research for
the real world

Using an Insightful Sales Compensation Metric

Compensation Cost of Sales (CCOS) should be a featured metric when evaluating sales compensation programs.

At its most simple, CCOS divides a sales organization's actual total compensation spend (includes base pay and actual incentives) by total revenue supported by the sales organization. This is a measure that relates to the return on compensation expenditures, and while seemingly easy to understand, it isn't always easy to measure successfully or apply appropriately. We'll explore these concepts in more detail.

Based on our interest in this topic, Better Sales Comp Consultants has frequently run studies related to CCOS, and this article will identify four important considerations. We will include initial findings from ongoing BSC CCOS studies, performed in conjunction with Xactly and OpenSymmetry, as well as a prior study related to BSC's High-Tech Roundtables.

1 Not All Companies Measure CCOS Although They Should

In our study, 26% of organizations indicated they either couldn't estimate their CCOS or simply didn't track it. Our sales compensation design experience suggests this metric is one of the gold standards for evaluating sales compensation programs. Because of that it should be part of every organization's annual plan review.

2 CCOS Can Be Surprisingly Challenging to Measure

Even in its most simple form of total compensation payouts over total revenue, companies can struggle to consistently identify the correct inputs.

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Exhibit 1 | Overall CCOS Results from Full Sample

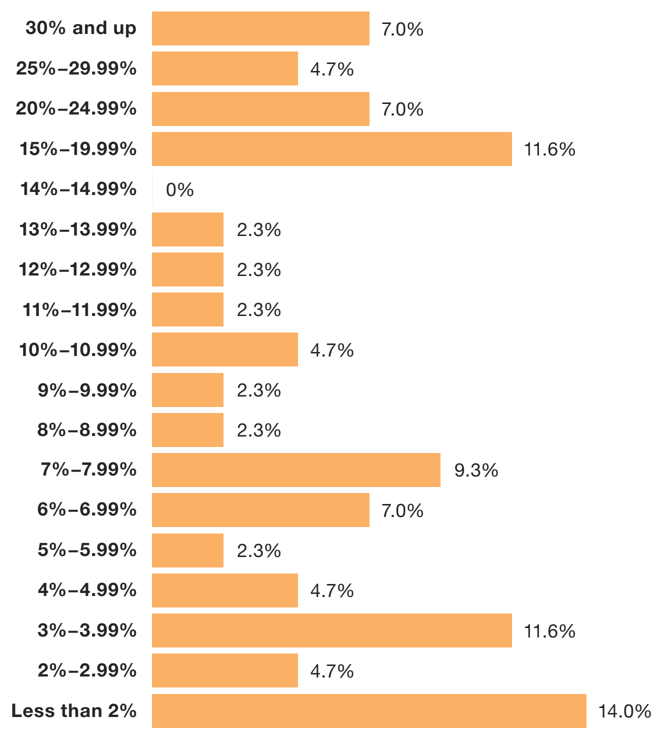

Exhibit 2 | CCOS Results by Selected Industries

CCOS Range	Software	Hardware	Healthcare/ Pharma
30% and up	20%		
25%–29.99%	10%		
20%–24.99%	10%		
15%–19.99%	10%	25%	17%
11%–11.99%			17%
10%–10.99%		13%	
7%–7.99%	20%		
6%–6.99%	10%		
4%–4.99%	10%		17%
3%–3.99%		25%	17%
2%–2.99%	10%	13%	
Less than 2%		25%	33%

- For compensation dollars, this should be all cash compensation spent for the entire sales organization — all levels and roles. But what about product folks who may work with sales but who are not formally on a sales incentive plan (SIP)? What about third-party contract salespeople who aren't technically on the payroll but help drive the final revenue results? Generally, BSC encourages including all compensation costs related to individuals who drive the sales outcomes that result. The key is to clearly and consistently define your criteria and what to include.
- On the revenue side, what happens in a world where a portion of revenue flows in without salesperson support? We've seen companies with certain alliance or cobranded product relationships that qualify in total revenue but have no associated sales organization compensation expenses. Here, we usually try to allocate only the portion of revenue directly supported by the sales team, with the key again to clearly and consistently define your criteria.
- What about cases where revenue isn't either the primary measure either being tracked or the primary basis for determining sales compensation payouts? Consider traditional software organizations who often track and pay on bookings or today's SaaS (software as a service) organizations that may pay on Annual Contract Value, Monthly Recurring Revenue (MRR), or similar metric. Revenue may not be the only outcome to consider. BSC recently had a software client who paid half of incentives on revenue and half on bookings, so they actually tracked and calculated two types of CCOS — E:B (earnings to bookings) and E:R (earnings to revenue). Companies may need to customize the components being compared to ensure the right analysis.
- Finally, be sure to look at Total CCOS (base plus actual incentive divided by results) and variable CCOS (just actual incentive divided by results) separately. Each measure can tell a unique part of the sales compensation plan story.

3 CCOS Is Not Well-Suited for External Benchmarking

Once armed with a clear understanding of one's CCOS, companies inevitably try to find market data and appropriate benchmarks. Unfortunately, CCOS is not a metric that lends itself to satisfactory external comparisons. Exhibit 1 shows the incredible spread of CCOS results from our recent research. The median value was 7% to

8%, but some companies were below 2% and others above 30%. One observation is this data set crosses industries and company sizes. Indeed, CCOS often varies because of industry economics, company maturity, go-to-market models, productivity realities, salesforce tenure, customer segments covered, and, last but not least, sales compensation plan designs.

Companies may try to create an appropriate peer group, perhaps tied to industry. Exhibit 2 shows the CCOS distribution related to the three most prominent industries in our study. Comparing software to hardware, as an example, the data reflects the common outcome that software CCOS is higher than hardware CCOS, but even within software, the spread is extreme. Digging deeper, the highest CCOS levels are tied to more SaaS-oriented organizations who are likely investing in compensation payouts today for ramped revenue run rate in the future. So even a general software cut wouldn't be a great SaaS benchmark. Ensuring appropriate apples-to-apples market benchmarks can be challenging and not particularly valid without them.

For another example, consider findings from another of our CCOS studies in Exhibit 3. Continuing our discussion of software, we again found a wide range of CCOS percentages, which correlated relatively well to the balance of direct than channel sales focus. We generally found that organizations with more direct sales efforts had higher CCOS percentages than more indirect-focused ones (with one unusual exception for Company A). So channel focus is another variable that can further compromise attempts at meaningful external comparisons. But can CCOS still be useful?

4 CCOS Is Best Used for Internal Year-over-Year Comparisons and Segment Analysis

Ultimately, companies should use CCOS as one of their annual scorecards to analyze the effectiveness of the sales compensation program. Specifically, we encourage companies to look at year-over-year trending, while being sure to examine the changes to better understand their causes. For example, CCOS may be trending upward because the company is investing in new markets that have not reached high levels of productivity; higher CCOS may be an acceptable outcome in the short term. Or CCOS may be trending upward because the company has too much of the sales compensation spend tied up in base pay and the company is having a poor performance year; this may not be acceptable and the alignment of individual salesperson incentives (or head count) and company results may need to be examined.

Companies will often use CCOS to calibrate performance across segments such as geographies, customer tiers, or other customer/deployment combinations. This can also be an effective way to understand payouts and drivers of performance, potentially identifying sales or coverage tactics from one area that should be applied elsewhere or areas needing extra scrutiny and efforts to drive greater performance. Again, though, it's important to try to understand why CCOS results may differ versus purely judging one as better or worse than another. Be cautious when evaluating groups with very different business conditions, investment and growth strategies, channel strategies and other influencers.

CCOS is a powerful metric, but it's important to understand what it can and cannot do, and how it should or should not be used. Ensure consistent input criteria, focus on year-over-year comparisons, and factor in appropriate qualitative considerations to help with your interpretation. ws

Clinton Gott and Ted Briggs are the founding principals at Better Sales Comp Consultants in Los Angeles. With five decades of experience, they have helped hundreds of companies in dozens of industries drive optimal sales results through better sales compensation plan designs and sales effectiveness solutions. Contact them at info@bettersalescomp.com.

Exhibit 3 | Direct/Indirect Channel Mix Impact

Company Number:	A	B	C	D	E	F	G
CCOS Actual (%)	2.65%	3.19%	3.64%	7.20%	9.12%	10.48%	14.73%
Direct/Indirect Channel Mix	63/37	15/85	5/95	80/20	100/0	100/0	100/0
Sales Model	Mostly Direct	Mostly Indirect		Mostly Direct	All Direct		