

DESIGNING Global Sales Incentive Plans

Implement sales incentives that would bring your company to global market. By Cedric Ng.



Your company has hundreds of patchwork sales incentive plans developed by various regions/countries after decades of mergers & acquisitions. As the Global Rewards Director, you are assigned by your CEO to reduce the number of sales incentive plans and align it to corporate strategy. Do you know what to do? The key to designing an effective global sales-compensation framework is to identify performance measures and design principles that can apply globally and yet provide some flexibility for business unit or local customization. These global design principles serve to protect the organization from bad practice rather than impose a single practice. Examples of global design principles is to have a consistent menu of performance measure for each role, limiting each plan to five measures, specifying that each measure should be weighted at least 15%, or specifying that the total of discretionary measures cannot be weighted more than 35%. In conjunction with the list of globally consistent items, there should be a list of components that can be tailored locally. For example, pay levels can be tied to local market rates, pay-mix can be tailored to the local selling strategy within expected ranges, performance measure weighting can be determined locally within the global guidelines, incentive payout frequency can be based on local selling cycles, and accelerators can be developed based on local expected performance range within global guidelines.

Sales function effectiveness:

When the sales team is not delivering, don't assume that your sales incentive design is the problem. Improvement in sales performance can only be achieved when sales incentives is considered in a larger context that includes business strategy, organizational design, work process, people, and culture. Are the right people in the right positions? Will re-assigning work from an overloaded salesperson to an under-worked salesperson improve your overall sales performance? If there is intense pressure for rapid growth, the company may need more sales people rather than a more aggressive incentive plan. Sometimes, changing the way a company segments their market is a more effective way to improve performance. E.g. a company that segments the battery market into "industrial battery market" and "consumer battery market" would probably do better than a company that uses a single strategy for the "whole battery market".

Incentive plan design team:

Other than driving performance, the sales incentive plan should be fiscally responsible, externally competitive, and internally equitable with non-sales jobs. Thus, salespeople who are beneficiaries of the sales incentives should provide input rather than controlling the overall sales incentive design process. Key members of HR, Sales, & Finance should be involved in the sales incentive design process. The role of sales head is to provide inputs on the business strategy/priorities & business lifecycle stage, identify who is eligible for B2B sales incentive, and set the sales, pipeline & strategic targets for the sales team. The role of Finance is to provide & validate the sales achievement figures for the computation of sales incentive payout. The role of HR is to review the overall Sales incentive design, act as an impartial party

for the sales incentive design, recommend the pay-mix strategy, recommend the pay curve, recommend the pay frequency, ensure that salespeople's remuneration package is externally competitive and internally equitable with non-sales jobs, and do sales incentive payouts cost modeling.

Understand the business:

Sales incentive plan for B2C businesses is not effective to drive performance for B2B businesses and companies in different maturity stages need different incentive plans. Some companies emphasize customer service in addition to its quantitative sales goals to differentiate itself from its competitors. Start the design process by interviewing the business heads to understand the business strategy, how the company segments the market, which market segments or product lines are not doing well, what is the product life cycle stage, how long is the selling cycle, and what are the strategic qualitative objectives?

Assess existing plans:

To assess existing plans, compare actual sales compensation to actual business performance to ensure there is a positive correlation. Performance distributions can be used to evaluate how performance relative to quota is distributed to determine if there are issues with quota setting. The ideal is to get a normal distribution. Typically, two-thirds of your sales reps should achieve quota, with a fraction exceeding quota. If 90% of your sales rep achieve quota, and 60% exceed quota, you may find that sales achievement expectations are too low. You can interview key sales reps for their opinions on issues such as their interaction with sales operations team, etc. Feedback from these interviews will give you important inputs on your new design.



To build effective incentive plans, sales incentive designers cannot overlook the sales quota-setting process.

Establish your pay strategy:

Establish your pay positioning (e.g. 40th, 50th, or 75th percentile of the market) by considering factors such as talent supply, employee mobility, company affordability, competitor practices, and business strategy/stage. Are there unique industry characteristics that require salespeople with special scientific or technical skills? Sales representatives in medical specialty products might be in a very unique and well-compensated industry. In a commodity business, where there is little product differentiation, a salesperson's personality may be the only reason for the customer to buy – and thus may require a more aggressive compensation plan. In consumer packaged goods business, where companies do intense advertising, individual salespeople may not have as much impact. Target total-cash compensation is the amount of base pay plus target incentive payments for employees who achieve on-target performance. There are two approaches to benchmark the compensation for salespeople. One approach is to benchmark to market annual-base-salary then use your pay-mix strategy to calculate the target-total-cash for each sales role. Using this approach, if the market annual-base-salary of an Accounts Manager is \$60,000, and your pay-mix strategy is 60:40, then target-total-cash is \$100,000 ($\$60,000/0.6$). The other approach is to benchmark to market total-cash, and then use your pay-mix strategy to set the target-annual-base-salary within a tolerable range for each sales role. Thus, if the market total-cash of an Accounts Manager is \$100,000, and your pay-mix strategy is 60:40, then target-annual-base-salary is \$60,000 ($\$100,000 \times 0.6$). Total-cash and annual-base-salary are two important factors to consider for compensation benchmarking. However, when total-cash and annual-base-salary are in conflict, companies need to decide which is more important.

Sales job design & determine eligibility for sales incentive:

When designing a sales incentive plan, it is important to consider the impact that each sales role have on influencing sales. Each distinct sales role in a company requires its own type of sales incentive plan. A key step to develop global sales incentives is to map the hundreds of sales jobs (with widely varying job titles & responsibilities) into a handful of globally standardized benchmark sales roles. Having aligned global roles definitions enable clearer career progressions, and make it easier to implement global compensation programs. After mapping the local jobs to globally standardized benchmark sales roles, determine who to include in the plan using criteria such as customer facing, revenue target responsibility, and influence of the job in the purchase decision.

Pay-mix strategy:

Pay-mix is the relationship of base-salary and target-incentive (commission or bonus). It is expressed as a percentage of target cash compensation. A 25:75 pay mix means that target cash compensation is composed of 25% base salary and 75% incentive. Generally, commission-only plans are more appropriate for sellers that work as independent agents and have ownership of their own accounts. It is important that setting the pay-mix comes after sales job design because the level of influence on customer's buying decision in each sales role is directly linked to its mix of incentive pay and base salary. Pay-mix should be unique to a company, rather than a number



taken directly from a market survey report. Pay-mix strategy is an important design component that drives the organization's strategy because pay-mix decision is derived from risk sales levels, business growth stage, sales role's influence on customer buying decision, sales strategy executed by the sales role, and barriers to entry to the sales job. Lower incentive component should be considered (e.g. 10% - 25% of salary) for widely advertised products where reorders are automatic, for mature companies trying to maintain market share and customer relationships, for roles whereby specific skills are needed, and for roles with limited influence on customer's buying decision (e.g. pre-sales technical jobs). Higher incentive component should be considered (e.g. 25% - 50% of salary) for products facing intense competition, for roles where little post-sales service is



required, for roles that rely heavily on influencing skills to produce a sales (e.g. direct sales reps, sales roles that focus on pursuing new accounts), and for startups that want to grow aggressively. Companies should also evaluate whether customers buy because of product advertising or because of the effort of the salesperson? More commission or incentive is used where sales are highly impacted by individual sales efforts, such as insurance. Pay-mix should be fixed for a role if there are no changes in business strategy and sales role, and it should never be used as a variable component that is adjusted every year just to match the incumbents to the market total-cash. The adverse effect of altering pay-mix particularly from a low salary/high incentive to a higher salary/lower incentive, is to reduce the motivation for sales people to perform at high levels! The right

approach to address incumbents who are below market for total-cash, is to gradually increase the incumbent's base salary via market adjustment. It is fine, for people doing the same role to have different levels of total-cash, because different employees have different experience/capabilities/value-add although they might be doing similar role. If a person is below market for base salary by 40%, you don't immediately increase his base salary by 40% to reach market median. You would most probably increase his base salary to market median gradually over the years. Same principle should apply to target-total-cash.

Setting performance measures:

It is critical to tailor specific performance measures to the company's

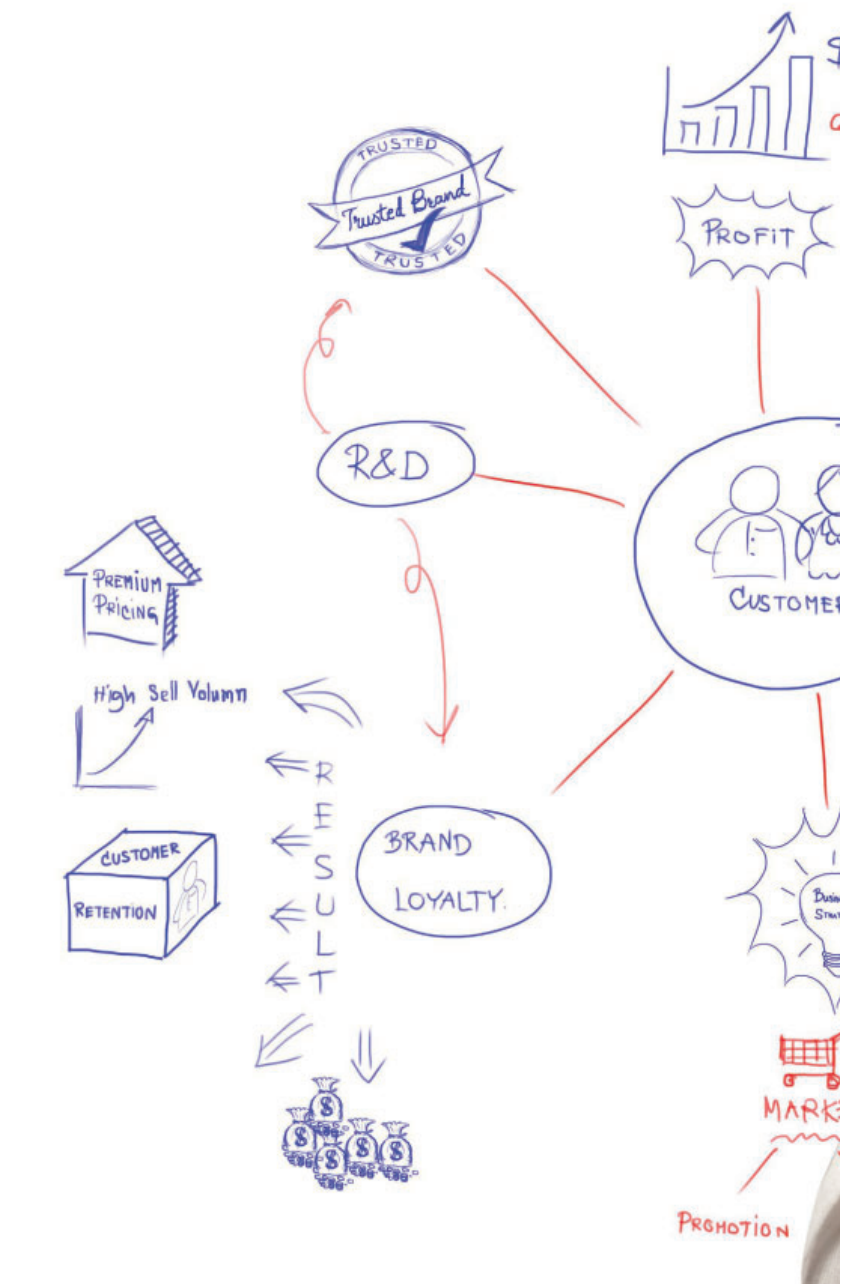
strategy and financial goals to maximize plan effectiveness. Compensation plans work best when they are simple. More than three measures can be confusing and may reduce the emphasis of key measures, and may even indicate the need to create another sales role. Most sales incentive plans have some form of sales revenue measure, with a profit measure included only if the sales person has some control over pricing. Companies at the start-up/growth stage might include performance measures such as growth of existing customer base, new customer acquisition, or new territory expansion. In contrast, companies at the mature/decline stage usually focus on performance measures such as margin or revenue. The finance team must be able to provide reports for each salesperson's performance measures.

In addition, different weights should be assigned to different measures depending on their relative importance to the overall business goals. If three measures are used, the weighting does not have to be 1/3rd for each measure. A more critical measure could have a weighting of 60%, with 20% allocated to each of the remaining two measures. B2B business that have longer selling cycle than B2C business should assign higher weight for pipeline quotas and strategic quota, while setting lower weight for sales quotas.

To build effective incentive plans, sales incentive designers cannot overlook the sales quota-setting process. Poorly set sales quotas can create either overpayment "windfalls" for salespeople or unrealistically high expectations that demotivate salespeople. Payouts in a quota-based plan are related directly to the percent of quota achieved in a given performance period. If you want your sales team members to achieve or exceed their assigned quotas, you need to ensure that the process for setting those quotas is effective. Start the quota-setting process by looking at historical sales trends. What was the total revenue from all the sales territories in the previous year? How much did your competitors sell? After looking at the historical sales, add a growth expectation on what is doable for your products in the current market. Some industries can realistically expect sales growth of 10% while others may see 100%. The quotas should be challenging & yet achievable. After adding the historical sales figures with a growth expectation, you might be tempted to divide this total revenue by the number of salespeople to define the quota for each person. But, not all sales roles are equal, and not all sales territories are equal. In some territories, the competition may be strong and hence reduce the potential for sales. In other territories, competition may be weak or non-existent. Two methods are commonly used to assign sales territories. Equal workload method equalizes the workload of all salesmen in the same grade/role. Territories are formulated so that they are equal in workload rather than in potential. In contrast, equal potential method starts on the basis that salesperson productivity varies depending on the territory potential. People in the same grade & same job role should be assigned similar sales quota. People at a higher grade should be given higher or more difficult sales quotas than people at a lower grade.

Build the plan mechanics:

After establishing plan measures, companies need to set the sales incentive formula. A typical commission formula is constructed as follows: $\text{target incentive} / \text{target performance} = \text{commission rate}$. For example, if the target incentive is \$50,000 and the target performance is \$1,000,000, then the "commission rate" would



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be 0.05%. Other potential plan features include hurdles/gates, thresholds, target, leverage/upside, and maximums. Using a maximum or cap on incentive pay is used by companies to preclude excessive earnings for unexpected large orders not obtained through the sales rep's efforts, and to overcome erroneous quota setting. Generally, sales incentive plans should be designed



without a cap so as to encourage those who can be extraordinary to be extraordinary. Hurdles/Gates are pre-conditions that must be met before any incentives will be paid and represent the minimum acceptable level of overall corporate performance that is of prime importance to management. Hurdles can be used



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to cover the fixed salary cost and can be determined based on break-even volume. A related design principle, called performance thresholds are used to set minimal levels of performance that must be achieved by the individual before an incentive is paid and can weed out underachievers. Thresholds can either be set at a level where there is a 70 to 80% probability of achieving the result, or set at a level that is equal to the actual average performance of the salespeople last year, or set at the sales forecast level that is considered recurring revenue. Target is set at the budget performance levels of the incentive year. Target should be seen as a realistic stretch measure and set at a level where there is a 50% probability of achieving the result. Leverage/upside is the maximum amount of reward for beyond target performance or the portion of compensation above target pay. Performance level for upside, can either be set at a level where there is a 10-20% probability of achieving the result, or at 10% higher than the target performance. Upside earning can either be set at 1-3 times the target opportunity, or set at the 75th or 90th percentile.

Set payout timing:

How frequently do we pay out rewards? In general, the closer to the sales event the better, and payout for sales incentive plans is typically monthly or quarterly. Factors to consider for payout timing are duration of the sales cycles, size of sales transactions, number of transactions, pay-mix, and administrative capabilities.

Model plan scenarios:

In real-world conditions, the plan can produce unexpected financial results. Thus, there needs to be a rigorous modeling of various performance scenarios. Incentive payout cost simulation can be done at threshold performance, on-target performance, and excellence performance. Plan modeling enables companies to assess the impact of each scenario at both the macro level (in terms of company cost) and the micro level (in terms of potential individual earnings).

Plan documentation & communication

All incentive plans need a plan document that outlines the purpose of the plan, how it works and what actions will be taken to address unforeseen circumstances. Good plan documents should include plan objectives, plan period, eligibility, goal setting, incentive award formula, timing of payouts, recovery of commission, resignation & termination, territory transfers or splits, special provisions, and plan administration. Many plans fail because of poor communication rather than poor plan design. Management must take the time to meet with the sales force to explain the sales compensation plan. If we ourselves do not understand how & why the plan works, how can we expect it to work?