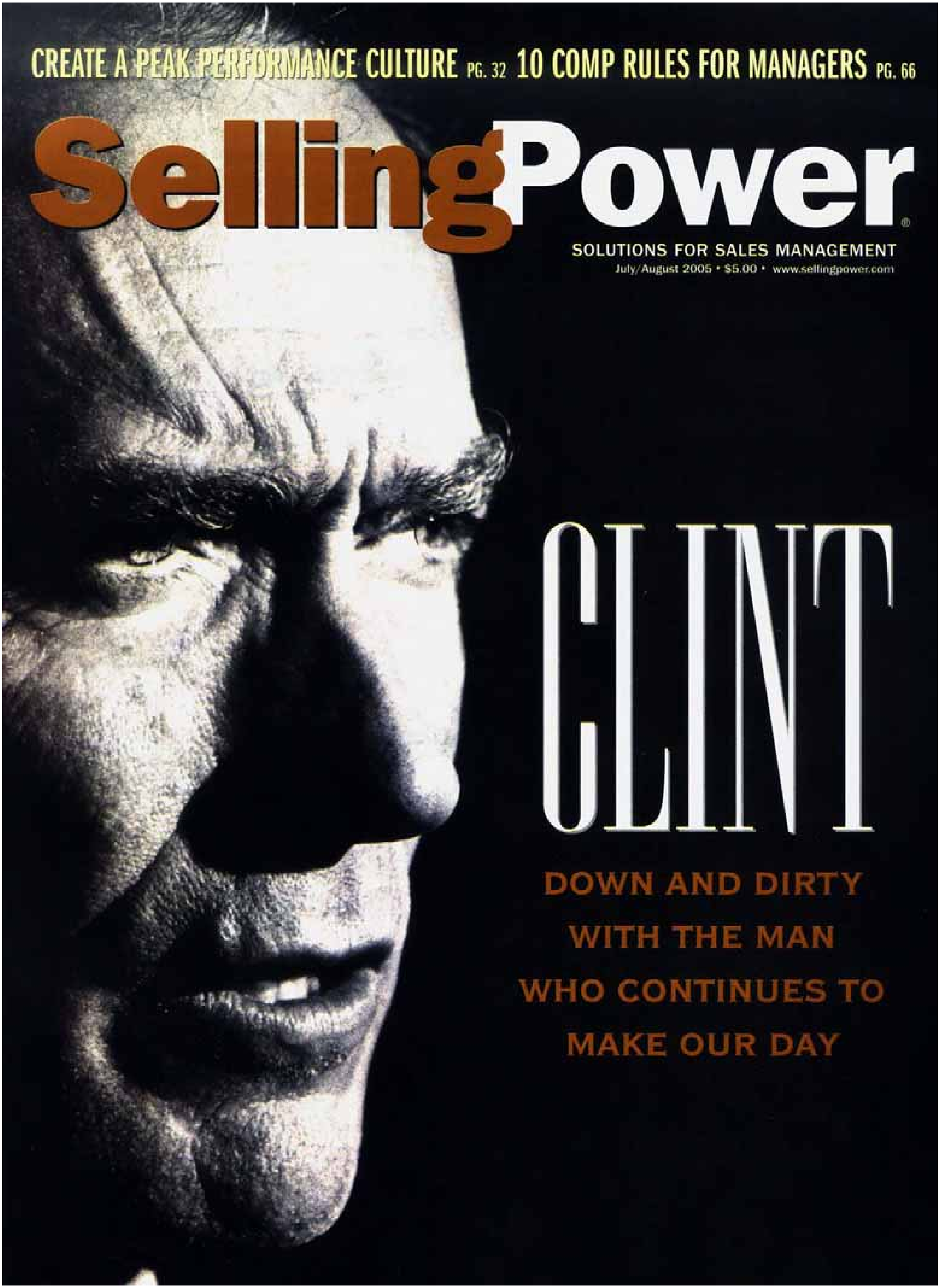
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By Henry Canaday

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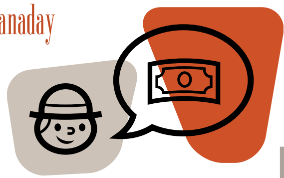
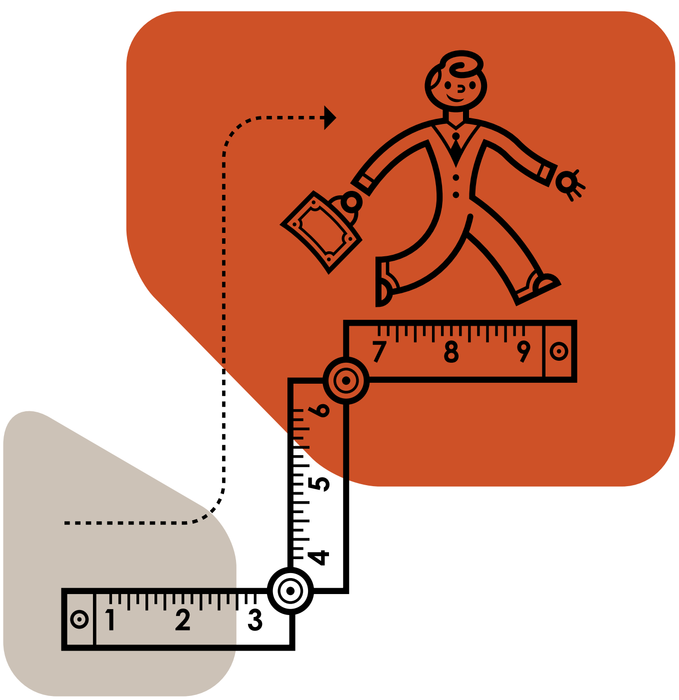


Money Talks

From experts in a number of fields, here they are – 10 reliable rules for sales compensation



1. Measure performance.

The compensation plan is not as important as underlying sales metrics. If you have the right metrics, you can often change behavior without tying in compensation. For example, reps who know that their activities are being monitored tend to respond.

The trick is being sure your metrics are closely tied to company performance. "Metrics are much more important than compensation," according to Jason Jordan, president of Go to Market Partners. "But it is critical to align metrics with company objectives." To do this, you must first determine the behaviors by salespeople that drive sales performance toward company objectives. Observe salespeople closely; then collect data that measure both behavior and results.

2. Stability is better than perfection.

"Changing the comp plan is a big deal," Jordan argues. "If you change comp too frequently, people lose faith in the incentives. If it becomes too complex, it becomes a mystery bonus at the end of the year." If you have a comp plan that is fair and generally aligned with company objectives, it is often better to leave it alone.

Even the best IT systems cannot track many behaviors that make top performers. "How do you know how many questions reps ask or how much time they spend listening, rather than talking?" Jordan asks. You need to observe the behaviors that drive success – such as negotiating and presentation skills – and train, coach and manage for improvement. Don't expect comp to do it all, or even most of it.

3. Don't overemphasize compensation.

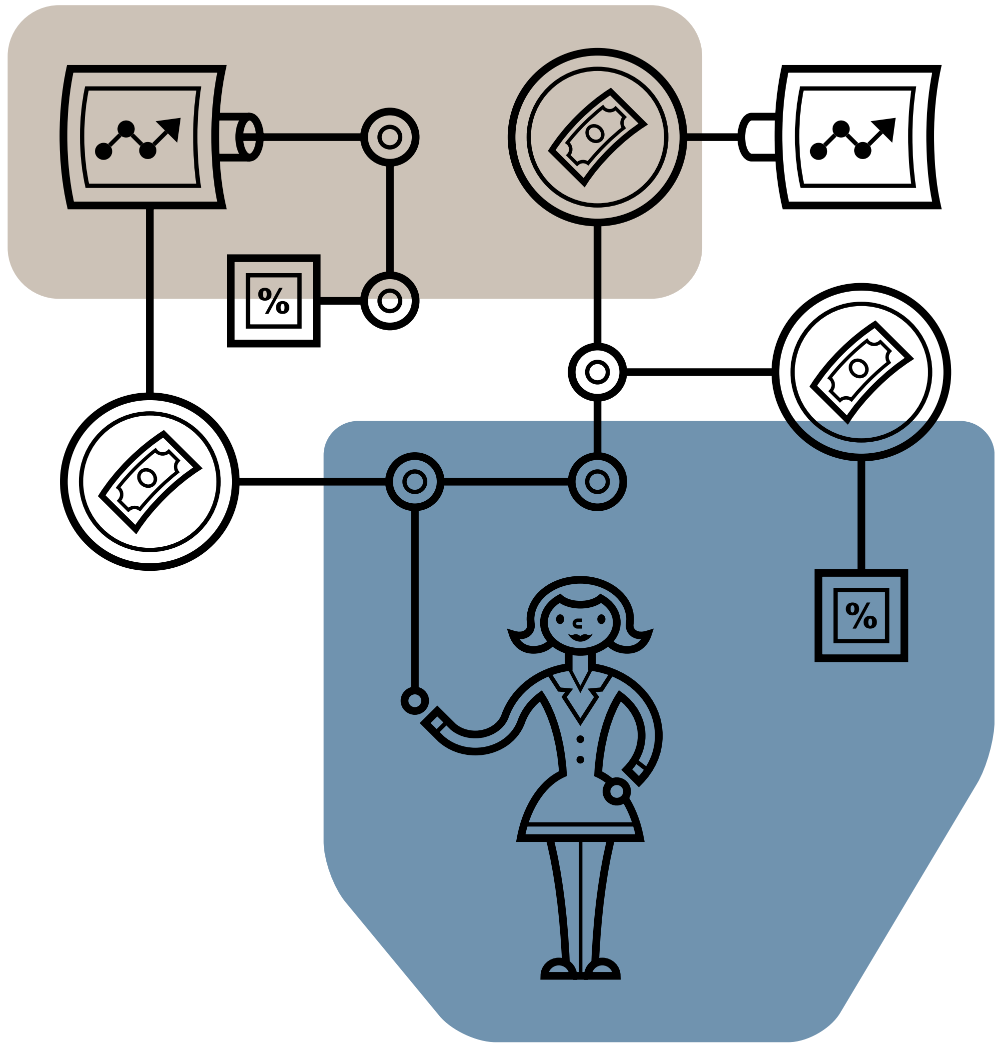
Overemphasizing compensation is the most common trap for firms trying to improve their sales, according to Steve Grossman, a sales consultant at Mercer Human Resource Consulting. Focusing only on comp can lead to complications, and it diminishes the role of other levers, such as first-line sales managers. "Overemphasizing comp sends a message that managers cannot manage well, so they put everything into the pay plan," Grossman notes. Instead, emphasis should be placed on sales management, training and the sales process, he urges.

Jordan, agrees. "Compensation gets way more attention than it deserves." Compensation is seldom the reason good sales reps leave but is often the reason they give for leaving. On the other hand, low-performing reps leave because they are performing badly and earning minimal commissions.

Market strategy is often more important than comp in sales success. For example, some firms need to shed their small, unprofitable accounts; however, this is hard to do when managers like big numbers and reps hate to lose accounts. Understanding and exploiting the buying process of valuable customers is more important than perfecting comp plans, because some reps simply lack the motivation necessary for sales success – and better comp will not fix this problem. "Hire people who are hungry and motivated," advises sales consultant Landy Chase.

Grossman acknowledges that comp can be useful in special circumstances. If a company assigns 25 reps to each line manager, it cannot expect much real management or coaching. For practical purposes, the comp plan is the management.

Compensation incentives also can be decisive for purely transactional sales, where sheer effort and volume count heavily. Transactional sales jobs, however, are shifting to the Web anyway.



5. Keep it simple.

Jordan urges that performance comp must be tied to only one or two variables. "Some people try to tie comp to everything, including return on assets. Well, reps don't sell assets."

Improved software can easily calculate the gains from the most complicated comp plan, but do not be fooled by nifty calculations. Comp plans need to focus the minds of harried reps. Even the best comp software cannot do that. Jerry Colletti, managing partner at Colletti-Fiss, says comp must send a crystal clear message to the field. Three-quarters of comp plans are much too complicated, in his view. Colletti says all incentive comp should be based on three or fewer variables.

Dahm agrees. "If a plan is so complicated that it needs special software, it will not motivate. Comp automation has not changed the rules of designing the plan. Software is not a license to make plans more complex."

Any unnecessary complication allows reps to "shop the plan," which is making money by striving to meet only a few goals. Some companies have slopes in comp, paying higher commission rates for higher achievement. Overdone, this is the same as having too many hurdles. It adds complexity and confusion.

"Don't use more than three variables, and don't overuse accelerators, multipliers and hurdles," Dahm summarizes. To include a performance measure in your comp plan, it must meet three conditions: reps must have a high degree of influence on the measure; the measure must align with your business goals and market strategy; and you must have accurate data on the performance measure.

4. Align comp with your objectives.

Another common comp mistake is failing to align comp variables with business goals, according to Joanne Dahm, a principal at Hewitt Associates. Sometimes, comp plans get compromised because too many constituencies are involved, and no one sets priorities. In other cases, companies allow the VP of Sales alone to write the entire comp plan.

You need a tight team and process to design comp. The team should include business leaders, sales leaders and human resource professionals. Comp plans should include a sales measure. For example, many reward net or gross profit margins. Then it is usually a choice among incentives for new customers, new business or specific product lines.

Dahm says companies have recently refocused on retaining sales talent and keeping upside potential attractive to top performers. Many Hewitt clients are now driving for top-line revenue growth by adjusting the risk-and-reward balance of comp plans. Others are adding upside potential, while some are adding incentives for new customers or new products. Some are adding a growth variable, such as paying extra for revenue growth or adding customers.

Still, Chase argues that most companies do not tie performance-based comp tightly to objectives. Firms need to develop new accounts, but base-and-commission plans often leave reps too comfortable.

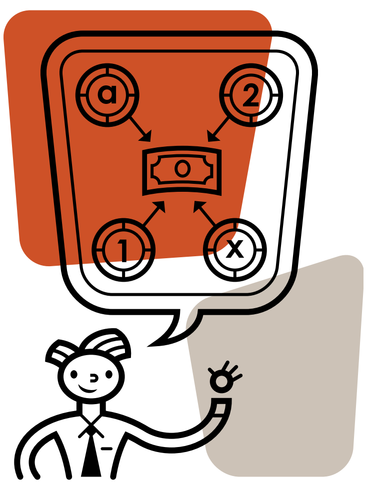
Chase thinks reps should have more comp at risk, depending on performance. He suggests a tiered commission structure, paying one rate for handling existing accounts and a higher rate for new accounts. "You need to turn farmers into hunters."

Grossman cautions that comp plans for consultative selling will always differ substantially from those rewarding transactional salespeople. He says many firms still pay salespeople extra for "things that are too important to put into the pay plan." Simply showing up, taking care of customers and developing best solutions for customers are too basic and essential to reward in comp plans. "You can trivialize these things if you give extra points for them," Grossman observes.

6. IT counts.

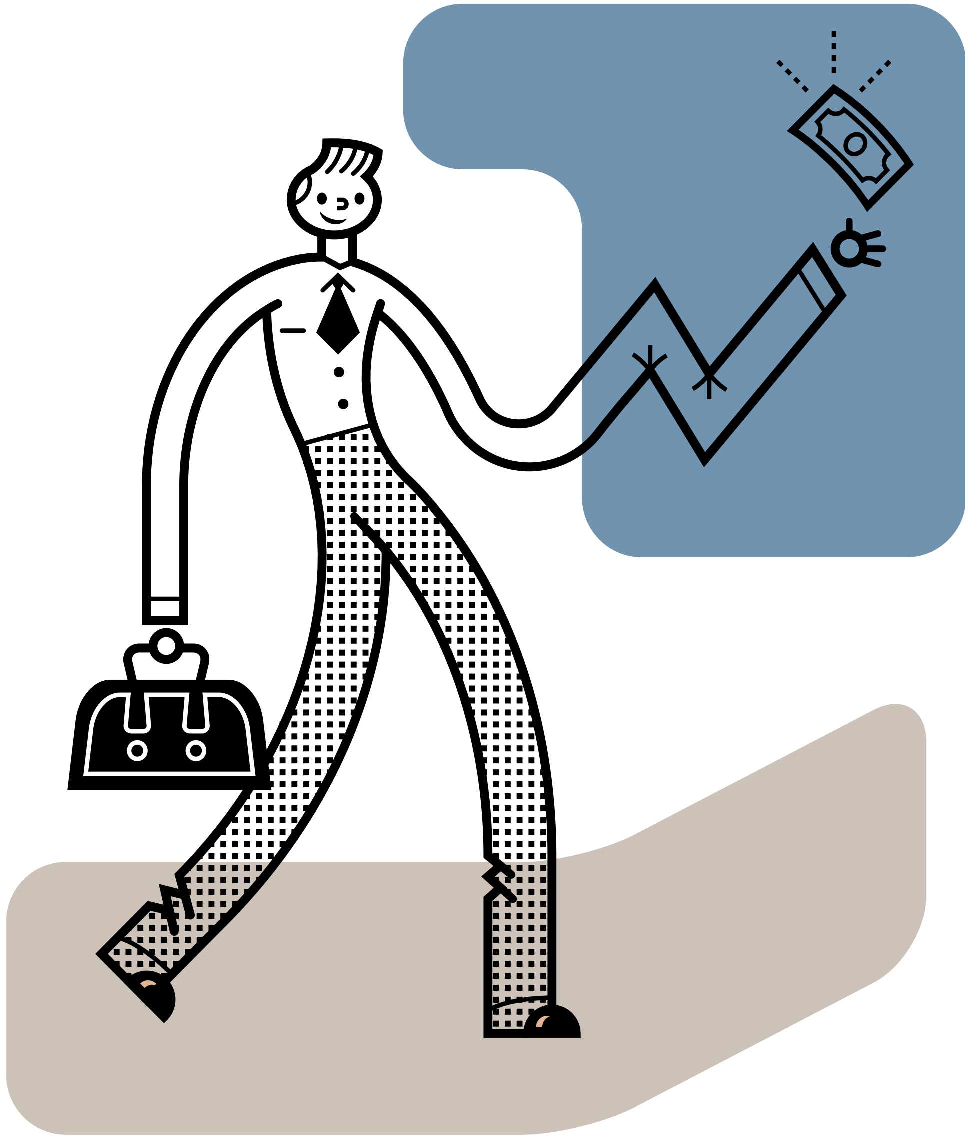
Many companies' information systems are weak in collecting and reporting the data that tie sales activities to company performance. Companies generally want to sell to their most profitable accounts, but revenue is much easier to measure than profits. Many firms still cannot accurately measure the profitability of individual accounts.

Improving measurement involves many departments, including marketing, finance and information technology (IT). Frustrated with the work involved in getting more relevant data, managers too often tweak the comp plan or spend more on training. "It is easier to train more and change comp," Jordan says. "Most firms take the easy way out."



7. Define the process.

To manage well, you need to know what activities you are managing. There are dangers in compensating for activities, though, because they may not convert to sales. Managers should be able to track important events, if only to estimate the efficiency of their reps in turning steps into sales. "A lot of decent companies do not have a good sales process," Grossman notes. "But the highest-performing companies always do."



8. Pay for results.

The general rule is, you should reward for sales results, not the activities that lead to them, says Dahm. There are limited exceptions to this rule.

If you seek a dramatic change in behavior, you can temporarily reward this behavior to put some teeth into the new policy.

Some sales are made by teams, which makes it difficult to allocate sales to all individuals. You can set activity objectives for some team members and compensate for their achievement.

Rewarding intermediate sales steps can make sense when a buyer has committed and makes intermediate payments. For example, manufacturers of large systems often receive progress payments, and their reps receive partial commissions before final delivery. Or a company may make it through bidding to become a finalist for a big job. Or a company may win the bid but must still negotiate the detailed contract. Grossman calls these compensable events that justify early payments to successful reps prior to invoicing or collection. These events are really results, not just activities.

Colletti says you may sometimes comp for activities that directly and strongly correlate to higher future value for your firm. If you bring on new reps for nine- to 18-month sales cycles, you may reward them for activities in the first two quarters. Developing qualified leads, entering the buying process or doing successful demonstrations might earn up to 25 percent of the incentive opportunity. This temporary rewarding of new hires can be easier to administer and more effective than allowing a simple draw.

In a sense, even base salary should be an incentive. With a well-defined set of expectations, reps are being paid to meet these expectations. Many firms, however, still do not define their expectations for earning base, or line managers do not have the metrics to track fulfillment of expectations.

9. Measure profits.

After revenue, profit is the most common compensation variable. Comp plans should focus on selling profitable business. Often, that means selling solutions, rather than a product, which brings a further gain. You are selling value to your customers, and it will be harder for rivals to replace you.

Estimating the profitability of sales is more practical than many people think, and it is preferable to rewarding just for revenue or units. Better information and customer relationship management (CRM) systems make it possible to track customer profitability. Grossman notes these systems can even spot the damage to profits from some customers' demands for heavy maintenance expense. Often, your biggest customers are your least profitable ones, due to their bargaining strength or demands for service.

Sometimes, you win a bid at a set price and approved gross margin, but you must negotiate the final deal, including implementation steps that can trim profits. "Still, there are mechanisms to deal with that, such as a final payout of 25 to 50 percent of total incentive based on the realized profit of the deal," Grossman observes.

Another hurdle to paying for profit is that some companies do not want reps to know the profitability of customers, because then reps will understand the firm's cost structure, an advantage to a competitor if the rep leaves. "Then you have to find a metric that is a proxy for profitability," Jordan argues. "Try to get as close as possible to profitability. That is much better than simply paying for revenue."

Companies that do not want to disclose profits or costs to reps can set threshold levels, in terms of gross margins, before incentives are paid. Colletti says, "Companies can put a hurdle rate on deals, in terms of profit or gross margin, before the sales earn incentive comp or count toward quotas and bonus plans."

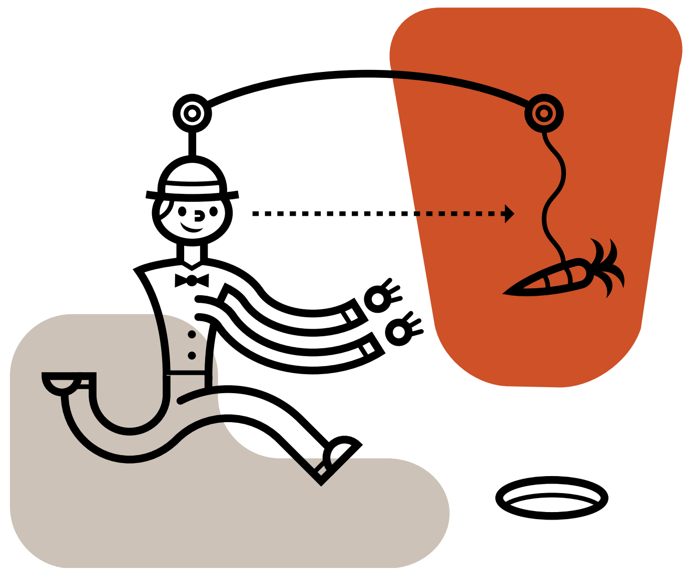
Grossman believes estimating customer value and profitability is just an extension of segmenting markets and assigning different sales units to work with different segments. Segmenting models are becoming more sophisticated and customer centric. Done right, they boost productivity and profits. "Most companies have spent heavily on new information systems," Colletti emphasizes. "They should be able to estimate profitability."

10. Be careful with spiffs.

Noncash incentives, or spiffs, may be useful for launching new products, for penetrating new markets or for rewarding support staff. Some companies, however, overuse spiffs to motivate product launches, according to Grossman. "The opportunity to sell a well-designed and highly competitive new product – and earn regular incentives on it – should motivate professional salespeople."

Spiffs and contests can produce short-term bursts of energy and selling efforts, but if a company is seeking high-value solution sales, these rewards can distract from the necessary long-term efforts. Furthermore, customers may notice the short-term sales pressure and interpret it unfavorably. Spiffs should never be used simply to fill a quota gap as the quarter ends.

Dahm says some Hewitt clients are restoring the reward vacations that were cut during the slowdown. "Trips and recognition can be effective in building a high-performance sales culture," she argues. •



CounterPoint

Paying for Customer Loyalty

Dennis Chapman, CEO of the Chapman Group, believes companies should be more creative in using performance metrics to drive sales behavior. His firm helps measure customer loyalty, and he thinks increasing loyalty should help determine compensation.

To estimate loyalty, Chapman conducts five-minute surveys of multiple customer staff at multiple times over a year. The result is a deep picture of each customer's likely future buying behavior and its trend over time. Where increasing loyalty clearly leads to higher sales, Chapman says it should be part of comp.

Nonsurvey methods may get at the same goal. For example, a firm can select its top-100 customers at the beginning of each year. Then it can track how many of these are still customers at year's end.

In another example, an account team creates a strategic plan to convert satisfied customers to loyal customers. The team collaborates with each customer on a work plan for the coming year, setting out key performance indicators upon which both sides agree. Chapman says achieving these performance goals should be part of comp for the entire team.

Separate metrics can be developed for teams who hunt for new business. Only high-value activities that clearly and strongly correlate with sales should affect a hunter's comp. For example, when prospect executives visit your plant, you may average a 90 percent close rate. These visits could be part of the rep's comp.

Critical performance activities should not become variables to determine commissions, but could determine annual bonuses. To be eligible for bonuses, reps would still have to achieve satisfactory sales results. Chapman says, "You are telling people that certain activities have merit."

Commissions to sales reps should be paid on revenue and profits. In addition, Chapman thinks "wallet share," or the fraction of relevant purchases each company makes from your firm, should be included in sales comp.

Chapman's approach is especially useful when selling is done by teams that include staff who are not usually paid commissions. He thinks nonsales staff should have from 10 to 20 percent of comp dependent on team performance. "You want just enough to get their mind share," he argues. Account managers should have 20 to 30 percent of comp at risk and reps about 40 percent."

Doesn't all this add too much complexity? "It is always wise to try to keep things simple, but sometimes simpler is not better," Chapman argues. "The world is getting less simple, and comp plans have to recognize that."