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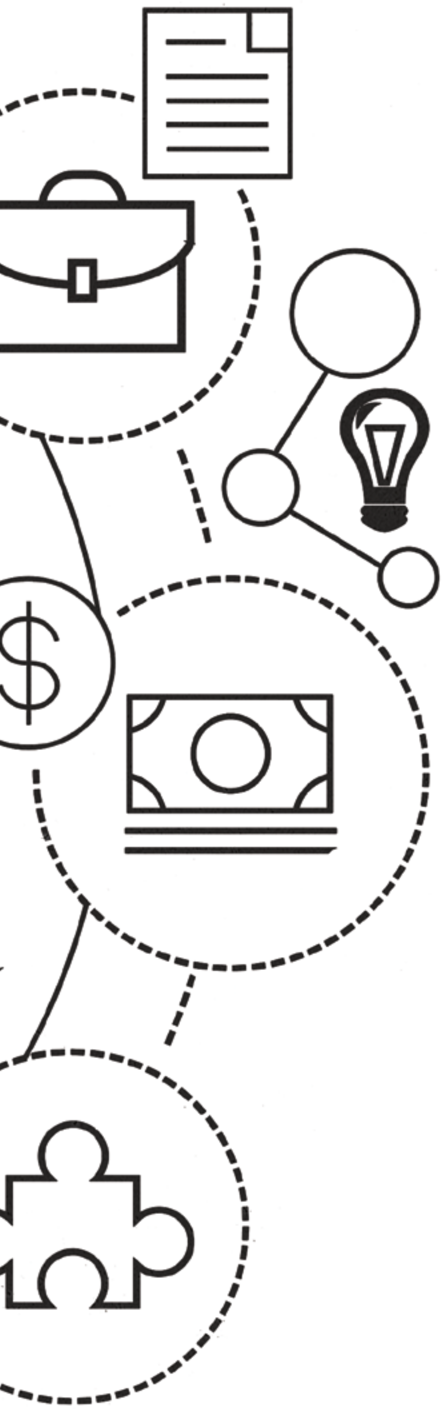
SALES COMPENSATION



How to Evolve Plan Designs for Growth

By Clinton Gott, Better Sales Comp Consultants

As strategies and goals evolve, incentive programs also need to change.

Sales compensation programs focus, motivate and reward the salespeople who help fulfill a company's strategic objectives. As these strategies and goals inevitably change over time, these incentive programs need to evolve as well. There are many potential plan designs and practices to consider. In most cases, creating optimal sales compensation designs means following better practices aligned to the stage in a company's life cycle. The plans will often look and feel very different as an organization moves from startup into high growth and on to the many challenges of mature or slower growth. Plans that never change will almost assuredly miss an ever-changing mark, so be sure to consider your designs at each step of your life cycle.

Cost-of-Sales Models in the Startup Phase

In the beginning, companies may struggle to find qualified sales representatives willing to take the leap and join an unproven opportunity. The company's offerings may be unknown, and success is not guaranteed. High-quality salespeople are incredibly important to ensure a positive outcome. Early on, plan designs tend to follow a very simple "cost of sales" notion. In its most basic form, such a plan usually features a simple absolute commission structure that pays a constant percentage of each dollar of volume captured (e.g., 10% of revenue, bookings or some other metric). The company is willing to pay a certain percentage of each deal as the cost of the sale, which represents a salesperson's cut of the deal. These simple plans can be effective in cases when:

- Any business is good business — salespeople are trying to sell anything to everyone.
- Productivity expectations are uncertain — it's hard to set goals or anticipate performance.
- Salespeople likely have similar opportunities in their assigned territories or accounts.
- A salesperson rather than the company sometimes "owns" the customer.

In most cases, companies using a cost-of-sales variable incentive model will still offer some kind of base pay. Very few sales environments are truly 100% commission. There may also be a likelihood of an equity component, which can smooth any rough edges in the fledgling cash incentive program. Quite often though, the absolute commission model will eventually start to show its age and begin to break:

- Startup companies often move from small and medium-size business (SMB) customers to enterprise sales. That often means much larger deal sizes resulting in much larger incentive payouts. Earnings can begin to dwarf the market cost of the sales talent needed. The first time a sales rep makes more than a top-level executive, design red flags are usually raised. This issue can bubble up even more quickly if executives are also helping to create and close the new massive enterprise deals. "Why should the sales rep get all that commission for the deal I drove?" becomes a familiar refrain.
- Salespeople will sometimes build a book of business that is large enough to sustain a comfortable wage year over year. Growth can start to stall in these instances if the extra incentives available don't feel significant enough to reward for the extra sales efforts needed to grow beyond a large base of business.
- Added products or services often lead to more complex sales environments that require more sales resources, including product specialists, technical specialists and inside sales. The initial absolute commission rate is no longer cost appropriate, although reducing a legacy commission rate usually goes over like

Table 1 | **Most Relevant Considerations for Design Mechanic Decisions**

Consideration	Potential Absolute Commission Plans	Preference for Quota-Based Plans
Stage in Life Cycle	Startup or high growth	Moderate to low growth
Customer Emphasis	New customers Acquisition focus	Current and new accounts Retention, penetration and acquisition focus
Sales Nature	Transactional	Consultative
Sales Cycle Time	Shorter and less complex	More complex and often longer
Sales Opportunities	Relatively equal opportunities in territory/ account assignments	Unequal sales opportunities in territory/ account assignments
Salesperson Prominence	Salesperson drives results independently Sense that salesperson "owns" account relationships	Other sales resources or factors help drive results Company owns account relationships
Productivity Expectations	Uncertain or unreliable	Reasonable expectations can be comfortably identified
Quota Data and Process	Limited data Uncertain process	Historical data and/or market data exist Process developed or evolving
Quota-Setting "Appetite"	Limited confidence Limited commitment	Reasonable confidence High commitment to the process
Talent Management Philosophy	Cost-of-sales methodology	Cost-of-labor methodology

a lead balloon. A company soon hears, “What happened to my 10%?”

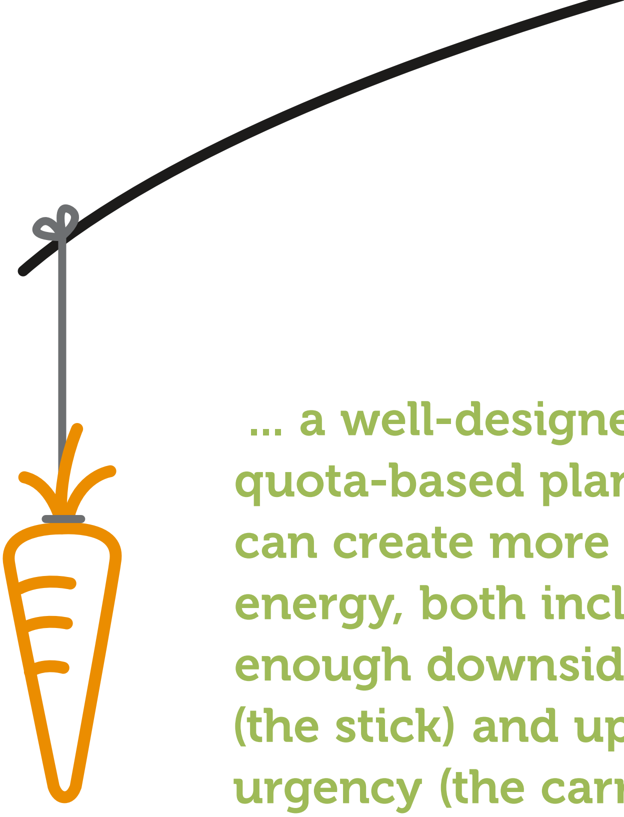
- Without clear quotas and incentives directly tied to quotas, leadership may feel disconnected from a clear vision on how the overall corporate goals will be achieved.

Those and other issues almost always arise, leaving companies looking for a solution to drive growth in a more reasoned and cost-effective manner, yet still one that’s exciting and motivating. Once past the startup phase, it’s very common to move to a cost-of-labor model.

Cost-of-Labor Models in Mature and Strategic Growth Phases

As a company matures, the sales incentive program will almost always shift away from the absolute commission model. The overall philosophy will evolve to a cost-of-labor model that attempts to offer a market-appropriate total pay level to each salesperson who achieves fair and reasonable productivity expectations, often called a quota or goal. The market level is usually identified as total target compensation (TTC) and is a combination of base pay and target incentive. The ratio is represented in the pay mix, (e.g., 50/50 means half in base and half in targeted variable pay). When a salesperson hits his/her quota, that person earns the individual target incentive amount. A common term for this is a quota-based bonus design. There are an abundance of design nuances to consider, such as when incentives should start being paid (threshold) and what happens for above-quota results (usually some acceleration). Companies usually find cost-of-labor quota-based models are ideal in many cases:

- More moderate to low-growth stages where every dollar of growth can be more challenging and feel more important. Acceleration above goal creates the necessary growth energy.
- Need to protect and penetrate a base of current accounts in addition to acquiring new ones.
- Unequal volume potential in assigned territories or set of accounts. This can lead to unequitable earnings opportunity from winning the “territory lottery” and create challenges in hiring and retaining new salespeople.



... a well-designed quota-based plan can create more energy, both including enough downside risk (the stick) and upside urgency (the carrot).

- Complexity requiring multiple sales participants versus “lone cowboy” market makers.
- Companies have a better understanding of the levels of productivity that can be expected from the salespeople. The data, approach and process for setting goals exist.
- A desire to have clear accountability for who is responsible for delivering a part of the total organizational goal.

It is extremely important to clarify that cost-of-labor models are not less exciting nor less energy-filled than cost-of-sales models. If anything, a well-designed quota-based plan can create more energy, both including enough downside risk (the stick) and upside urgency (the carrot). Offering the right level of upside in the form of the acceleration rate is absolutely essential. That topic alone deserves its own study and consideration.

In some sales environments or with some stakeholders, you may find nostalgic feelings for absolute commission plans. Or some may hold on to an ideology that absolute commission plans are simply the right way to pay and will best drive growth. Case after case though shows that in most instances, goal-based plans drive better

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results and create more-fair payouts than traditional absolute commission models. One example is an article in the October 2008 *workspan*, where we told the story of a company that piloted quota-based plan designs versus absolute commission designs in a relatively flat growth environment. Those on the quota-based plan drove revenue 3% greater than those on the commission design, and the new goal-based plan design was considered a stunning success. The pilot program gave us a unique opportunity to further validate the power of goal-based plans.

Threats to an Effective Cost-of-Labor Model

Goal-based plans are not always easy to design and manage. Companies should stay vigilant and look to counter commonly experienced threats such as:

- **Poor goal-setting methodologies and principles.** Goal setting is never easy, even for organizations that have set goals for years. You should use a documented methodology with the ambition to provide realistic expectations of performance. Fair goals motivate while unfair goals devastate morale and impair performance. The goal-setting approach, which often improves over time, should factor in top-down and bottom-up input and have some level of transparency so the field has a degree of confidence in the numbers handed down.
- **Excessive quota over-allocation.** Companies will often begin to extend the hedge between the top-line number and the sum of the goals rolled out to the field salespeople. It's hard to blame an organization that, when tasked with ambitious growth, will often resort to just layering on more quota to the salesforce. But it can actually have the opposite effect. A healthy and empowered sales culture should feature 50% to 60% of salespeople achieving or beating goal. A Better Sales Comp Consultants/WorldatWork quota study identified a total over-allocation of no more than 5% to 10% as the sweet spot to motivate and reward appropriately. A larger hedge can lead to a demoralized sales team and poorer performance than would occur with more realistic quotas.
- **Over-engineered pay lines.** Quota-based plans include decisions regarding the design of below-goal pay lines (soft and hard thresholds) and above-goal pay lines (acceleration rates and caps), which are often customized by role and even quota size. Companies sometimes become enamored with cost containment and may structure overly complex pay lines perhaps meant to save a certain amount in a given year based on one set of performance results. The plans can become complicated and cumbersome, eventually compromising their overall integrity and veering far from best practices. Keep the designs reasoned and simple to ensure a better outcome.

Sales compensation designs always require careful consideration and effort to work through the many necessary decisions. Some may see these details as complexity, while leading companies appreciate the potential for appropriate flexibility. Plans should be designed at the role level, and the types of designs should be aligned to better practices connected to the phase of the company life cycle. Plans should be evaluated annually with perhaps small refinements as needed, while it's common to see more-significant design changes every two or three years. Today's business world is moving faster than ever; business goals rapidly adapt and companies mature. One constant is ever-increasing growth expectations. Companies that consistently achieve their objectives feature evolving sales compensation plan designs that align with each stage of their company life cycle. ws

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