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Designing Effective Sales Quotas in Today's Market Requires Custom Tailoring

By Joseph DiMisa

Setting sales quotas has never been more difficult. Although the economy is showing signs of improvement, economic uncertainty and the sales volatility associated with it are making it more difficult than ever to set goals. Historically proven assumptions are unreliable barometers of what is to come. The challenge for organizations is to determine the best quota-setting approach in an environment in which next year's sales may be quite different from the previous year's.

It is important to note that there is no single solution. The quota-setting process must be tailored to each company's situation and limitations. This article offers "Ten Rules for Effective Quota Setting" (see the table on the next page) and provides guidance for tailoring those rules to meet a variety of challenges. It will cover how to:

- Gather the data that is needed to inform quota decision-making,
- Select the best type of quota,
- Choose the proper quota-setting methodology given the company's products, strategy, markets and representative profiles, and
- Manage expectations for the quota-setting process.

Gather the Data

To set accurate and effective quotas, an organization must first determine marketplace potential and identify the factors that affect sales performance. The key is to gather as much information as possible to understand and make assumptions about customer need, historic production, current capacity to sell and corporate sales objectives. Quotas are only as good as the data behind them, so the more data gathered the better. Organizations need to answer the following questions:

- ***How does the organization define sales performance?*** The answer to this question — volume, activities and/or revenue — will help the organization define sales performance and target the right production.

- ***How predictable are sales results?*** The answer will help the organization understand business cycles and the timing of sales results.

- ***What external and internal factors influence a representative's performance?*** Identifying these dynamics will allow the organization to make adjustments based on conditions that may be out of a representative's control.

- ***What is a representative's total selling and non-selling time?*** The organization needs to understand how much time a representative has available and his or her capacity to meet objectives.

- ***How many deals flow through the sales funnel? How long does it take? How much is the average deal worth?*** Understanding this process will put a realistic time frame on the length of a sale, the value of each step and, ultimately, expected production.

- ***How much is the organization willing to spend to achieve a sale?*** This will identify what resources should be used during the selling process and how much the organization can ultimately pay out for each sale.

- ***What is the incremental sales potential for areas where the representatives will do business?*** Answering this question will provide insight into the sales potential in each market and/or area. It will help the organization align its resources and set targets.

If certain market information is unavailable, quotas may need to be more company-centric, relying on performance or internal growth objectives and assumptions rather than customer or market considerations.

Ten Rules for Effective Quota Setting	
1.	**Simple is good.** The simpler the quota is, the easier it will be to communicate and administer, and the more likely it is to be effective.
2.	**Too simple is bad.** Quota-setting processes that skip fundamental steps will result in inaccurate quotas that will not motivate superior performance.
3.	**Consistency improves quality.** Annual use of transparent and predictable methodologies contributes to management and sales force comfort with quotas.
4.	**A bad process is better than no process.** Starting with a bare-bones process will enable continual modification and improvement. No process leads to disaster.
5.	**History, history, history.** When all else fails, gathering data on what has led to past success can help predict future achievement.
6.	**Sales funnels improve accuracy.** The steps and longevity of the lead-to-sales funnel make it a valuable quota-setting tool. The data can provide insight into sales conditions.
7.	**Know the who, what, where, when and why.** Understanding who will buy what is one of the fundamentals of good business planning. If you do not know this basic information, quotas are just a guess.
8.	**Model the options.** Modeling conservative and optimistic sales scenarios will arm sales, finance and senior executives with the knowledge to better manage quotas.
9.	**No pain, no gain.** Tension is good during the process because it inevitably leads to resolving issues. If it is not hard, it probably is not worth doing.
10.	**Ownership improves accuracy.** Assigning clearly defined responsibilities for the quota ownership process will reduce confusion and redundancy and improve the process.

Select the Best Type of Quota

The answer to the first question in the previous section — How does the organization define sales performance? — is a key determinant of what kind of quota to establish. Quotas should be determined by the type of performance the company wants to achieve. Sales organizations typically base quotas on volume, financial results, activities or a combination thereof:

- ***Volume quotas***, which are the most common, focus on units sold. They are simple to understand and compute and can be highly effective when representatives sell just a few products and their prices fluctuate.

- ***Financial quotas*** make sense if revenue or profit are more important to the strategic corporate goal than volume. Companies may combine financial and volume quotas to create an environment that values strategic thinking about margin and cost. Financial quotas can be difficult to set, as regional factors will affect costs and profit. Additionally, certain products or services may require a different sales process, which can escalate sales expenses.

- ***Activity quotas***, which measure representatives' actions, events or milestones, work when the company lacks good information or historical precedents or if it wants representatives to focus on progress towards achieving financial results. They also work well when a sales cycle is relatively long — more than six months — and certain activities throughout the selling process are the best way to judge performance. The key is to define the required actions or behaviors and specify a frequency for them. Representatives may be assigned simpler tasks at first (*e.g*., contact a certain number of clients), with more tasks added over time and combined with volume or financial targets.

To ensure effective control and motivation, quotas work best when broken down to the most precise level, such as salesperson, district, branch or specific products or service offerings.

Choose the Proper Quota-Setting Methodology

Armed with the right information and an understanding about the types of quotas that will be most effective for its sales teams, an organization's next step is to select the proper quota-setting methodology. There are five primary ways to set quotas (listed in order of complexity and thoroughness from least to greatest):

- ***Fixed Allocation*** This method sets flat targets across the entire sales team. It is company-centric and simple, but it may create a "free ride" for representatives in high-potential territories or impossible targets for those in low-potential territories. Companies use this methodology when little data is available and a cost-of-sale approach is in place. It is most common in transactional environments with shorter sales cycles.

- ***Historic Allocation*** This method assigns representatives a growth target on top of last year's performance. It is also a simple process and does not account for territory potential. It may penalize strong performers as they carry the burden of a growth goal on top of historically strong performance.

- ***Adjusted Value*** This method is similar to historic allocation, but applies factors that modify the targets (*e.g.*, market opportunity, penetration of an area, competition or representative experience). It typically creates equitable objectives and is easy to administer. It can work well for organizations that have accurate market data and in markets with considerable uncertainty.

- ***Account Planning*** This method evaluates account opportunity and assigns the corresponding target to the representative that owns it. It is most effective for territories or regions with a small number of large accounts per representative. Account planning can be difficult in organizations with a large number of accounts in which the potential for sales opportunities is unknown.

- ***Bottom-up/top-down*** This method considers the potential of all accounts — how much they can sell — and marries that with corporate expectations. This is the most complete method. It is commonly used by organizations with good data and a strong performance record. It is an effective method to use in any market.

There is no right or wrong approach. The "best" solution depends on what an organization wants to accomplish and the type of information that is available. Neither the fixed allocation nor the historic allocation method considers the potential of individual accounts. The adjusted value, the account planning and the bottom-up/top-down methods are more strategic because they consider factors that influence performance and a region's potential.

Although the most strategic method — bottom-up/top-down — blends a customer-centric focus with corporate expectations, it can be time consuming to determine. The simplest method — fixed allocation — applies an equal quota to everyone, but does not consider opportunity within a set of accounts.

Organizations often combine methods to accomplish specific goals.

Manage Expectations

An individual or group must be designated as the owner of the quota-setting process. Ideally, quota setting resides in a sales operations group and includes input from finance, marketing or other functions. Clearly, assigning responsibility for setting quotas and managing adjustments ensures consistency in management and accountability.

Quota setting can also improve over time if a company uses a consistent approach. If the process frequently changes, managers never have a chance to develop proficiency in allocating quotas. Finally, quotas work best when they direct behavior in one direction. Add-on compensation components (*e.g.*, management by objective and sales contests) may lead behavior in onflicting directions.

Conclusion

While quotas are no substitute for solid sales management, they are proven tools for motivating field performance. The accuracy of quotas directly correlates to the quality of the data and the time invested in getting the quota-setting process right. The goal is not to predict outcomes, but rather to allocate responsibility for achieving the business plan in a fair and reasonable way. Organizations that take the time to follow the steps outlined above will be rewarded with more accurate and effective quotas.

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