

The Seven Rules of SALES COMPENSATION SIMPLICITY

QUICK LOOK

- ⇒ Most sales compensation plans are too complex; sales representatives and sales managers are calling for improvements.
- ⇒ Improve sales job design, use shared principles, select the right measures, employ effective formulas and get reporting right.
- ⇒ Sales management can significantly reduce perceived complexity by investing in good implementation and communications.

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Assuredly, most sales compensation plans are way too complex. With good intentions, plan designers attempt to address varied and sometimes conflicting objectives. However, the outcome, while admirable, is too often an overburdened, overwrought pay program. Both sales representatives and sales managers alike call for improvements: “Make it simpler; we don’t understand it.”

Summation of Good Intentions

The first step to understanding a complex sales compensation plan is to explore each element of the plan. During this process, it’s beneficial to learn about the intent of each component. Normally, each element exists for a rational reason. It might relate to some type of performance expectation, special calculation requirement or company philosophy.

But be forewarned, while each of these components has good intentions, their summation can sometimes produce overwrought and complex designs.

Pay programs without major changes for three to five years frequently exhibit unnecessarily complex designs. Compounding this problem are “tweaks” made to the compensation plan on an annual basis. At the time, these minor changes seem small and may



be insignificant, but they can start to create additional wrinkles and calculation confusion. After several years, these “tweaks” create unintended complexity. Things are bad when sales personnel compare their sales compensation to the federal tax code, another example of how the “summation of good intentions” can go awry.

The 7 Rules of Sales Compensation Simplicity

To help reduce sales compensation plan complexity, follow these seven rules:

1. Improve sales job design.

No other issue is more challenging for sales compensation designers than poorly designed sales jobs. Well-designed jobs have clarity and a single focus. Jobs that are improperly designed have competing objectives with different job cadences. When sales compensation programs attempt to measure these competing objectives, complex designs are frequently produced.

For mature organizations, measuring sales time helps identify poorly designed jobs. Selling time should be 35 percent to 45 percent of available time. When selling time is less than 30 percent of available time, the sales job has reached a point of failure. Well-run sales organizations measure time to preclude the encroachment of nonselling actions.

2. Use shared principles. While sales compensation plans should match sales job content, corporate compensation should establish sales compensation principles for design purposes. These shared principles will help those designing sales compensation plans to create plans that support job content while being consistent with corporate guidelines. So, while

the performance measures will be unique for each job, the overall architecture of the sales incentive plans will be alike from one job to another. Examples of principles would include the following design constructs: eligibility, target cash compensation, mix, leverage, number performance measures, difficulty of quotas, sales-crediting rules and payment periods.

3. Select the right measures. Incorrect performance measures are the most common cause of sales compensation

• **Redundant measures.** Most sales compensation plan designers do not intend to use redundant measures. However, incentives implemented to support strategic product sales, special account efforts or cross-sell goals often duplicate existing measures. This adds unnecessary confusion to the plan.

• **Immeasurable measures.** While it seems obvious, only select those measures that you can measure. Occasionally, senior

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complexity. Typical mistakes include too many measures, the wrong measures, redundant measures and immeasurable measures.

• **Too many measures.** As a rule, sales compensation plans should have no more than three measures. Additional measures only dilute and confuse the performance message.

• **Wrong measures.** Sales management should select performance measures that sales representatives can affect. This precludes the use of corporate measures and any other measure outside their control. Also, sales compensation dollars should not be wasted on compliance measures; that’s the role of supervision. Use result measures such as sales revenue, gross margin dollars or units sold.

leadership will make a commitment to use a certain measure without asking if support resources can calculate the measure.

4. Employ effective formulas.

Pick the right formula engine. Use commission programs when territories are similar in size, or payout schedules tied to percent of quota achievement when territories are dissimilar in size. Also, while incentive linkages such as hurdles, modifiers and matrices are a powerful design tool, they can create enormous confusion. These conditional calculation methodologies make payouts dependent on one or more additional measures. So, while linkages can help ensure balanced efforts, overuse can create calculation complexity.

Use thresholds when the embedded base of business is assured. It's best to avoid the use of caps, but they are necessary when exceptional performance is not the result of selling efforts. In addition, avoid the use of forced rankings to determine individual payouts.

Another formula complexity is the use of "cumulative period-to-date" payout designs. In most

5. Use guarantees and buyouts for fairness purposes. In an attempt to be fair when territories change or new hires arrive, many sales compensation programs use account sales history to calculate payments. Sometimes sales operations create historical "mirror" territories to calculate estimated earnings, make back-end adjustments or use trailing credits for earnings assignments.

SALES CREDITING RULES

DEFINE WHEN AND HOW MUCH OF THE SALES ORDER IS ASSIGNED TO THE SALESPERSON FOR COMPENSATION PURPOSES.

instances, these are necessary and unavoidable. Cumulative period-to-date designs provide interim payments during a performance period. For example, a sales representative with a one-year goal could receive interim payouts each quarter. The problem is that the explanation of cumulative-to-date calculations is confounding and complex. Particularly nettlesome is the use of "clawbacks" when payments for multiple periods exceed the annual year-to-date eligible payments. Clawbacks use is amplified when aggressive incentive accelerators for over-quota performance are offered during the interim measurement period. In such cases, salespeople must "pay back" their excess year-to-date payments. A simple solution is to delay the over-quota accelerators until the annual number is achieved.

While each of these techniques produces accurate payments, these calculations are extremely complex and hard to understand. The best method for making these adjustments is to provide guarantees for new hires and buyouts when territories are changed.

6. Define crediting rules. Crediting rules are an integral part of every sales compensation program. Sales crediting rules define *when* and *how much* of the sales order is assigned to the salesperson for compensation purposes. Document crediting rules to avoid misunderstandings. Assign sales credit timing when salespeople have completed their customer tasks regarding the order. This might be at the point of booking, when the order is invoiced or at the time of payment. While some companies split sales credit between booking and invoice to serve some important objectives, this method introduces another

level of complexity. It's best to select one point in time to credit sales.

Two types of credit-split rules are "horizontal sales crediting," which describes credit assignment between two or more sellers, and "vertical sales crediting," which refers to sales credit given to supervisors. Vertical sales crediting is a normal cost element of the sales compensation program. However, horizontal sales crediting — where two or more sales people get sales credit — can create unnecessary costs unless closely managed. When two or more individuals influence the customer to purchase, the acting parties get a sales credit for the sale. These credit split rules must be documented and unambiguous. Field negotiations of these credit splits are less desirable. For commission programs, split the credit amount in equal parts, or in predefined portions. For bonus formula plans using a percent-to-quota payout schedule, double credit, but then double-lift the quotas of eligible sellers to avoid excess payments.

7. Get reporting right. It's time to retire your Excel spreadsheets and Access databases. Sales representatives should have online access with drill-down capability to view their sales incentive payouts and calculations. Today's enterprise, hosted and ERP systems bring power to the administration of sales compensation. Accurate calculations, performance visibility and self-help review put salespeople in a position to much better understand their sales compensation program. The sales compensation program payouts should be part of a comprehensive sales performance dashboard so sales representatives can monitor their sales success. Without the ability to do

self-audits online, sales personnel have every right to be concerned about the accuracy of their incentive calculations.


The Payback From a Great Implementation and Communication Effort

Sales compensation programs have start dates and termination dates, such as Jan. 1 to Dec. 31 for calendar-year plans. Based on this recurring annual cycle, sales departments have an opportunity to effectively implement and communicate the sales compensation program to participants — whether the plan has changed or not.

While complexity is sometimes confused with misunderstanding, sales management can significantly reduce perceived complexity by investing in good implementation and communications. The following topics offer an excellent opportunity to explain the incentive program and thus improve the perceived value of the reward system.

- **Strategic goals.** Sales leadership needs to communicate the fiscal-year strategic goals to the salesforce. The alignment between the company's goals and the sales efforts should be unequivocal. Sales leadership should demonstrate how the tools, training and incentive program support these strategic goals. The best forum for communicating strategic goals is a national sales meeting.
- **Formula mechanics.** Each pay plan has unique formula mechanics. Sales supervisors should sit with their sales representatives to explain how seller performance affects incentive payments. Multiple illustrations of formula payouts should be available. Online incentive calculators can provide "what-if" functionality to allow incentive scenario calculations.
- **Terms and conditions.** Fully documented terms and conditions ensure

that sales personnel and sales management have the same understanding of rules affecting the plan. New state laws require a signed sales

changes, carefully define crediting rules and provide intelligent reporting. Communicate well, and your salesforce will thank you. 

ONE-ON-ONE COACHING

BY THE FIRST-LINE SUPERVISOR WILL HELP SALES PERSONNEL UNDERSTAND HOW THE NEW INCENTIVE PROGRAM WILL AFFECT THEIR PAY. THESE SESSIONS ARE THE MOST VALUABLE MEANS TO IMPROVE UNDERSTANDING.

plan acknowledgment to confirm participants' understanding of these policies.

- **Personal impact.** One-on-one coaching by the first-line supervisor will help sales personnel understand how the new incentive program will affect their pay. These sessions are the most valuable means to improve understanding of the sales compensation program. Staff resources should provide PowerPoint presentations, workbooks and discussion guides to facilitate these sessions.
- **User lessons.** Today's complex IT systems require intense user training. In-person and online training sessions can teach sales personnel how to access reports, examine results and submit adjustments.

Observations

It is your responsibility to improve the clarity of sales compensation plans. Sales personnel should not have to suffer with confusing, complex and complicated incentive designs. The tasks are straightforward. Align the jobs, follow corporate principles, select the right measures, use the right formulas, let guarantees and buyouts bridge

EDITOR'S NOTE

Author David Cichelli is teaching *Sales Compensation Design—Developing Next Year's Plan* in cities across the United States this month. Go to www.worldatwork.org and click on courses and seminars for information.

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