribed… and the mix will probably differ between those doing direct sales and the support people. In many organizations the increasing complexity of products has resulted in the creation of sales teams, with direct sales, sales support and technical personnel populating them. This structure may result in yet another type of mix, and a need for rewarding group as well as individual results may arise.

Another key issue is whether there is a career path for sales reps, consisting of skill and knowledge levels. For example, Engineers and Accountants are typically classified into occupational ladders, with levels from "rookie" to "expert" being used to administratively acknowledge growth in individual competence. Some organizations use the same methodology to classify sales representatives, based on the principle that more experienced and accomplished reps are capable of contributing more and therefore command higher salary levels. The most common manifestation is a sales ladder, which consists of an Associate (trainee) level, a Representative (accomplished) level and a Senior level. Each level is in a different grade (if the sales people are integrated into the organization's salary structure) or at least have a different salary range. When this approach is used salary administration can be a traditional pay for performance system, with promotional progression handled much as it is in the rest of the organization. However, many organizations view all sales reps as being volume producers and choose to use variable pay potential to encourage people to develop and to perform at high levels. This latter approach is more reasonable when the sales rep has very substantial control over sales results, while the former would better fit the previously mentioned pharmaceutical sales reps who are primarily disseminating product information and communicating research findings on new products.

It is very possible that both of these approaches would work in an organization where some of the sales personnel are focused on direct sales while others are focused on support work and market development. It should be noted that sales management will often question the need for multiple systems and may be reluctant to implement performance appraisal programs, salary administration guidelines and the like. It this is the right thing for the organization to do HR can play a significant role in defusing the tension about the feasibility of such programs and can help sales management in the training, communication and administration associated with this approach.

Mix Of Base and Variable Compensation

Exhibits 2, 3 and 4 describe three mix profiles for the total sales personnel direct compensation package. Exhibit 2 is an "all base pay" strategy, which is best suited for a sales role that is primarily made up of activities that fall under the heading of sales support. Exhibit 3 is the other extreme, consisting totally of variable pay, and logically is most suitable for sales personnel who have total control over the amount of sales generated. Exhibit 4 is everything else in between the first two approaches. The variable portion of the third option can be in the form of commissions, which are incentives directly tied to sales volume and/or incentives (often called bonuses) that are tied to predetermined criteria and standards or that are rewarded after the fact for performance viewed as meritorious.

There are few organizations that use an all salary approach for true direct sales personnel. Some retail establishments pay floor personnel on an hourly or salaried basis, but it is difficult to call what they do direct sales work… the term "sales" implies persuasion and influence being applied to achieve an end result. Although pharmaceutical firms often pay newer "sales representatives" on a salary only basis their work would typically be termed sales support. This is not to rule out an all base pay package as being viable, but it will be assumed throughout the rest of this paper that direct selling activities argue for some form of financial incentive. If a role involves no direct selling activities it may be wise to call it something other than "sales" (e.g., customer service), since the sales label may encourage employees to make comparisons to market or to others within the organization that are not appropriate.

Correspondingly, there are few organizations that pay sales personnel totally in the form of variable compensation if they are full-time regular employees. Even if it is called a "draw" there is usually some weekly/monthly payment made on a regular basis and this payment is often the safety net sales personnel rely on when economic conditions are poor or when they are ill or taking time off. Again, this is not to rule out an all variable pay package, but only to suggest that the specific context should argue strongly for this approach before it is used.

The base/variable combination approach can come in an enormous variety of flavors. As already mentioned, the variable component can take the form of commissions, which vary income in direct relationship to sales volume. Typically a formula is used, which most often calculates earnings as a percent of sales, a percentage of sales over a specified threshold amount, or any number of different percentages that apply to sales in specified volume brackets (e.g., 2% of the first $ 200,000 of sales, plus 3% of the next $ 200,000 and 5% of all sales over $ 400,000). An increasing percentage is a recognition that as sales volume grows each incremental sale becomes more difficult. It may also be that additional sales are more profitable, since the employee has already covered their fixed expenses and therefore the net realized is greater for additional dollars of sales.

It is very common to set a "breakeven threshold" figure below which no commission is paid. If a territory is expected to produce $ 2,000,000 in sales the threshold may be set at $ 1,500,000, indicating that this is the absolute minimum expected and that below this level the rep has not even earned the salary paid and/or covered the expense of maintaining a rep in the territory. Once the threshold is exceeded commissions begin to accrue.

Commission rates may also vary based on the product sold and/or the customer the product was sold to. If a new product is a difficult sale, due to a lack of brand recognition, it may be necessary to offer a higher commission rate so that sales reps will devote an adequate amount of time and attention to get it off the ground. If new customers are harder to sell but are needed for future success it may be prudent to offer a higher commission rate than exists for sales to existing customers. Finally, if some products are more profitable than others the economics may both allow and warrant a higher commission rate.

Incentives or bonuses can be used in lieu of or in addition to commissions. Incentives are rewards based on pre-determined criteria and standards, while bonuses are determined after the fact, often on a discretionary basis, or for specific activities. Bonuses may be paid for actions that may or may not generate immediate sales, such as making new product presentations or achieving a high customer satisfaction rating. Sales functions also run contests, which are aimed at producing a specific result in a specific time period (e.g., generating the most new customers for a new product in a 60 day period). Particularly in competitive situations sales personnel encounter considerable rejection and it is often prudent to use contests and specific incentives to get their adrenalin levels back up or to focus them on doing something that might not produce sales in the short term… contests can offer a quick dosage of energy and can provide a very specific focus.

It is often preferable to base earnings on more than one performance measure. Exhibit 5 illustrates three options. The first two identify volume and productivity as the two critical measures and put the rewards schedule in the form of a matrix. The first matrix has the two factors weighted equally, while the second weights volume more heavily. The third adds sales to new customers as a third factor and rewards volume with additional earnings. Since there seem to be an endless variety of results that an organization might want to reward it is helpful to identify the tools that are available and to list those that might motivate specific results. Exhibit 6 gives examples of rewards that can be used to address specific objectives.

Unfortunately many sales functions enter a state of turmoil each year when setting sales quotas, determining commission schedules and devising bonus and incentive schemes. Even more regrettably some never come out of that state. Each sales person is concerned about the relative difficulty of the quota, the fairness/competitiveness of the commission rates or incentive/bonus formulas and the amount of support (product quality/diversity, advertising, sales materials, expense budgets, etc.) that will be forthcoming. This is natural and concern about equity and competitiveness is common to all employees. However, due to the numerical metrics used in sales compensation, everything seems very specific… and specific measures beg debate. There are debates about the relative attractiveness of territories or product lines and sales reps are very focused on comparing their "deal" to that of the others within the function. But the sales reps are also in constant contact with their counterparts from other companies and heresay (e.g., about what others make) is inevitably exchanged. This is not unique to sales personnel but it is usually much more pronounced than for other occupations.

Determining Competitive Position Relative To Market

If an organization is to be able to attract and retain high caliber sales personnel it must provide a competitive compensation package. Depending on the nature of the labor market other items such as employee benefits may also be critical, as might the availability of a company car and the policies governing sales expense. It is important to consider cars and expenses, since they can represent remuneration in a tax effective (or tax free) form, increasing their perceived value. Sales expenses are often a significant factor in determining the profitability of a sale… fancy dinners and golf outings at a private club can quickly dissolve the benefits of the resulting sales. There are many approaches to controlling expenses, the easiest of which is not to reimburse them. This may not be appealing to the sales person, however, and by not incurring any expenses they may lose sales that might otherwise be had. Real estate brokerages typically forgive a given percentage of commissions to cover advertising a property, meaning that a rep who sells a lot per dollar of advertising is compensated better than one who beefs up the Real Estate section of the Sunday paper every week.

Attempting to determine how competitive the sales compensation package is through the use of market surveys can be devilishly difficult. Surveying salary and variable compensation levels separately brings into question what a salary is. For example, if a competitor cuts a check for all sales reps for $ 3,000 every month as if it were a salary, but requires that this amount be covered by a given level of sales, should this be reported into the survey as a salary or as a draw? Because of this imprecision in measurement, many surveys do not even attempt to make the distinction and only report direct compensation earnings. This creates its own problem, since it still begs the question as to what a competitive base and variable mix is. Obviously most sales personnel would welcome a very high base salary as long as there is still a large upside opportunity achievable through variable compensation, since they are protected against the downside associated with economic downturns and yet prosper in the good times.

Surveys that only measure total direct compensation without attempting to differentiate between base and variable portions will often add a section on program design, that gets at what is earned under multiple outcome scenarios. For example, the author conducted a software industry sales compensation survey for several years. The survey asked what the threshold volume was (the point at which the employee had earned the salary/draw) for each product type and then asked what earnings would be at a number of higher sales volumes. Needless to say, this not only requires a great deal of effort on the part of the surveyor but it requires that the participants know the compensation plans in detail. Referring back to the sales management vs. HR issue discussed at the beginning, it is often HR that is reporting into the survey but it is sales management that knows the details of the sales plan, creating a dilemma (or, God forbid, estimated data being reported).

Critical Administrative Issues

No matter how well an organizations formulates the sales compensation strategy and designs the programs, success will be dependent on effective implementation, sound administration and continuous evaluation of the results they produce.

Implementation: Effectively communicating the objectives the organization wishes to achieve, the methods and processes to be used and the role of each of the involved parties is critical to success. Training people to discharge their roles allows the communicated intent to be translated into a reality. If sales managers will be doing performance appraisals on sales personnel for the first time the training challenge is significant, since a new dimension will have been added to the manager's role. HR can contribute significantly to ensuring the training is appropriate and adequate and every effort should be made to ensure HR is involved. Evaluating current managers against any new role requirements may indicate some of the incumbents will not make it in the new context, or that they will make it only with the help of extensive training. If the strategy or programs are new or substantially modified it may be wise to pilot them, or at least use historical data to ensure they will produce the desired result under conditions the organization experiences. Sales personnel do not like their compensation package to be subject to frequent and major overhauls any more than other employees, so it is prudent to take every step to ensure the new approach will be successful.

Administration: How well the day-to-day details of administering sales compensation programs are handled will go a long way to determining their impact. Although the data is dated the author several years ago discovered that sales compensation suits were one of the most numerous types of civil legal actions in the US. Since sales compensation plans are often very contractual in nature how well they are administered can have a significant impact on an organization's exposure to legal liability. And the degree to which they produce satisfaction among sales personnel will also impact the organization's ability to retain good performers, which impacts the expense associated with unwanted turnover.

Defining when a sale is a sale and whether returns or accounts that are not collectible are charged to a representative's earnings are administrative issues that are the source of most of the conflict between the organization and the sales person. Often the allure of making a sale results in a rep booking a transaction that "will not stick." Selling to an account that is unlikely to pay the bill is an issue that should be dealt with by the organization's credit function, but decisions are rarely clear-cut. And often the rep gathers the information on the account, opening the door to distortion of the facts, whether it is intended or not. Overloading an account in December in order to make the annual quota, even though a return is almost certain to occur, is an act that is difficult to detect in advance and the rep may be the only one with all the facts. Therefore the administrative policy that determines whether a sale is compensated when the order is written, when the product is provided, when the order is invoiced or when the money is collected is a very key one and it should be consistent with the realities faced by each organization.

Another administrative issue is whether a rep is given any price discretion. If there is no flexibility in the pricing a rep who is in the field with one chance to make the sale often feels that a less profitable sale is better than no sale at all. But the rep also lacks the broad perspective necessary to realize the impact of a single price reduction on the treatment of all other accounts and the behavior of all other sales reps. Often a policy is formulated by sales management that establishes prices, but that also allows consideration of the specific circumstances, and with the proliferation of communication technology the ability to get an instant answer on a potential concession has been greatly facilitated.

An associated issue is whether "supplemental payments" can be arranged for the party responsible for making the purchase. In some countries it is accepted practice to make payments to facilitate the transaction, while in the U.S. this is often illegal, or at least inconsistent with the organization's code of ethics. This issue has become difficult when reps find their competitor's are not similarly restricted and that failure to engage in the practice will surely cost them the sale. The answer to this dilemma is dealing with it in advance, by establishing global principles that govern how the organization does business… and how it does not.

How often incentive earnings are calculated and paid out is an issue important both to the organization and to sales personnel. Timing varies from monthly to annually and the option used should fit the sales cycle. A shorter determination period is typical when the base pay levels are low, when the sales cycle is short and when significant earnings variation across payment periods is acceptable.

One of the most emotional issue is whether sales compensation is "capped." If a sales rep makes as much as the Director (or even the CEO) it is certain that the event will prompt considerable discussion. The culture may accept this result, and even celebrate it, but it is very important to anticipate the reaction before the event is allowed to materialize. Behavioral scientists will argue against maximum earnings limits on motivational grounds but they are rarely the ones who have to deal with the results when extreme variations occur. If uncontrollable windfalls or cave-ins can cause compensation levels to vary wildly it may be prudent to anticipate this and to build parameters into the program design.

Evaluation: Sales compensation programs age and often do not do so gracefully. The rate of change in today's environment requires that organizations continuously evaluate effectiveness and whether its strategies/programs continue to be appropriate. The balance between sales volume and profitability is apt to change for a product throughout its life cycle, since market share is often a dominant consideration for a new product, while profitability may become the key measure when the product is established. The measures that drive sales compensation will decide which measures reps pay attention to, so continuous evaluation, adaptation and communication become pre-requisites for continued effectiveness.

Compensating Sales Support Personnel

Given the increasing complexity of products and customer needs the direct sales representative may often lack the technical knowledge needed to close the sale single-handedly. It is increasingly the case that Engineers, System Designers, IT Analysts and others play a significant role in preparing sales proposals and even whether the organization can respond to a customer need. Often these people spend long hours shoulder to shoulder with the sales representative making the sale possible and then see the rep off to the luxury car dealership to celebrate the financial benefits she/he will enjoy (alone). There may also be customer support or administrative support personnel in the regional sales office that make it possible for the rep to be effective and it is increasingly common for these people to question why their economic fate is not in some way tied to the sales they contribute to. This is always a difficult issue to deal with, since once others start being rewarded it is difficult to decide where to stop. It is, however, a very important issue for an organization to think through and to deal with.

Compensating Sales Management

The manner in which sales management personnel are compensated is just as critical as how direct sales representatives and support personnel are compensated. Those from the simplicity school of design often suggest adding up the results of the subordinate personnel and having that drive the compensation of the manager. This may in fact work in situations where the manager whose principal job is to make decisions on how to deploy the reps, how to allocate territories/customers and to monitor the activities of the reps. In situations where the dividing lines are clear relative to geographic territory or product lines offered the "add it up" approach probably is well suited to the first and perhaps second line of management (e.g., district and regional sales managers).

When developing a compensation strategy for senior sales management jobs it is often necessary to recognize that other responsibilities and objectives are an important part of the role. As a result, it often makes sense to treat these jobs more like the managerial jobs in other functions. The top sales executive in most organizations has at least a portion of their direct compensation contingent on the performance of the organization and/or the performance of the sales function defined by factors other than just volume or profit. When equity programs such as stock options are utilized eligibility is often determined by organizational level and sales management (at least at the senior levels) will typically participate, thereby broadening their focus.

Issues Associated With "Going Global"

When sales occur outside the U.S. and/or sales personnel are from other countries the impact of cultural differences should be considered when designing sales compensation programs. The culture prevailing in this country results in a propensity to focus on individual results and to apply one set of rules for everyone. Although few would change this culture, given the economic success it has produced, some would suggest moderating it or questioning the assumptions underlying it. If sales people are the free agents they are often thought to be, paying them based on what they sell makes a great deal of sense. The approach will probably be consistent with the way their role is defined and they way they work. However, if the organization sells its product in countries with very different cultures it is wise to consider how the sales compensation strategy works in those countries. Asian and Latin cultures tend to be more collectivist in nature and people there may believe it takes everyone to make a sale, thereby rendering the "reward only the hunter who fired the shot" strategy inconsistent with their beliefs.

It is not only respectful to consider the culture of the employees, it also may be economically prudent. If individually based incentives keep employees with great potential from performing as well as they could because they do not want to stand out from their peers one has to question the wisdom of pushing a philosophy that produces the wrong result. It may come to abandoning the “one best way” approach and allowing for local customization, as long as it is consistent with global principles.

Conclusion

Formulating sales compensation strategies, designing programs, implementing and administering programs and evaluating strategy/program effectiveness should be a joint effort, with sales management and HR each contributing. Their perspectives might be somewhat different, with sales management focusing on business results and HR focusing on sound, legal and defensible systems that can be reconciled, if not integrated, with the systems used for other employees. The sales function often operates more independently than do other parts of the organization, but HR must be concerned with the impact of what that function does on the rest of the organization. If a sales rep sues the company for breach of contract or discriminatory treatment it is not a lot different for HR than it would be if it were an Engineer or a Production Assembler filing the suit. High turnover or significant employee dissatisfaction can also harm the effectiveness of the organization no matter the job titles of those involved.

Exhibit 1

Impact of Human Resource Strategies/Programs on Performance

Prerequisite	**HR Initiatives to Facilitate**	**Needed for Individual Performance**	**Needed for Group/Org. Performance**
ABLE TO DO "IT"	Selection Placement Development Role/Job Design	Right persons hired People utilized well Training adequate/timely Resources adequate Role design appropriate	Interpersonal and conflict management skills developed Necessary knowledge exists within the unit Processes appropriate
ALLOWED TO DO "IT"	Culture Role/Job Design Nature of management	Permission/support for exercising appropriate autonomy Resources adequate Role design appropriate	Group structure appropriate Individual roles clearly defined Roles integrated/not conflicting Management oversight appropriate
WANTS TO DO "IT"	Rewards Recognition Culture	Rewards tied to performance Behavior and results are both appropriately rewarded "Heroes" are high performers Intrinsic satisfaction provided	Competition at individual level does not drive rewards Performance criteria/standards not in conflict with norms/values People experience intrinsic satisfaction from group success
KNOWS WHAT "IT" IS	Vision/mission Culture Performance criteria Objectives Management communication	Clear direction Values stated Objectives clear Performance criteria and standards accepted by all parties Communication channels open and feedback provided continuously	Clear direction Values stated Objectives clear Performance criteria and standards accepted Communication channels open and feedback provided continuously

Exhibit 2

"Base Pay Only" Package

<u>Characteristics</u>

- representatives paid salaries, administered in same manner as for other personnel
- sales results considered by using as a factor in appraising performance of representatives

<u>Advantages</u>

- employees are paid on same basis as all others, precluding feeling of "special treatment" or separatism often experienced
- income is reliable/predictable and costs are known in advance
- different types of sales representatives (technical assistants, account servicers, etc.) can be utilized without producing large income differences or "what's in it for me" reactions
- promotes identification with company and simplifies reassignment to different territories and product lines
- makes it easy to assign non-selling/missionary work

<u>Disadvantages</u>

- income is not tied to sales results, lessening motivation to sell
- encourages overemphasis on products easiest to sell
- best performers under-compensated relative to reps performing at lower levels
- compensation costs are fixed and do not vary with revenues

<u>Best Applications</u>

- when selling process is long and involves multiple contributors
- when support/missionary activity is significant portion of job
- when personnel are rotated in and out of selling force
- when product features or other factors are responsible for sale (only product available, market position dominant, stable customer base, high barriers to market entry, etc.)
- predominance of house accounts; other accounts are "nice to have"
- when it is desirable to have costs fixed and known

Exhibit 3

"Variable Pay Only" Package

<u>Characteristics</u>

- no salary; may be a "draw" against future commissions
- commission computed as percentages of sales, gross profits, number of units, etc., according to a formula

<u>Advantages</u>

- easy to communicate and administer

* requires no forecasting

- commission can be varied by territory, product sold, new vs. existing customer, etc.
- expense control; compensation level tied to results
- can be paid on any schedule (monthly, quarterly, annually)

<u>Disadvantages</u>

- no protection against excessive payments unless "cap" is used to limit earnings
- no protection against loss of income during slow sales ("draw" may provide short-term income continuity)
- rewards only sales, no credit for support activity or "investing in the future"
- creates different set of pay practices and raises equity questions by other personnel

<u>Best Applications</u>

- company feels no obligation to provide guaranteed annual wage (may be seasonal product, part-time personnel, etc.)
- "reps" or other non-employees are used as a sales force
- high variability in income is acceptable (no concern about supervisor/subordinate earnings relationships)
- there is no mobility between direct selling jobs and other jobs in the organization
- there is a high variable market demand and/or customer base

Exhibit 4

" Combination Base Pay Plus Variable Pay" Package

<u>Characteristics</u>

- salary only is paid until some quota or target sales figure is reached
- beyond the target, total direct earnings increase, according to a pre-determined formula

<u>Advantages</u>

- requires certain level of performance (to earn salary) before income begins to vary and costs increase
- quotas/targets can be set at different levels by territory and can be individual or group targets
- can be integrated with sales management and support compensation programs to produce equitable pay relationships

<u>Disadvantages</u>

- good forecasting is necessary (must determine what level of sales "earns" salary)
- salary portion of compensation is a fixed cost; if set too high rewards below standard performance
- fixed costs (salaries) reduce funds available to discriminate between high and low levels of performance

<u>Best Applications</u>

- relationship of compensation with other personnel is important (considerable mobility in and out of sales jobs)
- significant portion of job is sales support (need to elicit multiple behaviors)
- substantial amount of income must be guaranteed in order to attract and retain personnel

Exhibit 5

Alternative Strategies For Using Multiple Performance Measures

Alternative 1: Two Performance Factors; Equally Weighted

	Net Profit After Selling Expenses		
Sales Volume	***Threshold***	***Target***	***Bullseye***
Threshold	**100% of target**	**150%**	**200%**
Target	**50%**	**100%**	**150%**
Bullseye	**0**	**50%**	**100%**

Alternative 2: Two Factors; Volume = 75%; Profit = 25%

	Net Profit After Selling Expenses		
Sales Volume	***Threshold***	***Target***	***Bullseye***
Threshold	**150% of target**	**175%**	**200%**
Target	**75%**	**100%**	**125%**
Bullseye	**0**	**25%**	**50%**

Alternative 3: Added Bonus For Sales To New Customers

Sales (Quarter)	Added Bonus
$ up to 50,000	2% of sales
50-100,000	3% of sales over 50k
over 100,000	4% of sales over 100k

Exhibit 6

FITTING SALES COMPENSATION PLAN DESIGN TO ORGANIZATIONAL OBJECTIVES

OBJECTIVES	POSSIBLE PLAN DESIGN FEATURES
EMPASIZE SPECIFIC PRODUCTS	A. HIGHER SALES CREDIT PER $ OF SALES B. HIGHER INCENTIVE ON PRODUCTS/SERVICES C. CONTEST FOCUSED ON PRODUCTS/SERVICES
ENCOURAGE SALES TO NEW CUSTOMERS	A. HIGHER SALES CREDIT PER $ OF SALES B. HIGHER INCENTIVE ON NEW ACCOUNTS C. SEPARATE BONUS FOR EACH NEW ACCOUNT D. BONUS FOR PRESENTATIONS TO PROSPECTS E. CONTEST FOCUSED ON NEW ACCOUNTS
CONTROL SALES EXPENSE	A. BASE INCENTIVE ON “NET” (SALES-EXPENSE) B. DEDUCT EXPENSES OVER ALLOTTED LEVEL C. DO NOT REIMBURSE EXPENSES
PROMOTE CROSS-SELLING AND OTHER JOINT EFFORTS	A. ADD SALES CREDIT FOR GROUP SALES B. SPLIT SALES CREDIT BETWEEN REPS C. CREDIT SALES TO ALL CONTRIBUTORS D. AWARD “REFERRAL” BONUSES E. SEPARATE GROUP INCENTIVE PLAN
DEVELOP SKILLS AND EFFECTIVENESS OF SALES FORCE	A. PROVIDE TRAINING B. GIVE “PROMOTIONS” TO MORE SKILLED C. REIMBURSE/REWARD ADDED EDUCATION D. PROVIDE RECOGNITION AWARDS E. MAKE MANAGEMENT AVAILABLE FOR JOINT SALES CALLS AND FIELD SUPPORT