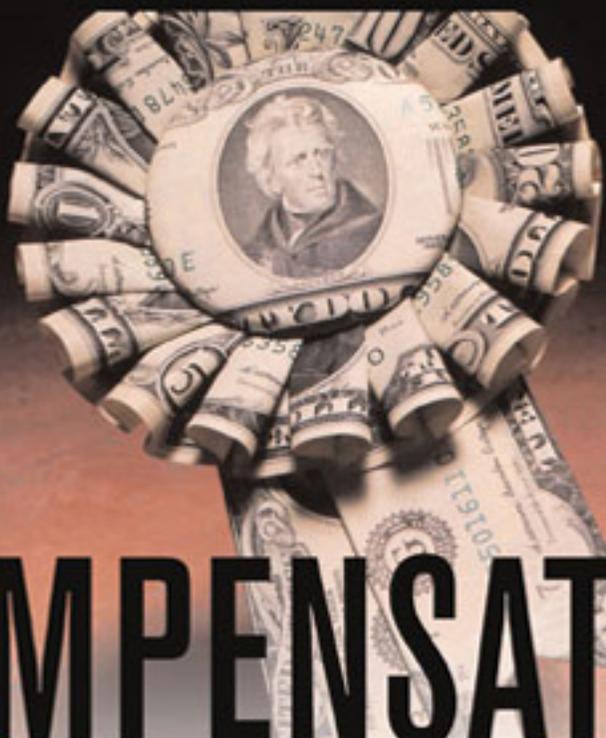


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—MARK ENGLIZIAN,
DIRECTOR OF GLOBAL COMPENSATION, MICROSOFT



COMPENSATING the SALES FORCE

A Practical Guide to Designing
Winning Sales Compensation Plans

DAVID J. CICHELLI

Compensating the Sales Force

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Compensating the Sales Force

David J. Cichelli

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0-07-143597-2

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DOI: 10.1036/0071435972

*Dedication to
Mario and Genevieve Cichelli*

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Acknowledgments

Sales compensation affects tens of thousands, perhaps hundreds of thousands, of sales personnel on a worldwide basis who work with driven enthusiasm on behalf of their employers. Sales management professionals strive to create win-win opportunities for both sales personnel and their companies. It's been my pleasure to work with—and learn from—exceptional sales management leaders including Rick Justice at Cisco Systems, Karen Chang of Charles Schwab, and T. Michael Glenn at FedEx, plus hundreds of others who have helped me test and retest the sales compensation principles you will find in this book. I thank all of my clients who have contributed to building this emerging body of knowledge.

Special thanks must be given to WorldatWork (formerly the American Compensation Association), which has supported my work over the years, allowing me to create, modify, and improve sales compensation courses now taught to thousands of compensation and sales professionals. Without the opportunity to meet with so many compensation professionals in a classroom setting, the material in this book would not have met the test of time or reflect the challenges and suggestions of thousands of students. For this, I am most grateful to the continued support of Anne Ruddy, the Executive Director of WorldatWork. Additionally, WorldatWork has granted me permission to use select charts and concepts from these courses.

Additionally, I am grateful to the small cadre of professionals who have dedicated their careers to helping sales departments improve their sales compensation programs. The conceptual advances made by these individuals are intertwined into this book. They deserve special credit for their unique contributions to this subject: John Moynihan, Jerry Colletti, Stockton Colt, and Gary Schroeder.

My partners at The Alexander Group, Inc.—Gary Tubridy and Robert Conti—continue to provide their unflinching support and encouragement. Also, my fellow consultants never rest as they look for

new sales effectiveness solutions to help clients adopt best-of-class sales growth solutions.

Although I probably should have said so many times during the time we worked together, I am most indebted to my managers who gave me guidance throughout my career including Richard Waterbury, Jay Schuster, and Jerry Colletti.

Also, thank you, Nancy Santos-Ramirez, my assistant, for proofreading and editing my manuscript.

Finally, to my wife, Kathleen, and daughters Diane and Joan . . . thanks for your loving support.

David J. Cichelli
Irvine, California

Preface

Welcome to the powerful—and sometimes confusing—world of sales compensation!

If you are reading this, you probably work with a sales force and your never-ending objective is to help improve sales performance. Your company might be a manufacturer, service provider, reseller, or retailer and your customers may be other businesses or consumers. Your company might sell direct to end users or through channel partners and your sales force might be small or large.

You know that sales compensation is one of many tools available to help you direct your company's sales efforts. You also know that if done correctly, sales compensation can dramatically improve performance and, if done poorly, it can cripple your sales efforts.

Whether you are a sales executive, sales manager, sales operations specialist, finance executive, human resources (HR) compensation manager, information technology (IT) professional, general manager of your division or CEO of your company, you recognize that the goal of increased profitable sales rests squarely with the sales force.

Let's assume you have one of two objectives: You either (1) want to confirm you have a great sales compensation program, or (2) need to develop a new sales compensation plan. This book will provide the answers you seek.

Let's begin:

Sales compensation works!

How salespeople are paid has an immense effect on their performance. With appropriate respect, we will avoid the quagmire of motivational theories that attempt to explain *why* sales compensation works. As any sales manager will attest, salespeople pay very close attention to their sales compensation plan. No, it's not the only reason why sales personnel succeed or fail, but it plays a pivotal role in the overall mix of sales management supervisory tools.

Why This Book

Even though sales compensation is a powerful tool, it can be confusing, too. The setting of target pay, selecting the right performance measures, establishing quotas, determining the mix and upside opportunity, and constructing the right formula are examples of the many choices facing those responsible for crafting the right sales compensation plan. The purpose of this book is to guide you through this effort, helping you make the right choices.

Over the years, I have had the pleasure to teach thousands of professionals how to design and implement successful sales compensation plans. I have also enjoyed the support of my clients as we work together to structure effective sales strategies. You will find other sales compensation books that are informative and helpful, particularly in understanding how strategy drives tactics. This book will take your learning to the next level by showing you how to construct effective sales compensation plans. While it will cover numerous technical topics, it will never stray too far from the practicality of this effort: Sales compensation can significantly affect a company's performance. Of course, it affects people's pay, too. Technical or not, it doesn't get much more personal than that!

How This Book Is Organized

Through the following chapters, you will learn how to construct sales compensation plans that reward sales excellence.

Chapter 1: Why Sales Compensation? Sales compensation helps sales organizations exceed their objectives. However, sales force and sales compensation plans can quickly become outdated. The challenge, as this chapter explains, is to keep the sales compensation plan contemporary with the sales job.

Chapter 2: Sales Compensation Fundamentals. This chapter outlines the basic concepts of sales compensation design. These concepts transcend industries.

Chapter 3: Who Owns Sales Compensation? This chapter explores the process and governance of effective sales compensation.

Chapter 4: Why Job Content Drives Sales Compensation Design. The source of sales compensation design is sales job content—

not industry, not legacy solutions, and not management whim. There are well over 35 different types of sales jobs. We examine several jobs to show how sales compensation varies by sales job type.

Chapter 5: Formula Types. In this chapter, you will find the taxonomy of sales compensation formula types. The chapter provides a hierarchy of formula types, terms, and applications.

Chapter 6: Formula Construction. This chapter describes the methods to construct and calculate formulas for payout purposes. You will need a calculator.

Chapter 7: Support Programs: Territories, Quotas, and Crediting. Sales compensation cannot exist without effective support programs such as quota allocation, sales crediting, and account assignment.

Chapter 8: Administration. Good methods to administer sales compensation programs are necessary so the payouts can be made in a timely and accurate manner. Follow the guidelines presented here to ensure you have the right level of support.

Chapter 9: Implementation and Communication. Rolling out the new plan and ongoing communication helps drive perceived equity into the plan.

Chapter 10: Program Assessment. Is it working or not? A lot of money flows through sales compensation programs. This chapter provides the criteria for judging and improving current programs.

Chapter 11: Sales Compensation Design. This chapter provides the how-to step-by-step approach to redesign the sales compensation plans at your company.

Appendix A provides a sample sales compensation plan. Appendix B is a list of sales compensation surveys. Appendix C provides a list of software vendors.

1

Why Sales Compensation?

The Role of the Sales Force

The role of the sales force is clear. Sell the company's products and services to new and existing customers.

Of course, most of us can easily visualize the "classic" salesperson. Our able and determined salesperson has a geographic territory, travels from one account to another visiting customers and potential buyers, demonstrating the latest gizmo easily drawn from a sample kit or well presented in a glossy brochure. However, this typical image is not fully consistent with today's modern complex sales force. While our fabled territory sales rep is not gone, he or she has been joined by a cadre of sellers. Many companies now sell through multiple sales channels. Our territory rep is now part of a complex customer coverage model that includes telesales, major account sales, product overlay specialists, and partner management. To compound matters, the definition of *products* now varies widely from physical products to services to solutions. To add additional variables, the definition of *sales revenue* has expanded beyond the initial purchase dollars to include rental, lease, product usage revenue, and maintenance revenue. Further, today's sales organizations are often fully integrated with other formerly disconnected customer contact units such as Customer Service, Contracts, Customer Finance, and Collections. In other words, while the classic sales job still exists for many companies, the territory salesperson traveling from one account to another is just one more member of a much more varied and complex sales coverage system.

For convention purposes, we will continue to refer to today's sales coverage system as the "sales force," fully recognizing the expanded characteristics of today's sales departments.

Regardless of the complexity of the sales organization, the sales force continues to serve its primary charter of identifying, securing, and servicing customers. The sales department has at the apex of its objectives what no other department has: the responsibility to manage the profitable revenue growth from the company's customers.

Why Sales Compensation Works

Some nonsalespeople assume sales representatives are solely money motivated. They believe the best (and only way) to manage the sales force is with an overly lucrative sales compensation program. Of course, this is not true. This monetary-centric view of sales representatives promotes a cursory view and inaccurate assumption about sales representatives. It can lead to some false and unfortunate conclusions about the importance of the sales compensation program.

The source of effective management has many competing theories. While the names and themes of these theories might vary, they all subscribe to at least two critical elements: *leadership communication* and *performance measurement*. Great sales compensation plans optimize both of these elements: communication (“this is what’s important”) and performance measurement (“your incentive payment for last month’s performance”). However, clear communication messages and measurement systems don’t always fit tidily into a sales compensation plan. There are other and more powerful ways to manage salespeople. For example, day-to-day, hands-on committed sales supervision is considered the best “system” for optimizing sales performance.

A typical conversation between the first-line supervisor and his or her sales charges would sound something like this: “Now, ladies and gentlemen, we are on the line here to achieve this month’s sales objectives. I have a commitment from each of you to reach your monthly quota. It’s important to me, and it should be important to you. At our next sales meeting, we will put the numbers up on the board to see who we *cheer* and who we *sneer*! If you are having any trouble closing a deal, I can help you. Call me, and we will schedule joint sales calls. Remember, your success is my success!”

This pitch by the first-line supervisor shows the importance of leadership communication (“... it’s important to me, and it should be important to you . . .”) and performance measurement (“... at our next sales meeting, we will put the numbers up on the board to see who we *cheer* and who we *sneer* . . .”). Notice, no mention of money was made, but a heavy dosage of personal accountability and peer pressure is evident.

Interestingly, this vignette illustrates how sales compensation is considered “cross-elastic” with effective sales management. In other words, the better the sales supervision the less the need for aggressive

incentive plans to manage sales performance. Further, sales compensation is not a birthright of salespeople. We estimate that 20 percent of all sales personnel are paid with a salary-only program without any variable pay plan.

Regardless of the pay plan, high-performing sales organizations feature ongoing leadership communication and robust performance measurement systems, whether these functions are found in the sales compensation plan or projected through effective sales management, or are a combination of both.

Yes, we agree, the economic transactional value of the incentive compensation dollars *does* provide motivation for increased performance. However, we consider it complementary to other factors such as pride of performance, supervision, affiliation, and goal accomplishment.

Well-run sales departments treat sales compensation as one of several levers of effective management. Along with other management tools, sales compensation can play a contributing role to successful sales production. However, it cannot be the only factor because alone it cannot provide leadership, commitment, and purpose of endeavor that effective sales management can so ideally provide.

The Power of Sales Compensation

A well-designed sales job and sales compensation program can provide dramatic improvement to a company's sales results. When products, customers, sales leadership, jobs, measures, and rewards are in alignment, sales results can be more than remarkable. Sales compensation can provide the right focus on revenue growth, profit improvement, product focus, account penetration, and solution selling.

If sales compensation programs are so powerful, why do they seem to be so “noisy”? In a league of their own, like no other compensation program that the company has, sales compensation programs seem to produce a disproportionate amount of challenges and conflicts. Why is that? There are several reasons. Some issues are to be expected, but others are a result of poor design and poor alignment. Here are examples of some challenges and conflicts:

1. *The chief executive officer (CEO) and the chief financial officer (CFO) are unhappy that the sales compensation program is too*

costly while the company is performing below objective. This is not an uncommon situation. Before concluding that the sales compensation plan is overpaying, you might want to look at the cost of sales. A high cost of sales might be a result of overstaffing and not overpayment to individuals. If actual payouts are too high, then examine the quota system first. Perhaps quotas are too easy.

2. *Product management wants greater product focus from the sales force.* Product managers want to put extra incentives in the sales compensation plan to promote specific products. Product focus is a legitimate measure for sales compensation purposes; however, prior to making changes, product managers have to make good on their own responsibilities, including rationalizing the product offering, segmenting customers, and providing sales messages for unique buyer populations.
3. *Salespeople complain sales quotas are too difficult.* Sales quotas should be difficult. That's their purpose—to stretch performance. Sales compensation is not an appeasement program.
4. *Salespeople seem to ignore components of the sales compensation plan.* This is often the result of a poor sales compensation design, not a motivation issue. A poor design is frequently a reflection of strategy and alignment confusion by senior management. Too many measures, inappropriate measures, or unrealistic objectives will cause sales personnel to ignore one or more components of an incentive plan. Solution: new job definition and a new sales compensation design.
5. *The company spends too much money administering the pay program.* Using low-power tools such as desktop software will cause an increase in headcount for program administration. This may not be the fault of the incentive program, but may be a problem of failing to provide proper information technology (IT) administrative support to the program.

Sales compensation *is* noisy. Sometimes the design is at fault, and sometimes it's an issue of alignment. It can even be just a by-product of an effective program. As a sales compensation designer, this book will help you sort out what problems are real and what are not, where the solution resides, and how to make the right changes.