SEVEN
Vexing Sales Compensation ISSUES
Before selecting an incentive formula, sales compensation designers need special solutions to address seven vexing conditions.

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Sales compensation is a superb, time-tested compensation tool. Companies use sales compensation to confirm sales objectives, improve sales productivity and reward sales results. Generally, a sales compensation design team can successfully devise an effective incentive plan simply by identifying and rewarding the preferred outcomes. In most sales situations, this is not an overly complex undertaking and easily accomplished. However, the success of a sales compensation plan often is thwarted by one of the following seven vexing sales compensation issues. Not all companies will have these issues, but when the issues do arise, the sales compensation design team needs to use creative techniques to ensure the success of the sales plan.

Vexing Issue #1: Rewarding Long Sales Cycles
A sales cycle is the time needed to close a sale. Sales compensation plans are ideally suited to reward selling efforts that are considered short sales cycles, which are typically less than 12 months and often cluster between one and three months in length. Sales compensation works best with short sales cycles. In such situations, the sales incentive plan can rely on relatively accurate quota setting under circumstances that give sales personnel many selling chances, or times "at bat," to achieve sales success. Short selling cycles allow for frequent payouts that are consistent with the motivational intent of sales compensation. However, with long sales cycles – more than 12 months – three important sales compensation fundamentals do not work well:

- Twelve-month quotas are inappropriate – they represent too short of a measurement period
- High-mix (low base salary) plans are implausible because of cash flow considerations
- Infrequent payouts compromise the motivation created by frequent rewards.

Solutions for Long Sales Cycles
Sales compensation designers use the following techniques to address the situation of long sales cycles:

- Raise the base salary, reduce the upside potential and tie incentive payouts to management-by-objectives (MBO) goals – the accomplishment of sales actions
- Continue to use high-risk plans while letting the pay plan operate with a boom/bust pattern: "When you win, you win; and when you lose, you lose.”
- Provide MBO earnings up to target pay; grant significant contract signing bonus at time of order booking
- Shift job to an “asset manager” status and reward for performance against a comprehensive and accountable customer account strategic plan. Each of these techniques provides some relief, but does not fully solve the problem.

Vexing Issue #2: Handling Unpredictable Mega Orders
Most sales organizations are happy with large (mega) orders even when such orders are not predictable. Top management always will seem to find virtue in such mega orders even when they fall below target profit objectives. Why? Because such orders help achieve a sales division’s objectives. Frankly, most companies welcome such orders – the more the better. Unfortunately, sales compensation programs struggle to anticipate these orders. Assigning uncertain quotas makes for unpredictable payouts that can be either too small or too large. Pay variations can be stark with “empty envelope” payouts or “lotto-ticket winning” paychecks.

Solutions for Rewarding Unpredictable Mega Orders
Companies use several methods to address unpredictable mega orders:

- Cap large orders. While caps are effective at managing pay, they spawn widespread negative perceptions.

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Quick Look

- Sales compensation works best with short sales cycles; however, special solutions are needed for long sales cycles.
- Sales compensation plans are most effective when revenue can be fully recognized at the time of order placement.
- It’s important to define a true ‘global’ account before selecting the appropriate crediting choice.
- Companies should avoid crediting sales personnel for e-commerce orders in which they do not influence the sale.
• Exclude large orders from the quota and provide a separate regressive payout schedule.
• Exclude from quota, but pre-register large orders. Provide a reduced rate for such orders, but provide an even lower (paltry) payout for non-registered mega deals. This practice helps flush out such orders for planning purposes.
• Constantly change quotas in anticipation or delay of a mega order – one of the most common and least effective methods.

Sales compensation plans work best when revenue can be fully recognized at the time of order placement.

Vexing Issue #3: Paying for Multi-Year Contracts/Continuing
Sales compensation plans work best when revenue can be fully recognized at the time of order placement. Multi-year contracts present an unusual challenge for sales compensation plans. For example, when should revenue be recognized for pay purposes? And, what happens if the contract is cancelled and not fulfilled? Likewise, continuing revenue presents similar challenges. Examples of continuing revenue include insurance premiums, rental payments, subscription fees and, in some cases, usage-sensitive revenue such as telecom services and hosted software applications. The question remains: When should the compensation plan recognize the sale for incentive payment purposes?

Solutions for Recognizing Multi-Year Contracts/Continuing Revenue
Three choices exist for multi-year contracts:
• Stagger payouts over the life of the contract, with later years having lower payouts than the initial years
• Calculate a "location life revenue" for estimated revenue contribution over life of contract, apply net present value discount and make payment
• Provide contract-signing bonuses at the time of initial order. Link payment to estimated value of contract.

For continuing revenue, the least preferred solution is to make incentive payments on continuing revenue as if it were "new" revenue. This creates an "annuity" mentality and contributes to the decline in sales productivity. As with multi-year contracts, an estimate of sales value (first year revenue, location life or total contract value) can form the basis of the payout.

For usage sensitive revenue, two choices are available:
• Sample revenue period, such as month four and month five to measure and reward sales success
• Or, provide incentive payments for all incremental business during the first 12 months or some other comparable period consistent with contract duration.

Vexing Issue #4: Crediting Global Accounts Sales
Global accounts purchase products on a worldwide basis. For these accounts, the sales event – where the point of influence occurs – and the "ship to" location may not be the same. In such cases, the person who sells the account may not receive credit for the sale because the accounting system only recognizes the "ship to" location for sales-creating purposes. For example, while headquarters may authorize the purchases, the local facility – possibly in another country – places and accepts the order. In this scenario, the local salesperson gets full credit for the order, even though the headquarters sales person was responsible for "selling" the product. How should sales be credited for global accounts?

Solutions for Crediting Global Account Sales
An obvious question, which is sometimes overlooked, is whether or not the account is truly a "global" account. In some cases, sales management mistakenly assumes that a large multinational corporation is a "global" account and assigns a global account manager to the headquarters location. However, the customer is actually run very locally with little or no headquarters influence over purchases. This type of account is not a global account.

If the customer is a true global account, the following crediting choices are available for sales compensation purposes:
• Double credit the global account headquarter sales representative and the local representative for the same sale. Inflate the quotas of both sellers to reflect this double crediting.
• Provide a fixed split for all sellers, for example, 50 percent for the headquarters seller and 50 percent for the local seller.
• Use customer relationship management (CRM) software to identify and reward point of sale.

If the account buys in a central manner, then place all sellers in a self-contained global account team. Reward all personnel for worldwide global account results.

Vexing Issue #5: Crediting e-Commerce Sales

e-Commerce is a new and rapidly growing sales channel. Should sales personnel receive credit for e-channel orders or should they receive no sales credit for such orders? In some cases, the e-channel operates independently from the existing sales channels, even providing unique products. In other cases, the sales person encourages the customer to order via the Web, the e-commerce site being a fulfillment vehicle for their orders.

Solutions for Crediting e-Commerce Sales
The following represent various crediting practices reflecting differing roles of the e-commerce channel. As a general principle, avoid crediting sales personnel for orders that they do not influence. If the e-commerce channel provides fulfillment of sales generated by the sales personnel, then credit the sales personnel with the order. If necessary, for cooperation purposes, provide a "token" payment for orders placed by the customer without sales involvement. This "token" payment should be less than the full credit. This program should have a "sunset" clause where such payment expires at some point in the future.

If the e-commerce site operates without the influence of sales personnel, do
not provide credit to sales personnel for compensation purposes. Finally, consider creating multiple Web sites for “assisted” sales, those involving sales personnel and “unassisted” sales for customers that make purchases without the support of sales resources. Provide incentives for customers to use the “assisted site,” reward sales personnel for such sales, but not for sales on the “unassisted site.” Differentiate the offerings between the Web sites.

In some cases, the e-channel operates independently from the existing sales channels, even providing unique products.

Vexing Issue #6: Rewarding Sales-Out Performance
Rewarding sales-out performance is one of the most vexing sales compensation issues, with costly and only partially effective solutions. (“Sales-out” is the sales event when the end-user buys a product at a dealer or a local distributor.) Most manufacturing companies deploy “end-user” sales personnel, although the product is bought through an indirect channel partner such as a dealer, distributor or value-added reseller (VAR). In such situations, the end-user seller causes the customer to buy, but because of order tracking limitations of channel partners, independent verification of the final order to the customer is problematic. Most go-to-market strategies feature several levels of distribution. Consequently, securing accurate “sales-out” data is next to impossible with 100 percent accuracy. As a result, assigning sales credit for “sales-out” influence to the original end-user seller often is confounded by the channel partners’ cooperation and data constraints. End-user sales personnel know they are responsible for the sale, but information from channel partners often is incomplete, inaccurate and not timely. This creates great frustration for sales personnel, often turning them into accountants as they scour the order records from channel partners to confirm shipments to their customers.

Solutions for Sales-Out Crediting
Not many good choices exist to solve this problem. The following are examples of how companies try to solve the issue of sales-out crediting for end-user sales personnel:

- Put all end-users on a “team” incentive
- and recognize total volume of “sales-in” to all channel partners
- Reward the channel partners for providing sales-out data on a customer-by-customer basis
- Realign sales personnel around channel partners, not end-users. (This works best when few channel partners exist and channel partner conflict is minimal.)
- Alter the role of the end-user sellers from product pushers to the sellers of branded integrated solutions. See Vexing Issue #7 about product selling versus solution selling.

Vexing Issue #7: Rewarding for Solution Selling (Not Product Selling)
Most sales organizations begin their existence as a seller of products. Over time, the value of the core products may reach a commodity or low margin status. Concurrently, customers begin seeking more comprehensive integrated solutions. Management often makes substantial investments to provide this full solution; however, the sales force struggles to adopt these new sales models. This mid-stream change in sales charter from product to solution selling presents a difficult challenge for the sales organization. Can the compensation program help foster this change?

Solutions for Rewarding Solution Sales
The best “solutions” to initiate integrated solution sales usually are not compensation-related. Instead, successful companies focus on segmenting the customer base into accounts that show the best promise for making such purchases, and dedicate a unique sales team to this effort. Another helpful technique is to request that marketing provide well-developed sales collateral to help sales personnel “pitch” the new, comprehensive offering. A final, non-compensation method is to provide “solution specialists” in the field to work with sales personnel to promote the more complete solution offering. If, however, the current sales personnel only need a minor “nudge” to promote the solution, then adjusting the pay plan to reward solution sales at a greater rate than product sales may provide the needed push to migrate to the new sales model. A second, more compelling method is to reward solution sales and to provide no credit for “product only” sales.

Be Prepared
Compensation managers need to anticipate potential vexing issues. As part of the planning process, compensation managers should be on the lookout for these situations. Rather than attempting to deal with these issues during the formula design discussions, it is best to get them pre-identified and addressed as policy issues. But the seven vexing sales compensation issues are just that – vexing. Solutions can be crafted to address these situations; however, they will remain a challenge for sales compensation designers.

ABOUT THE AUTHOR
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