

Paying for Sales Performance: New Research for Designing High Impact Sales Incentive Plans

Mark Dancer and Marc Wallace*

Relative to other functions within today's organizations, sales leaders and their sales forces are uniquely focused on driving performance in every minute, hour, day, month and quarter of the business year. To do otherwise is to sacrifice sales and profits, and to diminish the satisfaction of customers, which can lead to the poor performance of the entire business and failure to deliver satisfactory returns for shareholders. As a result of this hyper-performance orientation, sales incentive plans receive a great deal of attention and are subject to constant review, helpful suggestions and nitpicking from within the sales organization and from the entire company.

The focus on performance and the attention given to design decisions is entirely ap-

propriate, of course, and it creates an insatiable need for checking plan assumptions and for new thinking that can lead to productive adjustments, creative changes and occasional redesign. With this in mind, this article offers data from our "2011 Sales Incentive Report: Cross-industry Plan Design" and when combined with our experiences, a strong foundation for compensation and incentive plan practitioners, sales leaders, and others interested business professionals. Ultimately, our goal is to communicate and reinforce a wide range of best practices that can lead to higher levels of performance and an appropriate return on sale incentive investments.

Throughout this article, important findings are highlighted by differences across several industries: Industrial, Chemicals,

Life Sciences, Health Insurance, Insurance / Financial Services, Fast Moving Consumer Goods / Beer Wine & Spirits (FMCG / BWS), and Retail. General Market findings represent the cumulative results across all of these industries, and a few others. Organized in this way, our findings explore a sales continuum from business-to-business (Industrial) through consumer-focused businesses (FMCG / BWS). The Retail findings include businesses that are for the most part, a channel for products and services, with a strong focus on end consumers.

GET THE BASICS RIGHT

When designing sales compensation and incentive plans, it is important to get the basics right. Sometimes, plan designers consider this requirement to mean matching standard indus-

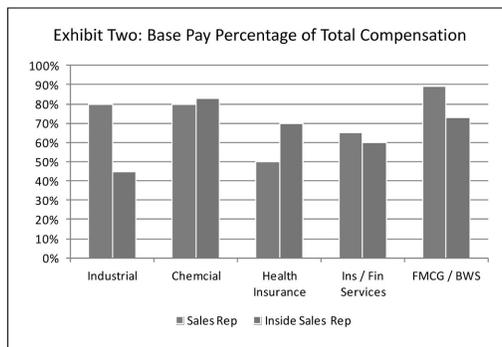
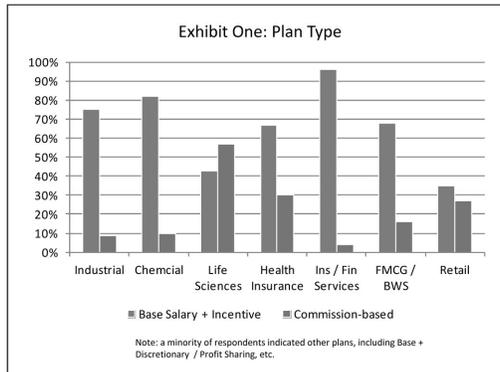
*MARK DANCER Senior Principal, leads Hay Group's Sales Effectiveness practice, and can be reached at mark.dancer@haygroup.com. Marc Wallace, Vice President, leads Hay Group's Sales Compensation practice, and can be reached at marc.wallace@haygroup.com. Hay Group is a global management consulting firm that works with leaders to transform strategy into reality. We develop talent, organize people to be more effective and motivate them to perform at their best. Our focus is on making change happen and helping people and organizations realize their potential. Visit www.haygroup.com. Hay Group's sales practices assist clients on a global basis to develop optimal channel strategies, sales organizations, roles and incentive approaches.

try practice. However, it is almost always more important to align core plan design elements with the fundamentals of your company's business strategy, work culture, performance model and sales roles. Poorly designed plans can create frustration across the entire sales force, demoralizing sales people and making it difficult to achieve sales, growth and profit objectives.

Exhibits One and Two provide cross industry benchmarks for plan type (base + bonus vs. commission-based plans) and pay mix (the ratio of base-to-

incentive pay components). Industrial plans are dominated by base + bonus plans and with sales rep base pay at 80% of total compensation, on average. This finding reflects the fact that most industrial manufacturers sell products destined for factories, machine shops and other customers that use the products to produce goods or as an input for original equipment. Purchase criteria favor long term product performance, delivery commitments and sustained quality, and brand decisions reflect total cost of ownership. Sales people have limited impact on immedi-

ate, short-term purchase decisions and instead position their company as a long-term supplier. Interestingly, telesales reps in industrial markets have a much higher percentage of variable pay (more than 50% in our study). This likely reflects the fact that telechannels are often utilized to win spot business where customers are more likely to switch on price from one purchase to the next. Thus, the impact of a telesales rep on each and every sales attempt is significant, resulting in increased use of variable incentives to drive and reward behaviors.



In contrast, sales people in the Retail industry are more likely to have a commission plan, reflecting the fact that retail sales people can have an immediate impact on shopper purchase behaviors. All of our readers have experienced this reality in their personal lives, as evidenced by the “too-aggressive” behavior of commission-based sales people. However, our data also indicate that many retail companies use a base + bonus structure. For these companies, the customers’ experience may be a critical success driver and efforts to commit sales people to interacting with customers in a way that reinforces the stores brand and market position take precedence over motivating discrete sales.

From year to year, these basic incentive plan design components generally do not change significantly. Industry players tend to get them right, and stick to what works. However, our experience indicates that companies can get in trouble when role definitions change, often as the result of new strategies that try to get different results and subsequently need different behaviors from well established positions. Examples include asking service or training positions to drive sales, or requiring “hunters” to become “farmers,” or vice versa. As the basic require-

ments of the job change, plan designers often adjust the mix of base and variable pay, and perhaps change the overall structure from bonus to commission. Or the position’s compensation plan may shift to a sales incentive plan (SIP) where it previously was not.

Trouble often comes in two flavors. Being unfamiliar with sales plan practices for fundamentally different roles, compensation practitioners often fail to design appropriate plan components. But even if they get it right, a larger issue often emerges—that sales staff often may not have the right competencies, skills or interest in changing behaviors. In these cases, the “personal DNA” of individuals has a much greater effect than incentive plan design, and it can be a mistake of monumental proportions to assume that variable incentives will drive change in the workforce. Employee engagement, customer dissatisfaction and change fatigue can all occur, and cause massive disruptions of organizational effort and business results.

REWARD PERFORMANCE, ACHIEVE ROI

Well-designed incentive plans adequately discriminate in compensation between top, middle and bottom performers. Top performers achieve excellent sales results, measured by rev-

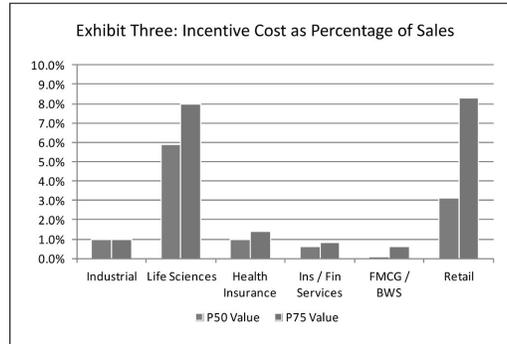
enue, growth or profits according to individual company business priorities. Middle performers deliver solid results and represent the bulk of the sales force and associated sales results. Bottom performers either develop as sales people and deliver better sales results, or are encouraged to pursue a career more in line with their interests and abilities. These are the cold hard facts of managing a sales organization, and incentive analysts and designers spend countless hours examining correlations of sales results and sales force demographics including performance, tenure, competencies, customer assignments, territory balance, etc. Variable pay is designed to reward performance and while fairness is an important consideration, sales organizations are at their core, meritocracies. As the office kitchen sign in the movie adaptation of Glengarry Glen Ross proclaimed, “Coffee is for closers!”

Sales incentive plans are also an investment and the sales force is often considered one of the largest assets of a company, meriting comparison with hard and soft assets such as physical plant and intellectual property. A company’s sales force is most likely to be the one asset that is most responsible for keeping the lights on by satisfying customers and

generating cash. And like all assets, a sales force must generate an acceptable return on investment . . . and so must the investment in the variable sales incentives that promises to maintain high level of engagement and drive business results.

Exhibit Three highlights this requirement by providing data on sales incentive spending as a percentage of sales, as measured by companies that target 50th percentile and 75th percentile compensation plans. The difference in data across indus-

try highlights two important findings: 1) the cost (and therefore, importance) of sales incentives varies across industries, and 2) companies that invest in a more costly sales force must demand significantly higher levels of performance.



In our experience, consideration of a sales force as an asset subject to normal business management practices identifies an important and often overlooked priority: C-suite executives must demand that the sales force contribute to organic growth through measured gains achieved from continual improvement and performance management. Companies that adopt this mindset often achieve success by implementing programs that move middle-level sales performers closer to the results achieved by top performers. The numbers tell the story. In a sales force with a standard 20% / 60% / 20% distribution of performers, improving the results delivered by the “middle 60” to approach the level of top

performers can deliver incremental sales gains of 15 to 20 percent! These results can be a career-making outcome for sales leaders, and should more often be a standard expectation.

Exhibit Four brings this discussion back home to incentive plan design. For plans that include a threshold on incentive payout, setting plan specifics relative to meeting or exceeding individual targets, and the distribution of payouts across the performance range is important for establishing appropriate motivation and rewards for performance. In the aggregate, this aspect of plan design should also address the plans for organic growth targeted through sales force continual improvement efforts. Ultimately,

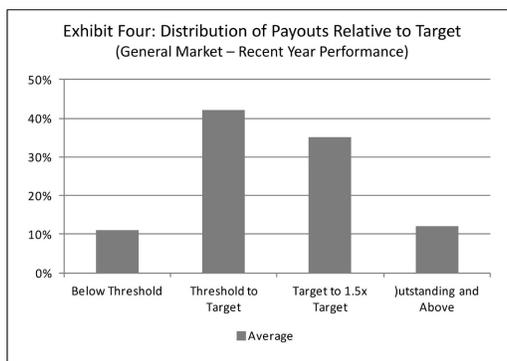
decisions around threshold and differentiated performance also reflect the desired sales culture, as measured by the specific behaviors and values that achieve the desired aggressiveness, competitiveness, customer orientation, and value vs. transactional selling.

Exhibit Four reinforces another critical aspect of incentive plan design—setting goals for sales person performance. Our General Market findings indicate that only 40% of sales people, on average across all respondents, achieved “threshold to target” results. This implies that for the remaining 60%, goals were either too high or too low. Depending on the specific situation of individual companies, this structure may motivate

sales people to excel, but it could also have the opposite effect if sales people view the

goals as unrealistic. Either way, it's important to follow a disciplined process for setting goals,

and to judge results against sales force engagement and other satisfaction factors.



THINK (JUST) OUTSIDE THE BOX

Companies with a reputation for leadership and innovation are increasingly challenging their assumptions behind incentive plan design, as well as the results that incentives are intended to achieve. Sometimes, new ideas rock the foundation of long-held beliefs, but our research indicates that variable incentives are here to stay, if for no other reasons than a self-fulfilling prophecy. Most companies tend to hire sales people that are competitive and achievement-oriented, and reward plans match these profiles with appropriately designed variable incentives, which in turn reinforce intrinsic motivations and validate success. A failure to do so will likely cause a top level sales rep to find this reinforcement elsewhere. Still, some companies sense an opportunity for creating competi-

tive advantage through fundamentally different incentive strategies, and attempt to do so with care not to “blow up the ship” through rapid, large scale change. That is, they think “just outside the box.” Most importantly these changes should be rooted in the business priorities, work culture, and performance model of the organization.

In Exhibits Five and Six below, our research provides data in two key areas of incentive plan design: shared performance measures and qualitative metrics. Plans that address shared performance reward more than one individual against the same sales, revenue or profit result, often measured at a higher level than achieved by an individual sales person. Qualitative factors can include management by objective (MBO) goals, customer satisfaction, customer relationship management (CRM) policy com-

pliance, and a host of other measures. Traditionally, qualitative factors are strongly deemphasized in favor of easily measurable, direct output measures including sales, share, growth, etc.

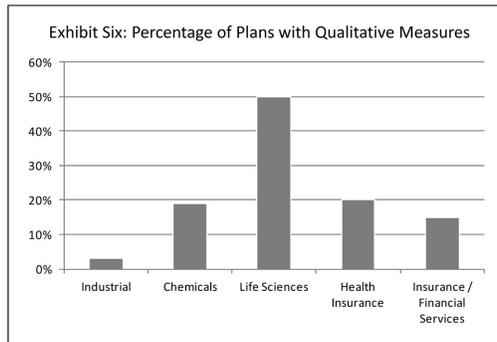
As for shared performance, today's hyper-competitive markets are diminishing the ability of a sales person to succeed as a lone wolf. Value-selling and solution-oriented offerings require cross functional execution that is difficult to achieve if the goals of leaders (across functions and markets) are not aligned, and in turn, reflected in the reward plans of individuals further down in the organization. For sales people, this can mean added emphasis on incentive plan components that roll up performance to aggregated geographies or business units. Team incentives can also be introduced or receive increased weightings, with teams de-

signed fully inside the sales organization or across functional boundaries.

Exhibit Five : Individual vs. Shared Performance

Includes performance measured as ...

| | District / Corp. / Div. / | | | |
|--------------------|---------------------------|--------|------------|------|
| | Individual | Region | Subsidiary | Team |
| Industrial | 82% | 32% | 87% | 18% |
| Chemicals | 87% | 38% | 61% | 18% |
| Life Sciences | 54% | 23% | 23% | 8% |
| Health Insurance | 81% | 2% | 15% | 28% |
| Ins / Fin Services | 68% | 16% | 21% | 5% |
| FMCG / BWS | 57% | 9% | 73% | 13% |
| Retail | 62% | 23% | 12% | 4% |



Successful executions of these incentive plan strategies pay attention to two realities. First, shared plan components, at least historically, are not the primary plan metric in terms of overall weight. But when they are important, qualitative metrics must receive sufficient weighting to be meaningful for driving sales behaviors, or risk being ignored. Second, as the sales incentive plans emphasis on individual performance decreases, other drivers of sales effectiveness must step up, and can include new requirements for first line managers, coaching programs, or investments in fostering the desired sales culture.

Qualitative metrics are another plan component that is getting increased attention. In our experience, qualitative measures are often viewed as blunt instruments for effectively rewarding performance because, by definition, qualitative metrics are difficult to measure, highly subjective and hard to communicate. However, they can play a pivotal role during sales force transition. Or, qualitative metrics can help balance plans that tip heavily toward score card metrics. In these situations, qualitative measures focus on key inputs (vs. output metrics) and may help improve sales effectiveness and financial results by encouraging actions that improve personal develop-

ment, operational practices or customer goals. Examples include compensating account managers for the quality completion of customer account plans, or reflecting mystery shopper results in sale person incentives as part of a strategy to improve customer experiences.

Our findings highlight higher relative use of qualitative measures in the Life Sciences industry, an industry that has been in transition for several years, and facing years of change to come. The strategic importance of these company's sales forces is shifting from field reps that indirectly influence sales through physician pre-

Paying for Sales Performance

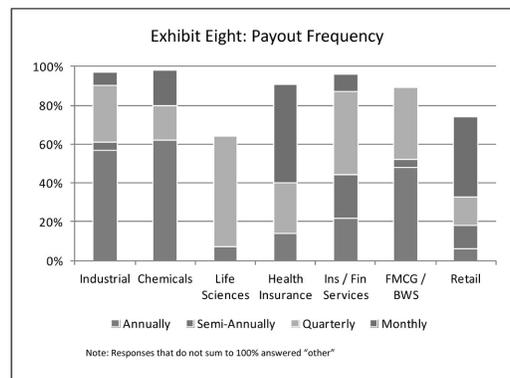
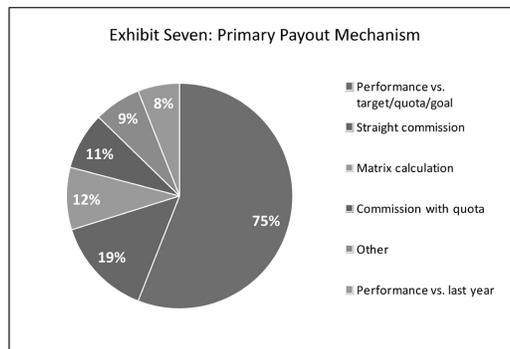
scriptions to business-to-business strategies that seek to create value across the ecosystem of healthcare players including health insurance payers and healthcare providers, among others. As the impact of healthcare reform continues to unfold, one can expect qualitative measures to make a strong contribution to the constantly evolving organizations responsible for market access and business results.

MATCH SALES PROCESS; EXCEL AT CULTURE

Having considered the basic and strategic ends of sales incentive plan design, our re-

search now turns to the mechanics—payout mechanisms and frequency. Exhibit Seven provides General Market findings around quotas, commissions, matrix tradeoffs, and other combinations. Exhibit Eight provides industry benchmarks for payout frequencies from monthly to annual. For both data, however, it's important to note that while there are often standard industry practices, most plan designs boil down to making decisions about what is "right" for the individual company based on its business priorities, work culture and performance model and the sales process executed by its sales force.

One important guiding principle is to provide payouts at a frequency consistent with sales effort or key outcomes. For long sale processes, this implies an annual payout. When sales results are achieved more frequently, monthly payout can provide timely rewards, although an administrative burden. Quality goal setting is another key requirement. When goals are poorly conceived, sales incentives may not reflect individual performance, which results in declining motivation or too-high (or too-low) sales costs.



Working with clients, Hay Group has found that sales plan professionals pay considerable attention to these important components of incentive design, but that the organization as a whole neglects other variables that drive truly excellent or outstanding results. In essence, these “mechanics” of compensation plan design are an “engine” for driving sales results, but top sales organizations pay even more attention to “the driver they put behind the wheel.”

Best-in-class sales organizations complement quality plan design with additional investments in three areas: well developed competency models, high-impact coaching programs, and careful nurturing of the sales culture. In practice, all three investments are interrelated. Competency models identify the distinguishing behaviors that lead to success, which enables first line sales managers to provide coaching that actually drives measureable, incremental gains. As sales people improve their understanding on how to become better sellers, they achieve increased levels of performance, and are rewarded with recognition and compensation. Sales culture is the glue that holds everything together, and is a unique re-

quirement relative to other functions inside a company.

Sales organizations can be characterized as collections of aggressive, achievement-oriented people, working in parallel, often in far flung geographic locations with little direct, in person day-to-day observation by sales managers. Clearly articulated and frequently reinforced values, managed as the sales culture, are essential elements for success. Outside the sales organization, the execution of the sales culture is often viewed as annual sales meetings, expense budgets for travel and entertainment, and deference / visibility provided to top performers. Inside the sales organization, the impact of a high-performing sales culture is evident in more practical outcomes. Is coaching by sales managers effective, consistent and continuous? Do district sales meetings achieve the right balance of “focusing on the numbers” and enabling sales people with practical solutions for “moving the ball” across the sales pipeline? Is marketing considered “part of the solution, or part of the problem”? And so on.

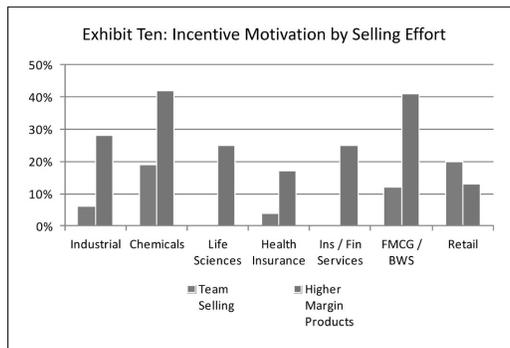
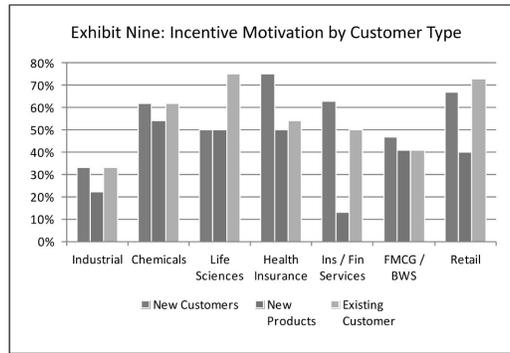
INITIATIVE VS. DIRECTION

Many companies create a

false choice between letting high-skilled, professional sales peoples set their own priorities versus micromanaging through daily directives and incentive plans that attempt to control behavior. The choice is false because there is truth and value on both sides of the equation. Talented sale people will make good decisions, but all sales people, including the best, do even better when they understand what is expected of them, and when they are well versed in the specific behaviors that drive success.

Sophisticated sales plan designers, and the leaders to which they are accountable, understand the danger of accepting the false choice and the resulting “under management” of the sales force that can result. Thus, while it is not a requirement, many sales plans include elements that align incentives with business and sales objectives that prioritize prospects, products, and customers. Others address behavior such as team selling or placing emphasis on products (or customers) according to relative profitability. Our research findings across industries are presented in Exhibits Nine and Ten.

Paying for Sales Performance



Experienced sales leaders know that the proper perspective is not that “you can lead a horse to water, but you can’t make it drink,” but rather, sometimes, “you must lead the horse to water so that it can drink.” Sales people are genuinely appreciative when they are pointed at opportunities that can be closed quickly with the maximum benefit for the customer and the company.

DESIGNING FOR SUCCESS

The guiding principles and research benchmarks provided

in this article and our research touch on many of the basic (and some advanced) requirements for high impact sales incentive plan design. However, true success is achieved within individual organization, and is fostered by setting clear goals around expectations for business results. Successful companies confirm strategies, review past data and results, think creatively, and then set objectives around the organic growth that must be contributed by the sales force. Clear direction is provided to incentive plan designers, and also to the first line

managers that will track results, provide coaching and manage performance. To skip any of these practices is the organizational equivalent of “getting behind the wheel” of a high performing sales organization without communicating a destination, providing road maps, or identifying the fueling stations along the journey. To paraphrase sage advice, “If you don’t know where you are going, there is no telling where you will end up.”