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CRI News *Current Insights on Compensation*



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SALES COMPENSATION: THE BIG PICTURE



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The driving force behind virtually every company's ability to survive and flourish is the willingness of customers to purchase its services and/or products. This requires a significant sales effort to encourage consistent and ongoing revenue streams. Without the sales force driving these purchases, little or no revenue would be generated. No revenue means insufficient funds to support the operation of the company.

Every entrepreneur knows that sales equal revenue, and therefore, the emphasis is on developing sales compensation programs that will achieve the desired results. The basic objectives of any compensation program, including those specific to sales activities, are to *Attract*, *Retain*, *Motivate*, and *Focus*. From a 30,000 foot level, sales compensation programs are designed to Atract qualified and capable sales personnel. Once on board, the organization wants to Retain the most talented individuals - those that can effectively sell. The pay program then can Motivate the sales force to sell by recognizing and rewarding those who perform. Experience has shown that it is also critical for the sales compensation program to Focus the sales forces' attention on specific, desired results. These four (4) main compensation design objectives are referred to as "FARM".

As basic as this may sound and as well-intentioned as many companies are, far too many sales compensation programs never achieve their intended goals. As a result, the companies tend to either continually tweak or perform more radical surgery on redesigning their plans,

sometimes on an annual basis. This often results in discontent and mistrust among sales people, who can lose sight of two of the aforementioned objectives - Motivation and Focus - which can then result in disengagement to sell.

Rest assured, a successful sales compensation plan is not impossible to achieve. Understanding some of the factors that relate to sales compensation will help to address some of the common errors many companies make in designing sales rewards. Our analysis and design of sales compensation programs for the past 40 years has resulted in some common findings:

- Salespeople tend to sell within their "comfort zone" and will venture out only when the reward is significant enough. This becomes a significant issue when a company is trying to refocus its sales efforts to market to new customers or new products/services to increase market share.
- The pay plans are typically much too complicated. This results in problematic, difficult administration, lack of understanding by participants, inconsistent interpretation, and lack of focus.
- There is often a variance between the business model and marketing plan and what the sales compensation plan is telling salespeople to do.
- The sales quotas are a major source of friction between management and the sales force. Sales quotas are often considered by the sales force to be unrealistic, unattainable, and extremely arbitrary. However, they

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typically become the basis for establishing the company's financial plan. Lack of communication between managers and their sales team often results in these unrealistic quotas, but many managers are afraid to approach their salespeople for fear of "rocking the boat."

In order to design an effective sales compensation plan, we have devised a simple five (5) step process that considers and integrates the pay plan with the company's other plans and programs. Specifically:

Step One: Clarify the company's expectations for maximizing its overall sales effort.

- Should the emphasis be on selling new customers or maintaining and broadening sales to the existing customer base?
- What is the company's intended market differentiation? Will it be the low cost leader, or provide the best quality, or offer the fastest service? Will the company be known for one-stop shopping, or will its differentiation be as a product specialist or the most innovative?
- Does the company have a clear understanding of what the customer wants, needs, and expects from its products and/or services? The sales compensation plan and the sales process should reinforce the customers' expectations. Thereafter, are your salespeople delivering on what they promised?
- What is the best method to get to your existing and potential customers? What type of support is the company providing to the sales force (advertising and marketing materials, staff personnel, quick turnaround, training assistance, warranty services)?

Step Two: Determine what works and what doesn't work in sales compensation.

- Most companies have tried many different approaches to paying their sales staff; however, most have not spent much time trying to analyzing what works. This is where many plans fail, because a company fails to plan accordingly.
- Pay plans are typically made up of several components which are often complicated. In many cases, the underlying plans may be fine and, therefore, only portions of the plans have to be redesigned.
- The actual administration of the plans is often the culprit, rather than the plans themselves. The administrative requirements of a plan should not outstrip a company's administrative capabilities. The administration must be able to recognize the length of the sales cycle, track sales efforts and assign credit appropriately, provide quick and accurate data, and calculate rewards on a timely basis.

Step Three: Identify other influences and issues related to sales success

- Sales compensation is only one component

impacting a company's overall ability to attract capable sales staff, retain the most productive people, and provide sufficient motivation and focus. Although money has a strong influence on all of these processes, there are other significant aspects that must be evaluated and addressed. These include the profile and capabilities of candidates (and therefore their ability to succeed), the level of sales and product training that the company provides, inherent "sacred cows" and historic procedural rules, and organizational issues, as well as a host of other non-monetary considerations.

- The company also needs to recognize its competition, both from a business and compensation standpoint, in order to address attraction and retention issues through its sales compensation design.

Step Four: Model and test new sales compensation programs.

- The first thing that must be done when a new plan is ready to be launched is to agree on how performance will be measured. The target has a tendency of moving based on reality, and therefore, it is important to set realistic goals, minimum levels of acceptable performance, and performance levels that would be considered as outstanding.
- Based on the agreed-upon performance metrics, the company should use historical performance levels to assess how the new plan would work and what awards it would pay out, compared with what actually was paid under the prior plan. This assessment is critical to understand how the new plan will impact overall compensation for the sales force.
- Pilot studies are an effective way to assess how the new plan will work in a real-life setting. The performance of the plan in a discreet area of the business will help the company determine its future success on a broad scale, and provides the opportunity for fine-tuning.

Step Five: Implement new plan and measure plan success.

- Implementation is a critical aspect of how a new sales compensation plan will eventually work. Successful implementation is based on the manner in which the new plan is communicated to participants, management and administrative staff, and the monitoring of activities to determine its effectiveness. Training the sales force, their managers, and the administrators on the plan's mechanics is also a key aspect of success.
- A key component of implementation is determining how the new plan will be phased in. A new plan is often compared with changing the tires on a moving vehicle; careful planning is needed to avoid upsetting the "apple cart". While there are different approaches for timing the implementation of a new plan (such as cold turkey, grandfathering, phase-in, etc.), each approach has its merits and potential disadvantages,

so it is important to think the alternatives through carefully.

- To the extent possible, it is better to sacrifice how much business the new plan generates for how well it works within the economic realities of the company's business environment. This can best be gauged by looking at the company's performance against its peers, changes in market share, etc.
- The plan should be evaluated on a periodic basis, consistent with the length of the sales cycle (short sales cycles would suggest a more frequent review of plan performance, and vice-versa). Any identified issues with the operation of the plan can then be addressed and any changes can then be made. The result of this evaluation should yield no major changes in plan design if the steps above were followed. Ultimately, the company needs to ask itself if the new sales compensation program is achieving the

objectives it was originally intended to accomplish.

The point in preparing this overview is to reinforce the awareness that sales compensation relates directly to the success or failure of companies, and it requires a thoughtful and systematic process to analyze what the plan should do, and how to maximize its effectiveness. In other words, we believe that it is critical for companies to take the time to conduct a systematic and thorough review of their sales compensation plan. The payoff will be well worth the effort by recognizing when and where adjustments will be required, particularly as the market, your business, and your competitors change. But don't keep tweaking it, or worse still, trashing it annually. You will lose the trust of your sales force, and they will assume that your intention is merely to save money at their expense.

WHAT OUR PEERS ARE SAYING: INSIGHTS FROM WORLDTATWORK AND SHRM SHOWS

Members of **CRI's** staff were proud to participate in this year's annual WorldatWork and Society for Human Resource Management (SHRM) conferences. As expected, attendance was not as strong as in previous years as a result of reductions in expenditures, but those that attended proved to be a receptive audience seeking insights into specific human resources and compensation "ailments."

As expected, attendees expressed the desire to be able to do more with less, whether it be in providing salary increases or motivating staff using incentive dollars. Although the current state of the economy has severely impacted many organizations financially, basic HR needs still need to be met—providing competitive pay, retaining key staff, evaluating performance. Many organizations still work with outdated base pay programs, but have little or no means to correct them. Making an effort to provide some form of motivation, such as non-cash rewards or gift cards, can go a long way to help keep spirits up. Even a well-earned "thank you" to an employee who has done a good job will go a long way.

A key aspect of survival is an organization's ability to effectively and honestly communicate to their staff. This takes many forms—from the financial and operational performance of the organization, to the individual performance of each team member. In tougher times, many feel that if you don't talk about it, it will go away, but operating with blinders on will only have a negative effect in the end. Employees need to know how the company is doing, but don't need to know all the details. Being honest and forthcoming with information will avoid false perceptions and rumors that can hurt morale.

While some say that we have hit the trough in the recession cycle, the labor market still has a significant way to go. But being prepared is a sign of a strong organization poised to deal with each new situation. With the future upswing in the economy, companies must prepare for the possible turnover of staff who may feel the grass is greener somewhere else. Keeping up with compensation and HR processes, including performance evaluations, looking at market pay, reevaluating current plans, etc., will help to prepare you for that future.



Pictured L-R: Sean R. Gimpel, Diana D. Neelman, Pamela S. Dorf, and Paul R. Dorf, Principals of **CRI**.

DESIGNING A NEW COMPENSATION PLAN: WHERE TO GET STARTED

Although some people may question it, in light of the recent economic conditions, we believe that organizations are generally well-intentioned as far as their human resources and compensation processes go. They understand the value of human capital and the costs (both direct and indirect) of turnover. They know that providing competitive, motivational pay with rewarding career opportunities will enable the organization to keep its best talent. However, many organizations, particularly those that were recently formed or have experienced significant staffing changes, struggle with the mechanics of designing a new plan or updating a current program. Often, internal staff, while talented to tackle such initiatives, just does not have the time to devote to such a project. Many, however, find themselves in a position to **need** to develop new plans. So where, therefore, do you get started?

Ultimately, the success of any program, particularly a compensation plan, starts at the top. Top management commitment is essential to ensuring a plan's effective implementation, and communicates the "right" message to staff—that they are important and that their efforts are appreciated. Getting buy-in, however, can be a daunting task, but need not be an exercise in futility. Prepare key statistics regarding turnover, conduct preliminary research on pay levels for benchmark jobs, and assess when the last update (if any) was made. Evaluate your culture and assess any morale issues that can be tied to pay. Understand the pros and cons of what you want to do. Be prepared to answer tough questions from the boss, but stand behind your message.

Once top management commits to the process for a new/ updated compensation plan, the following key steps should be undertaken to allow for a systematic process for accomplishing your goals:

- Prepare a work plan covering approach, timetable and deliverables
- Clarify your compensation strategy (as it relates to your business plan)
- Identify resources and collect data
- Conduct a thorough investigation and analysis
- Design an appropriate plan
- Test and model assumptions
- Prepare and review findings and recommendations
- Implement, communicate, and train
- Provide on-going program support and follow-up

This may seem like a tall task, but if you are able to enlist the help of individuals within your organization to assist, it would lighten your load. Use other resources as well, such as your local compensation or HR professional association, a qualified compensation expert, or peers.



CRI provides compensation and human resource consulting services to mid- and small-cap public companies, private, family-owned, and closely held firms, as well as not-for-profit organizations. **CRI** specializes in executive compensation, sales compensation, pay-for-performance and incentive compensation, performance management programs, and expert witness services.

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2009/2010 Annual Salary Budget Planning Survey

Results to be released shortly!

CRI is scheduled to release the results of this important survey by September 30, 2009. This survey provides critical information for compensation trending and planning purposes, covering companies of all sizes, locations, and industries. To find out more about this and **CRI's** other surveys, visit our website at:

www.compensationresources.com/members/