



# Introduction to Sales Compensation – Part II

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# Agenda

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- > Introduction and Part I review
- > Aligning sales compensation plans with the business strategy
- > Steps in sales compensation plan design
- > Sales incentive plan types
- > Plan variations by role
  - Base-incentive mix
  - Plan accelerators and payout scales
  - Plan measures
- > Critical factors outside the plan design

# Introduction and Part I Review

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- > This is a ***follow-up*** and ***not a repeat*** of last year's Introduction to Sales Compensation webcast
  - A copy of that presentation and audio file is available on the webcast page of the Radford Network
  
- > Topics covered in Introduction to Sales Compensation – Part I
  - Common sales compensation terms
  - Non-sales vs. sales compensation
  - The team approach to sales incentive plan design
  - The sales executive as a client
  - Sales compensation plan design basics
  - Common mistakes new sales incentive plan designers make
  - Top ten ways to ensure sales compensation plan success

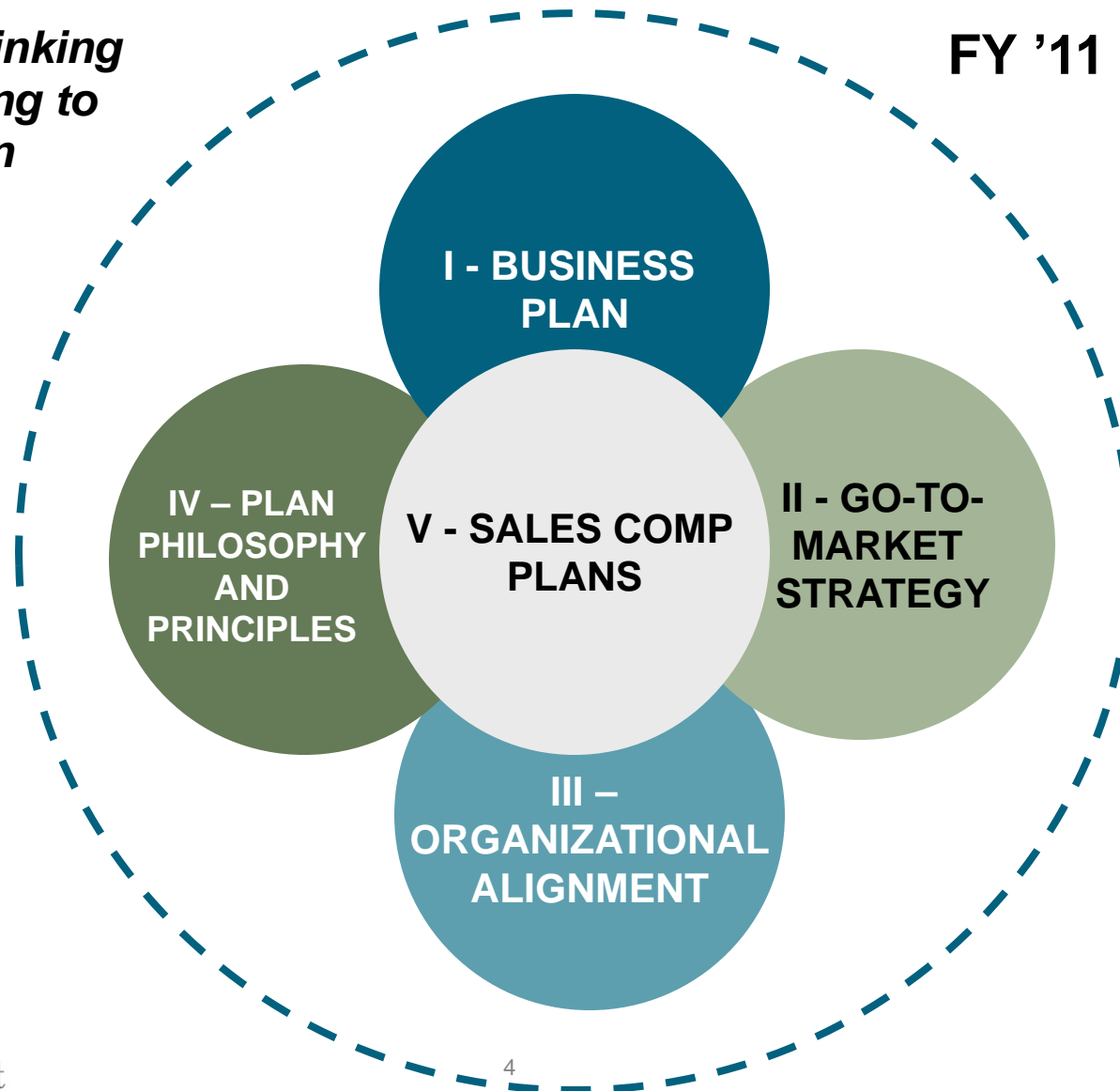


# Aligning Sales Compensation Plans With the Business Strategy

# Sales Compensation Plan Alignment

*Focus on linking  
the following to  
plan design*

**FY '11 FRAMEWORK**



# Sales Compensation Plan Alignment

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- > Designing sales compensation plans is the last step
- > An understanding of the following are critical precursors
  - Business strategy and objectives
    - > Growth vs. flat vs. declining revenues
    - > New vs. recurring accounts
    - > Legacy vs. new products
  - Go-to-market strategy or coverage model
    - > Territory and/or accounts (small, mid, major, national, or global)
    - > Direct to end-user customers vs. indirect channels
      - Original equipment manufacturer (OEM)
      - Value-added reseller (VAR)
      - Distributors
      - Retail

# Sales Compensation Plan Alignment (cont'd)

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## > Critical precursors

- Roles in the sales organization to deliver on the strategy
  - > Sales incentive plan eligibility is a critical first step. Which roles are essential in driving sales results?
  - > Common sales incentive plan roles
    - Territory or Account Manager/Sales Representative
    - Global, National, or Major Account Manager
    - Product or Sales Specialist
    - Channel or Partner Account Manager
    - Inside Sales Representative
    - Systems or Sales Engineer
    - Bio/Pharma Sales Account Manager
    - Managed Care Account Representative
    - Clinical/Surgical Consultant
    - Middle Sales Management (District, Region)
    - Top Sales Executive



# Steps in Sales Compensation Plan Design



# Steps in Sales Compensation Plan Design

Step	Activity
I – Target market positioning	<ul style="list-style-type: none"> <li>&gt; Establish position-to-market strategy keeping in mind focus on total cash compensation (base salary + target incentive/commission)</li> <li>&gt; Determine plan risk strategy relative to market (base and target incentive/commission as a percentage of target total cash compensation)</li> </ul>
II – Market and plan assessment	<ul style="list-style-type: none"> <li>&gt; Complete a market analysis comparing current company pay practices relative to the market</li> <li>&gt; Complete an assessment of current plan performance               <ul style="list-style-type: none"> <li>- Sales Rep performance distribution</li> <li>- Actual incentives/commissions paid relative to target, performance</li> </ul> </li> </ul>
III – Base-incentive mix	<ul style="list-style-type: none"> <li>&gt; Consider the following when determining base-incentive mix               <ul style="list-style-type: none"> <li>- Prominence role</li> <li>- Sales cycle length</li> <li>- Complexity of products, services</li> </ul> </li> </ul>

# Steps in Sales Compensation Plan Design (cont'd)

Step	Activity
<b>IV</b> – Plan measures and incentive weightings	<ul style="list-style-type: none"> <li>&gt; Determine performance measures for the variable portion of the plan</li> <li>&gt; Strategic vs. financial vs. activity measures</li> <li>&gt; Consider individual vs. team measures</li> <li>&gt; Plan measures may be quantitative (bookings, revenue, margin, etc.) and/or qualitative (MBOs/KSOs*)</li> <li>&gt; Rule of thumb: no more than three measures and at least 20% weighting in any measure</li> </ul>
<b>V</b> – Incentive or commission methodology	<ul style="list-style-type: none"> <li>&gt; Determine which methodology is appropriate based on maturity             <ul style="list-style-type: none"> <li>- Flat commission rate (3% of revenue for all sales reps)</li> <li>- Individual or personal commission rate (3% of revenue for Sales Rep #1 and 4% of revenue for Sales Rep #2)</li> <li>- Target incentive or bonus (100% of quota = 100% of target incentive, or 100% of \$50,000)</li> </ul> </li> </ul>

\*MBO = management by objective; KSO = key sales objectives

# Steps in Sales Compensation Plan Design (cont'd)

Step	Activity
<b>VI – Payout scale</b>	<ul style="list-style-type: none"> <li>&gt; Establish the payout scale for each plan based on the following:               <ul style="list-style-type: none"> <li>- Higher risk = higher upside</li> <li>- Minimum threshold often set at level of bottom 10% of performers</li> <li>- Upside limitations (caps or regressive rates) are occasionally used when forecast ability or control over transaction size is limited</li> </ul> </li> </ul>
<b>VII – Quota or target setting</b>	<ul style="list-style-type: none"> <li>&gt; Establish quotas or targets relative to each measure</li> <li>&gt; Top-down plus bottom-up</li> </ul>
<b>VIII – Plan roll-out and implementation</b>	<ul style="list-style-type: none"> <li>&gt; Often the most critical step in the process, develop a plan implementation strategy to address the following:               <ul style="list-style-type: none"> <li>- Plan communication (roll-out presentations including business and plan strategy, highlight of plan changes, plan payout examples; plan presenters include sales leadership, management, HR, compensation and/or sales finance)</li> <li>- Plan documentation (plan documents, goal sheets, commission calculators)</li> </ul> </li> </ul>

# Sales Representative Plan Example

Plan Component	Performance Measures and Weightings	Compensation
Target Total Cash Comp	100% of targeted total cash comp	\$100,000
Base Salary	50% of targeted total cash comp	\$50,000
Target Incentive	50% of targeted total cash comp ( <i>Target incentive = 100% of base salary</i> )	\$50,000
Quota Interval	Annually	Quota of \$2M
Incentive Payout Interval	Quarterly	N/A
Incentive Measure(s)	Individual Revenue – 100% of target incentive	Individual Commission Rate (ICR) (Total target incentive/quota)  Target incentive of \$50,000/quota of \$2M = ICR of 0.025 or 2.5%
Payout Scale	0%–100% of quota      1 x ICR Above 100% of quota      2 x ICR	N/A



# Sales Incentive Plan Types

# Sales Incentive Plan Types

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- > Applicable to the variable portion of compensation (not base salary)
- > Sales incentive plan type considerations
  - Strategic initiatives: volume of sales vs. opportunity-based sales
  - Ability to set quotas and link them to the business plan
  - Comprehension by sales representatives: Can they calculate the payout during an elevator ride?
  - Ease of plan administration and management
- > Focus on the three most significant decisions (“the three Ms”):
  - Mix: ratio of base salary to variable (at target performance)
  - Measures: performance metrics that align with strategy, role
  - Mechanics: the mathematical formula that converts performance to pay



# Base-Incentive Mix

# Base-Incentive Mix

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- > Determine how much of the target total cash compensation should be variable
  - The higher the amount in variable, the higher motivation to drive sales results
  - Lower variable portion supports patience and objectivity
- > Factors that influence base-incentive mix
  - Higher risk plans
    - > Closer to the customer
    - > More frequent sales transactions
    - > Shorter sales cycle
    - > “Hunter”
    - > Direct channel
  - Lower risk plans
    - > Management
    - > Technical sales
    - > Relationship or strategic sales (“Farmer”)
    - > Indirect channel





# Plan Accelerators and Payout Scales

# Sales Incentive Plan Accelerators

- > Balance between plan complexity and plan simplicity
  - Increased accelerator ramp points increases plan complexity
  - Usually used to drive specific levels of performance
- > Increased plan risk = increased plan upside
  - Risk defined
    - > By base-incentive mix

<b>Base Salary</b>	50%	60%	70%	80%
<b>Target Incentive</b>	50%	40%	30%	20%
<b>Accelerator above 100%</b>	3x	2.5x	2x	1.5x

- > By quota size (management or major/global accounts)
  - > An assessment should be completed comparing performance to quota size
  - > Some companies have had accelerators relative to quota size but this is often not a sustainable solution as quota sizes change from year to year

# Sales Incentive Plan Accelerators (cont'd.)

> Payout scale options:– up to 100% of quota

0% - 50% of Quota	51% - 100% of Quota
<b>1x</b>	
0.75x	1.25x

> Payout scale options: above 100% of quota

100% - 150% of Quota	Above 150% of Quota
<b>3x</b>	
2x	3x
3x	2x

> Payout scale examples

Example #1	Target Incentive	Commission Rate
0% - 100% of Quota	1x	3%
Above 100% of Quota	2x	6%
Example #2		
From 50% - 100% of Quota	1x	3%
From 100.1% - 150% of Quota	3x	9%
From 150.1% - 200% of Quota	2x	6%

# Minimum Thresholds and Upside Protection

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- > Minimum thresholds in sales incentive plans
  - Not common for highly leveraged individual contributor plans
  - May drive more complex formula mechanics
  - More common in management or major/global account manager plans
    - > Business rationale: a minimum level of performance is required prior to any payout (if a sales leader does not achieve 50% of quota, the company is less likely to achieve its revenue objectives)
- > Upside protection options (*not common in sales plans but if needed*)
  - Cap at level just above 95<sup>th</sup> percentile reps
  - Regressive rates (2x from 100%-150%, and 1.5x above 150%)
  - Plan protection language (“Prior review of the VP of Sales is required prior to payout above 150% of quota”)
  - No more than 50% of quota can be retired from any single sales transaction (or account)



# Plan Measures

# Plan Measures

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- > Rules of thumb
  - No more than three measures in the plan, ideally one or two is better
  - At least 20% on any one measure to achieve adequate focus and motivation
    - > Otherwise, can overachieve on other measures and ignore the lower-weighted measure
- > Individual vs. team measures
  - Sales representatives are typically paid on individual results
    - > Examples: 100% individual account revenue; or 100% individual territory bookings
    - > Exceptions
      - Inability to set quotas or credit at the individual contributor level
      - Quota and credit on team measure until run-rate established (e.g., new product)
  - Management typically paid on team measures
    - > Examples: 100% region bookings; or 50% region revenue and 50% company revenue; or 50% region bookings and 50% region margin

# Plan Measures (continued)

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## Quantitative measures

- > More effectively differentiates performance compared to qualitative measures
- > Most commonly used measures:
  - Bookings: preferable to the Sales Rep and closest to the sales event, but not always to company leadership (particularly Finance) who may not want to advance commissions to the Sales Rep prior to the company receiving payment
  - Revenue: often preferable to company leadership for the reasons cited above (collections only used in rare situations)
  - Margin: most commonly paid to management since targets are more easily set at the team level vs. individual level; management can focus on the “quality of the deal” and lead the team accordingly

# Plan Measures (continued)

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## Qualitative measures

- > Management by Objectives (MBOs) or Key Sales Objectives (KSOs)
- > Used to drive/recognize achievement of strategic objectives and activities
- > Most commonly/effectively used for:
  - Sales management (linearity, margin, expense management and forecasting)
  - Global, Strategic or Business Development Managers
  - Applications/Systems Engineering
  - Channel Account Management
- > Typically does not differentiate performance as well as:
  - Complete analysis of current payout distribution
  - Assessment of MBO/KSO spend relative to total incentive spend
- > Objective statements
  - Not written by individual managers
  - Menu of statements determined by sales executives or sales finance





# Critical Factors Outside the Plan Design

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- > Quota setting and interval (monthly, quarterly, semi-annual vs. annual)
- > Crediting (sales event at which Sales Rep is credited toward commission payout)
- > Plan payouts
  - Payout intervals
    - > Monthly, quarterly, semi-annual and annual
    - > The higher the plan risk, the more frequent the payout
    - > For high-risk plans, provide draws in lieu of monthly payouts
  - Systems vs. manual administration
  - Systems capabilities should not drive the business, but...
  - Increased systematization leads to increased visibility and greater motivation
- > Draws paid to new hires or those new to the plan (or instead of more frequent commission payout)

# Critical Factors Outside the Plan Design

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- > Special Performance Incentive Funds (SPIFFs) used to reward sales employees for short-term initiatives
  - New product sales
  - Other initiatives where quotas cannot yet be set
  - Should be limited to one or two plan periods, and if they continue longer, they should be eliminated or added to the plan
  
- > President's Club
  - Trip and/or cash for highest performers (volume of sales and performance to quota)
  - Often about 2% of the total incentive budget



**Conclusion**

# Some Closing Thoughts

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- > Focus on target total cash compensation and back into base salary vs. target incentive based on desired focus on sales results
- > Try to keep the plans as simple as possible even while driving very complex business initiatives
- > Quotas and targets should be set to differentiate performance
- > Measure plan performance, especially where MBOs/KSOs are involved
- > The sales compensation plans cannot do it alone
  - Alignment with culture, business initiatives and go-to-market strategy
  - Leadership reinforcement and messaging
  - Recruiting and staffing
  - Management training and education
  - Performance management

# Thank You! Questions?

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# Appendix

# Plan Payout Methodologies

Flat Commission Rate	Individual (or Personal) Commission Rate	% of Target Incentive
<ul style="list-style-type: none"> <li>&gt; Not quota-based</li> <li>&gt; Same commission rate(s) used for all Sales Reps</li> <li>&gt; Payout derived from multiplying commission rate x sales volume</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Quota-based</li> <li>&gt; Different commission rate(s) used for all Sales Reps due to varying target incentives and quotas</li> <li>&gt; Payout derived from multiplying commission rate x sales volume relative to quota achievement x applicable accelerator</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Quota-based</li> <li>&gt; Individual target incentives are established as a % of base salary (or to drive identified base-incentive mix)</li> <li>&gt; Payout derived from multiplying % of quota achievement x target incentive x applicable accelerator</li> </ul>
<p><u>Examples:</u></p> <ul style="list-style-type: none"> <li>&gt; 5% commission rate for all sales; OR</li> <li>&gt; 5% commission rate up to \$1M in sales and 10% (2 x 5%) above \$1M</li> <li>&gt; 5% commission rate = target incentive of \$50K/sales target or quota of \$1M</li> </ul>	<p><u>Examples:</u></p> <ul style="list-style-type: none"> <li>&gt; Sales Rep #1 with commission rate of 5% (target incentive of \$50K/sales target or quota of \$1M); AND</li> <li>&gt; Sales Rep #2 with commission rate of 2.5% (target incentive of \$30K/sales target or quota of \$1.2M)</li> </ul>	<p><u>Examples :</u></p> <ul style="list-style-type: none"> <li>&gt; Sales Rep #1 with target incentive of \$50K and sales target or quota of \$1M; AND</li> <li>&gt; Sales Rep #2 with target incentive of \$30K and sales target or quota of \$1.2M</li> </ul>
<ul style="list-style-type: none"> <li>&gt; Most commonly used in start-ups or where there is no ability to set quotas</li> <li>&gt; Drives volume of sales rather than sales results relative to a specific target or quota</li> <li>&gt; Sales Reps can quickly determine payout</li> <li>&gt; Easiest to administer</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Most commonly used in more mature companies where there is an ability to set quotas</li> <li>&gt; Drives sales relative to specific sales target or quota as opposed to any sales volume</li> <li>&gt; Sales Rep can more easily determine payout (than % of Target Incentive)</li> <li>&gt; More challenging to administer</li> </ul>	<ul style="list-style-type: none"> <li>&gt; More challenging for Sales Rep to quickly determine payout</li> <li>&gt; Easier to administer</li> </ul>



# Plan Payout Examples

Sales Results (Quota of \$1M)	Flat Commission Rate (5% With No Accelerators)	Individual (or Personal) Commission Rate (5% With Accelerators of 1x to Quota and 3x above Quota)	% of Target Incentive (\$50K With Accelerators of 1x to Quota and 3x Above Quota)
<b>\$750K;</b> or <b>75%</b> of quota (where applicable)	Commission rate of 5% x sales volume of \$750K = payout of <b>\$37,500</b>	Accelerator of 1 x commission rate of 5% x sales volume of \$750K = payout of <b>\$37,500</b>	Accelerator of 1 x performance to quota of 75% x target incentive of \$50K = payout of <b>\$37,500</b>
<b>\$1M;</b> or <b>100%</b> of quota (where applicable)	5% x \$1M = <b>\$50,000</b>	1 x 5% x \$1M = <b>\$50,000</b>	1 x 100% x \$50K = <b>\$50,000</b>
<b>\$1.25M;</b> or <b>125%</b> of quota (where applicable)	5% x \$1.25M = <b>\$62,500</b>	5% x \$1M = \$50,000 (for performance to quota) + 3 x 5% x \$250K = \$37,500 (for performance above quota) Total payout = \$50,000 + \$37,500, or <b>\$87,500</b>	1 x 100% x \$50K = \$50,000 (for performance to quota) + 3 x 25% x \$50K = \$37,500 (for performance above quota) Total payout = \$50,000 + \$37,500, or <b>\$87,500</b>