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Sales Compensation Insights

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Introduction

An effective sales compensation program is a critical element to boosting sales force motivation and growing both sales and market share. An effective sales comp plan also makes selling costs more predictable and reduces the cost of administration.

Yet designing and administering an effective plan isn't easy.

ZS has been helping companies design and administer their sales compensation plans for more than 30 years. In 2013, we began publishing two blogs–The Carrot and The Exchange–to share tips, tricks, opinions, insights and best practices across a variety of different sales compensation areas.

This booklet contains a collection of select posts written by various sales compensation experts at ZS.

If you find the information useful, we encourage you to subscribe to our blogs and visit www.zs.com/financialservices for frequent sales compensation insights.

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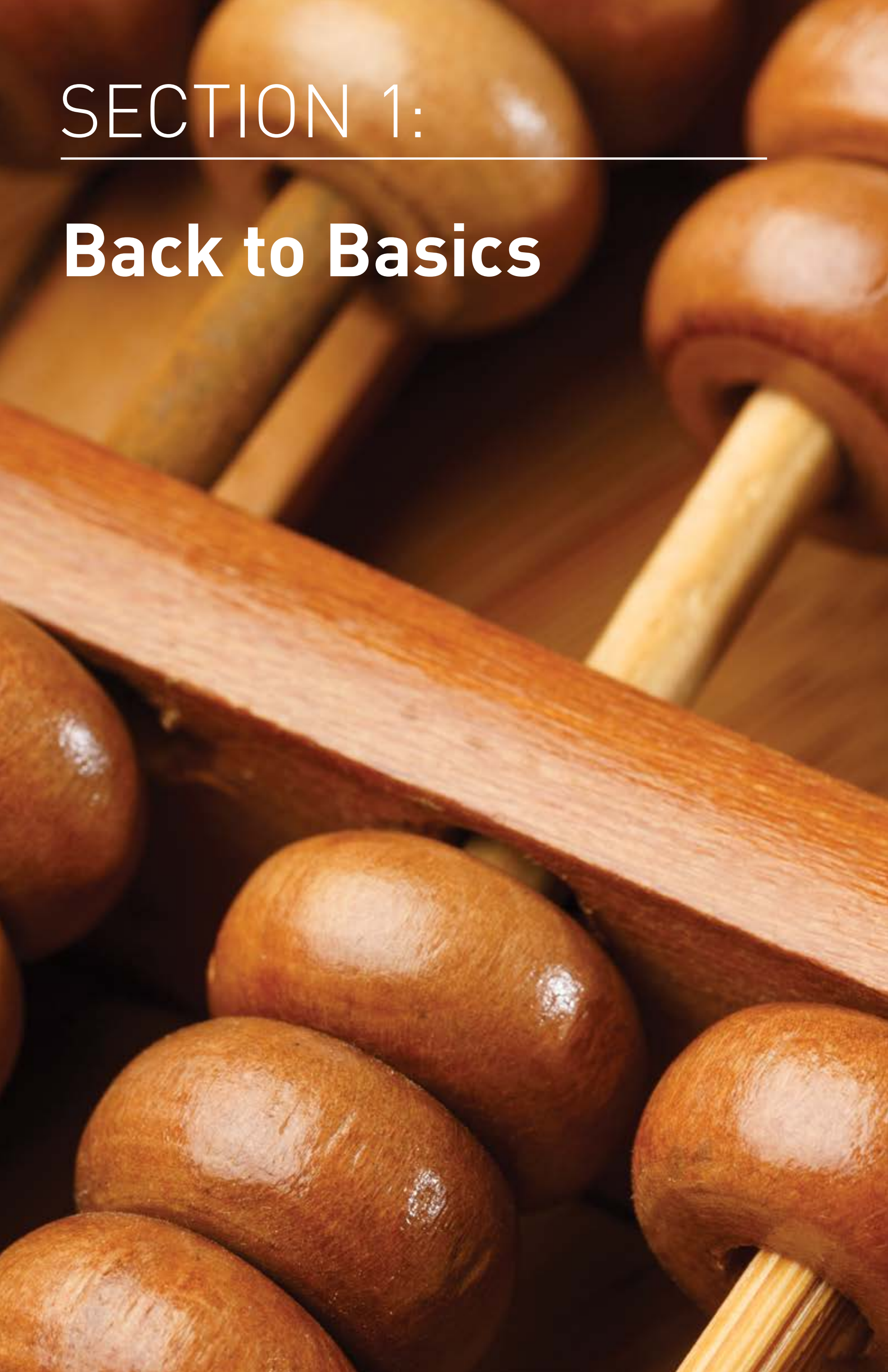
Back to Basics



How to Prepare Next Year's Incentive Plan Design

By Chad Albrecht

For when your company kicks off next year's plan design, we're going "back to basics" and covering the building blocks of sales incentive plan design so you have everything you need for your new plan.

We want to focus on two critical elements of the design process—incentive plan eligibility and plan guiding principles.

What we mean by eligibility is, who should be on a true sales compensation plan as opposed to a broad-based or management incentive plan? The simple answer is, that salespeople should be on a sales incentive plan. But, of course, roles aren't that cut and dried. Many roles influence top-line growth in the company that should not be on a sales incentive plan.

The simple rule of thumb is that, to be eligible for a sales incentive plan, the role should be customer-facing and influence the purchase decision. Both of these elements are important. Customer service personnel, while customer-facing, usually do not influence the purchase decision and therefore are usually not on a sales incentive plan. Marketing personnel may be able to influence the purchase decision through price and advertising but are not customer-facing and, therefore, not on a sales incentive plan.

A third criterion for eligibility is that the individual (or role) spends at least one-half of his or her time in this customer-influencing role. For example, senior executives (such as the CEO) are asked to get involved in large sales periodically but spend less than one-half their time in that function and, therefore, should not be on a sales incentive plan.

Once the roles eligible for sales incentives have been decided, companies must then develop guiding principles. Guiding principles are a set of eight to 12 unbiased "guideposts" established up front that steer decision-making in an objective fashion. Anyone who has gone through the incentive plan design process knows that it can get emotional, perhaps even heated at times, and having unbiased objective principles to fall back on will steer the group toward a peaceful resolution.

Guiding principles link back to strategy ("plans must include a pricing component worth at least 20% weight") or reflect a company compensation philosophy ("hunter sales roles will have a minimum of 45% of their pay at risk").

For guiding principles to be useful, they should be as specific as possible. For example, a guiding principle of "the plan should pay for performance" is not particularly helpful in the process. But a guiding principle such as the following would be very instructive and useful: "The plan should differentiate payouts by paying the top 10% of performers at 2.5 times the target incentive amount or more and the bottom 10% of performers at 0.3 times the target incentive amount or less." The specificity in the principles will eliminate ambiguity and reduce arguments within the core team on the final plan design.

Ideal Pay Level and Mix for Your Incentive Plan

By Chad Albrecht

As a follow-up to our coverage of incentive compensation plan eligibility and guiding principles, we now turn to targeted pay level and mix. By "target" pay level, we mean the pay level that the "average" salesperson will earn for achieving expectations (often 100% of sales quota) in a given year. When we say "target" mix, we mean the way that total pay is delivered, either in base salary or in incentive pay. The mix is normally stated as a ratio, first with the percent base salary, and then the percent incentive. For example, if a job with a target pay level of $100,000 has $70,000 of that delivered in base salary, we would say that the pay mix is 70-30.

Step one in establishing a targeted pay level and mix is finding good market sales compensation data. For some industries, such as technology and pharmaceuticals, there are industry-specific studies that cover the vast majority of roles. For other industries, you may need to turn to a broader, all-industry survey such as those conducted by the HR houses.

When you match your sales roles to the jobs in the survey, make sure you match to the job descriptions in the survey and not simply by job title. Also, you may not find exact industry matches to yours. In these cases, match to the labor pool, not the industry—in other words, which industries do you hire from and lose people to? These should provide good insight into which industries to compare.

The final input is the desired percentile you want to match to. This largely comes from your compensation philosophy and company culture. The majority of companies match their base salary, target incentive and total pay against the 50th percentile, or median (within 10% of the median is generally considered to be "at market").

But perhaps your incentive compensation philosophy is slightly below market on base (say, 40th percentile) and well above market on incentives (say, 75th percentile). This pay mix sends a very different message to the market about the type of salesperson you are seeking: an aggressive salesperson seeking high, risk-high reward.

Other companies may have a more paternalistic or conservative culture and benchmark above market on base salary (say, 65th percentile). This type of strategy assures your base salary will be more than competitive but will not attract the most aggressive salespeople on the market. Depending on your organizational culture, that may be exactly the type of sales personality you are seeking.

The last thing to consider in benchmarking pay level is benchmarking not just the "target" or average pay levels, but also the high and low performers. In other words, ensure you pull the 10th and 25th percentiles from the market study and compare them to your own 10th and 25th percentiles to see how your low performers are paid versus market. Similarly, benchmark your 75th and 90th percentiles against the market. Even when your target pay is at market, you may find that your low or high performers are not at market.

Three Criteria to Select Your Incentive Compensation Plan Metrics

By Chad Albrecht

After covering how to determine the ideal pay levels and mix, we turn to the initial decision required for the sales compensation plan—metrics upon which to pay for performance. Businesses measure their performance on many metrics, but for a metric to be appropriate for the sales compensation plan, it must meet the following three criteria:

+ **Strategic:** Everything in a sales incentive plan should derive from the business strategy and goals. If you have a focus on price maintenance or increases, then the incentive compensation plan should include a gross margin or average selling price metric.
+ **Measurable:** Oftentimes, companies want to hold salespeople accountable for things they either cannot measure—or, if measurable, the chosen metrics are not "comp grade." For example, many companies want to measure and pay for territory-level gross margin, but their systems are not yet able to measure profitability down to that level.

- **Controllable:** Salespeople must be in control of the metrics. Companies that put metrics in the plan that are not in the salesperson's control quickly find that salespeople look to the metrics that they can control to reach their incentive compensation goals.

Once these critical criteria have been met, there are other decisions that will help you finalize your plan metric:

- What "level" is the metric? Only the accounts or deals the salesperson "touches"? All sales in the salesperson's assigned geography (which may or may not be the same as the deals the salesperson touches)? Team metric?
- Against what should we compare the measurement? If the metric is revenue, should the metric be absolute revenue? Revenue growth? Revenue versus quota?
- Do you care "how" salespeople sell? In other words, are all sales dollars created equal? Or do you want to reward selling the "right" products to the "right" customers at the "right" price and in the "right" way? All of these may imply different metrics.

Finally, here are some general best practices on metrics. I say "general" because there is always an exception but, in the vast majority of cases, these hold true:

- The plan should have a maximum of three metrics.
- All metrics should be weighted at least 15% of the total incentive payout.
- Pay for performance on measurable results and avoid paying on activities, if possible.

Choosing a Sales Compensation Plan Type

By Mike Martin

We've discussed the basics of choosing the most appropriate metrics upon which to pay for performance. Now let's tackle the question about which plan type to use.

There are four sales compensation plan types that are most common for salespeople:

1. **Sales commission:** Each rep is paid a set dollar amount per unit sold.
2. **Goal:** Each rep earns his or her sales bonus based on how he or she performs against a preset volume, sales or market share target.
3. **Rank:** Reps are ranked against each other on a single metric and paid based on their performance relative to the group.
4. **Management by objective (MBO):** MBO plans involve some manager input to rate rep performance on objectives that are typically not directly measured through sales.

There are a number of factors that will drive the decision on which plan type is most appropriate for your team. The following are a few of the most common drivers for choosing one plan type over another. Keep in mind that company culture and past experiences with different plan types can also be significant inputs into which plan type will ultimately best motivate your sales team.

When would you use a sales commission plan? Sales commission plans work well for new products or when the selling process is undefined. In these cases, companies often want to remove any distractions from the reps, such as complex calculations, and help them focus on the end result only. Commission plans also work well with "hunter reps." For these roles, the ability to clearly see the results of sales wins can be a powerful motivator.

Another benefit of sales commission plans is that they cover the "cost of sales" because payouts are based on making the sale and the rate can be set to account for margin and other costs. One caution with commission plans is that if the territories are imbalanced on potential or sales, you will find that reps in territories with high potential or sales often earn more, regardless of performance. Therefore, reps in territories with smaller potential or sales can become disengaged.

When would you use a goal plan? Goals can be a good option when there are local territory differences (such as starting volume or potential market size) that need to be accounted for. Fairness in incentive compensation can also be improved, since reps receive their own custom goal that will account for these differences.

However, that improved fairness does come at a cost: Goal plans can become complex very fast depending on the number of local attributes used in the calculation. In these cases, it is recommended to use a goal methodology that is slightly less fair but simpler to communicate and, thus, will likely be perceived as fairer than a more complex approach.

Another challenge with goal plans that allocate a national forecast is that they require a high degree of confidence in that national-level forecast. If the forecast is too high, then all of the territory goals will be too high, thus risking low payouts and disengagement. Some companies will create goals from the bottom up to help avoid this but then face a challenge if the sum of goals does not match the corporate expectation.

When would you use a rank plan? Rank plans can work well if you want to pay for performance on a single metric but also want more control over the budget than you would have with a commission plan. Because reps are paid based on their sales ranking, there is no link to the national forecast. Thus, if the nation over- or underperforms, the sales force earns the same amount. The most significant challenge that users of rank plans face is the worry about internal competition. This worry is most likely with small sales forces of less than 70 reps since larger sales forces are unlikely to have a strong teamwork element regardless.

When would you use MBOs? MBOs can be very useful in a variety of situations, including when sales data is hard to come by, when you want to encourage activities beyond sales results or when you want to measure different outcomes for different reps. One example where you would want to measure different outcomes is when customers are at different stages of the buying continuum. For some reps, their focus may be on establishing contracts with key accounts whereas more established territories are focused on market share. MBOs allow for this type of individualization within a structured framework.

Hopefully, this summary gives you a starting point for deciding what incentive compensation plan type to use.

Calculating Your Incentive Compensation Plan's Payout Formula

By Chad Albrecht

We've discussed metrics to include in the incentive compensation plan and the plan types that you should use. Now we turn to the actual calculation of the payout amount.

Regardless of the plan type that you put in place (such as sales commission, quota bonus, etc.), you should start with some key inputs. These inputs come from a variety of sources, such as sales compensation philosophy, plan guiding principles, executive leadership and benchmarks for each metric.

Here is a sampling of the type of inputs needed to create an effective payout formula:

+ Percentage of people who should earn $0 in sales incentives
+ Desired incentive paid to the top 10% (as a percentage of target incentive)
+ Any caps
+ Sales compensation plan budget

These inputs will help you achieve parameters to structure the payouts. Regardless of the type of plan you use, these inputs are critical to establish the payout formula.

After considering these key inputs, collect historical performance distributions from the past two years. For example, if you had a revenue quota bonus plan in place in 2014, collect the actual performance for all salespeople during that time period. If there is any reason to believe the future performance distribution will differ from the current performance distribution (due to, for example, a new metric, a new product launch, change in sales-quota-setting method, etc.), then you will need to make an adjustment to the performance distribution, either qualitatively or through other performance distributions.

Now that you have the required inputs and the historical performance distribution, the payout formula comes down to a few key decisions:

Element	Description	Input This Supports
Threshold	Performance below a certain level where no incentive is received	Percentage of people who should not earn an incentive
Accelerator Below Quota	Increased rate of pay between threshold and sales quota	Limiting the payout to bottom performers
Accelerator Above Quota	Increased rate of pay above sales quota	Ensuring top performers earn adequate incentive
Cap or Decelerator	Mechanism limiting rate of pay above a certain performance level	Maximum payout and total plan cost

This covers the basics of payout formula creation. Of course, there is a much more elaborate discussion to be had if the payout formula includes complicated elements such as linked metrics, kickers, hurdles and matrices. But this should provide the basics of how payout formulas are designed to arrive at best-in-class pay-for-performance statistics. ■

Adding Accelerators or Decelerators to Your Incentive Compensation Plan's Payout Formula

By **Mike Martin**

We've previously described how to design your incentive compensation plan's payout formula, and we briefly mentioned the concepts of accelerators and decelerators. At a high level, accelerators are used to encourage increased performance and decelerators are used to safeguard against significant overpayments.

We would like to highlight some additional scenarios where including an accelerator or decelerator can significantly enhance sales rep motivation.

Using accelerators to encourage growth over the prior year: In order to reward growth, many companies will have a low commission up until last year's sales. Once the sales rep achieves that sales level, an accelerator will kick in to reward "new sales." This method is also done with quota plans. The exact point at which the accelerator begins could either match last year's sales exactly or be slightly less to approximate the portion of sales that would have carried over without sales rep promotion.

Using decelerators to increase portfolio focus: A common challenge that secondary product managers face is how to ensure their products receive sufficient focus from the sales force. One way that companies will do this is by putting decelerators above quota for all products in the portfolio. Up until achieving quota, sales reps will focus on the primary products. However, due to the decelerator, it will be more profitable for them to achieve sales quota on the other products versus continuing to exceed goal for a single product.

Using accelerators to "push through the quota": Contrary to the prior example, some companies have found success in putting an accelerator in place that starts just before the sales quota and continues shortly past the quota (for example, from 95% to 105% attainment). The payout range in this "success zone" can be three times the payout rate in other performance zones and helps to maintain motivation even after the quota has been achieved. Companies that use this approach effectively create a stretch-goal-setting scenario for the reps.

Using decelerators instead of caps: Through interviews with sales reps, we have found time and again that having a cap on payouts, even if no one hits it, can significantly demotivate and frustrate the sales force. Even sales reps who are not near the cap will often complain about it. By changing that cap to a decelerator, the plan can now be marketed as "uncapped" and still maintain fiscal responsibility.

These are just four examples of when either accelerators or decelerators can augment a sales compensation payout formula.

Incentive Compensation Plan Periods and Payout Frequency

By Chad Albrecht

The majority of companies follow an annual incentive plan period for salespeople. This is likely for multiple reasons. First, executive compensation and broad-based compensation programs—two additional categories of compensation programs—are almost always annual. For consistency, companies place salespeople on annual plans, as well. Second, most companies have an annual business-planning process, and annual incentive compensation plans and goals tie in nicely with this planning process.

But based on research, a case can be made for using less-than-annual periods to drive performance. An article in *Harvard Business Review* cited research revealing that bottom performers performed 10% better if there were "pace-setting" bonuses to ensure they were on track to hit their annual sales quotas. In other words, simply having multiple "mini performance periods" in addition to the annual performance period helped bottom performers achieve higher levels of performance. These "pace-setting" sales bonuses are different than simply paying salespeople more frequently: If salespeople didn't perform at a certain level during certain periods, those bonuses would be gone for good.

Below are some of the features of shorter and longer plan periods:

Shorter Plan Periods (such as monthly)	Longer Plan Periods (such as annually)
Drives immediate focus	Drives longer-term results
Less dependent on long-term forecasting	Dependent on good long-term forecasting
Drives performance each and every period	Only drives annual number
May encourage salespeople to "hold" sales across periods	Unlikely for salespeople to "hold" sales
Preferred by salespeople	Less expensive to administer

Some plans try to obtain the benefits of both short-term and long-term plan periods. For example, a tech-based inside sales force pays its salespeople on quarterly plan periods throughout the year but it also has a "fifth quarter" that pays on annual performance. In this way, it reaps the benefits of both shorter and longer plan periods.

Payout Frequency

The frequency with which you pay incentives is another important incentive plan design decision. Timely measurement of results and prompt payment of rewards for performance are critical for incentive plan success. The motivational power of incentives diminishes significantly when there is a long lag in measuring the results or salespeople are not rewarded soon after they complete the work that creates the results.

The primary determinant of payout frequency is the salary: incentive mix of pay. Below is a grid that provides a rough guideline for how frequently companies should pay their salespeople based on their pay mix.

Pay Mix: Percentage of Cash Comp Paid in Incentives	10%	10% to 15%	15% to 35%	35%
Payout Frequency	Annual	Semiannual or Annual	Quarterly or Trimesterly	Monthly

For example, salespeople with a 50-50 mix of pay are almost surely going to be paid their incentive payouts monthly. Because so much of their target income is in incentives, paying them any less frequently than monthly may cause a cash flow crunch.

However, salespeople with an 80-20 mix will almost always pay their incentives quarterly and not monthly. Paying these incentives monthly would lead to a minuscule check every month (less than 2% of their annual cash compensation on average), making each reward check less meaningful and providing a sizable burden on the sales compensation administrators forced to generate the checks.

While pay mix is the primary consideration in determining payout frequency, another is the administration of the plan. For some companies, the data can be extremely difficult to collect, aggregate, calculate and pay upon on a frequent basis. This could be due to the source of the data (for example, obtaining "tracings" data from distributors), the number of data sources or the size of the sales compensation administration group. In these cases, the payout frequency may result in a payout frequency slightly less frequent than the above table suggests. ■

1. Steenburgh, Thomas J. and Ahearne, Michael, Motivating Salespeople: What Really Works (2012). Harvard Business Review, Vol. 90, No. 7/8, 2012.

Four Ways to Maximize Your Use of SPIFs and Contests

By Steve Marley

My associate Chad Albrecht has written previously about sales compensation plan periods and noted that the majority of companies follow an annual performance period. I look at annual performance periods as akin to a long race, whether it's a 5K run or the Indy 500.

Unlike shorter races—such as 100-meter or 200-meter dashes or an automotive drag race, where you go full speed for a brief duration—longer races require strategy: when to pass, when to conserve energy, when to work with someone for mutual benefit or when to take a break (like a pit stop).

If companies look at sales compensation as a longer race, sales performance incentive funds (SPIFs) and contests can be an effective mechanism to create that short-term focus or burst.

Time to pass someone? Need a kick to infuse some energy? Then maybe a SPIF or contest is for you.

Here are four ways to maximize your use of SPIFs and contests:

1. **Use SPIFs and contests sparingly. They are not intended to correct flaws in your base sales compensation program.**
   + If you face a challenge in the base compensation program (for example, unrealistic goals after a market event), SPIFs can provide upside opportunities and maintain motivation for short periods of time until the compensation plans are adjusted.
   + Be careful not to use SPIFs as a mechanism to correct fundamental flaws in the base incentive program, such as a focus on the wrong product or metric. A SPIF intended to correct these flaws can send contradictory messages to the sales force.

2. **Limit the number, length and total spend on SPIFs to ensure they don't compete with the main variable compensation components.**
   + If SPIFs are used nonstop throughout the year, what is the base incentive plan design driving? Limit the number of SPIFs to two or three per year for most industries, and keep the duration to less than three months. More than that, and they may begin to feel like they are components of the base sales compensation program.
   + Limit the spend on SPIFs to no more than 5% of your compensation spend.
3. **Ensure your contests don't become an "arms race" between competing functions (for example, different marketing groups pushing their products).**
   + SPIFs should be used strategically. Be cautious of running a SPIF on Product B because it is losing focus to Product A when Product A is also running a SPIF. If both products have SPIFs, will your salespeople do anything different?
4. **Be creative. SPIFs enable companies to exert more creativity and freedom than the base sales compensation program.**
   + Short-term SPIFs and contests allow you to use themes to generate excitement that may not be possible with an annual program. For example, you could use a "Summer Break" SPIF to drive sales during traditionally slower months, a World Series contest in October to coincide with baseball playoffs, etc.

Keep these four points in mind, and you'll greatly increase the usefulness of your SPIFs and contests. ■

How to Set Good Sales Quotas

By Chad Albrecht

We have previously walked through how to establish pay levels, pay mix and the incentive plan design. But many plan designs are tied to performance versus sales quotas and, as any salesperson will tell you, the plan design is only as good as the quota that goes with it.

With that in mind, we turn to how to set good sales quotas. Setting fair and accurate quotas has been the biggest issue in sales compensation for many years. In fact, incentive practice research study participants over the past several years have listed quota setting as their No. 1 issue across all industries every year.

Best-in-class companies spend a significant amount of time setting good quotas. There are four primary elements to make this happen:

+ **Data:** Best-in-class companies use some combination of historical sales and territory opportunity. For a high-repeat-sale environment, historical sales carry a higher weight. For more of a hunter environment, territory opportunity plays a greater role.
+ **Process:** Companies that set good quotas establish a sound process to allocate the overall quota down to the salesperson level. Companies use various methods, but weighted index is the most popular. The weighted index method allocates a certain portion of the overall quota based on historical sales and the remainder based on territory opportunity.

- **Analytics:** In finalizing a process to set the quotas, analytics will determine which method is best. The two primary analytics are “fairness” and “accuracy.” Fairness ensures that no territory is unfairly penalized based simply on its makeup (e.g., territory size, number of prospects, etc.). Accuracy ensures that the goals are set as close to the actual result as possible. Both elements can be tested by setting quotas for a prior period for which the actual results are already known (for example, set quotas for the year and compare them to the sales results you already have).
- **Manager refinement:** While you should begin the process with a rigorous quantitative approach, you should end it by allowing the managers to make final revisions before they roll out the quotas. This improves buy-in of the quotas by the manager and also ensures that any unique situation not accounted for in the data is addressed in the process.

Good quota setting is a critical part of the sales incentive design process. If your sales incentive plan design payouts are dependent on quota achievement, your sales compensation plan is only as good as the quotas that go with it. ■

Two Simple Reasons to Use an Incentive Compensation Management Solution

By Steve Marley

I was working with one of our software partners to describe the benefits of an incentive compensation management (ICM) solution to a company that was interested in purchasing. After articulating the benefits of an automated software solution to help one with the processing of performance, payouts and reports, the company asked one simple question: How much money will it save us? Discussions stalled at that point.

Why?

Because the company had two people working on incentive compensation administration, each part-time, using Excel workbooks.

If you consider the question of ROI on the purchase of a compensation administration platform, the basic formula is incremental revenue divided by the money spent on the system (including implementation, training and license fees, to name a few cost drivers). This company was focused mainly on the denominator—the investment part of that equation. Given this company's historical use of part-time and low-cost resources, it was basically impossible to justify an ICM solution without looking at the numerator of the ROI equation. Unfortunately, the organization was unwilling to accept that an ICM platform could help drive revenue.

Is this is a common concern? Perhaps, but let's consider why an ICM platform can help the "R" in ROI.

First, consider the situation where you might only have a fractional person helping with the incentive compensation administration. In such cases, an ICM platform can provide capability beyond what is currently present. For example, consider the company that was generating basic payment statements in Excel at the end of each quarter. Implementing an ICM solution allowed this company to publish monthly scorecards with more insightful and actionable information. I call this capability building—an ICM solution allows companies to do things they could not previously do.

Second, consider the situation where you spend a lot of time processing your incentives. I speak with many companies that want to focus more time on the strategic or incentive plan design parts of the sales compensation plan and less time on the administrative and tactical outputs. In these cases, and often with the same resourcing levels, you can gain efficiencies in administration through the use of an ICM platform and repurpose some of those people into other tasks that could use more focus.

In these two cases, it would not be hard to imagine how revenue or the numerator in the ROI calculation could improve. A purpose-built tool allows you to do something better than you've done it before—even if that something is tangential to the administrative processing.

This is clearly an oversimplification of the calculation of ROI but offers reasons to consider use of an ICM solution at your organization.

SECTION 2:

Incentives in Financial Services

When "Gaming" a Contest Is a Good Thing

By **Jason Brown**

Customer actions like spending significantly on an offering or purchasing across multiple lines of business are precursors to long and profitable relationships, according to widely held beliefs. So it is not surprising that insurers and financial institutions will spend heavily to nudge customers or intermediaries down the path to deeper and broader purchasing behavior.

This nudging comes in many forms, including contests, awards, discounts or rebates. These incentives are almost always based on the customer or intermediary reaching an incremental milestone tied to trial or increased use (spend). And pushing a customer or intermediary to achieve a milestone has value—unless it doesn't.

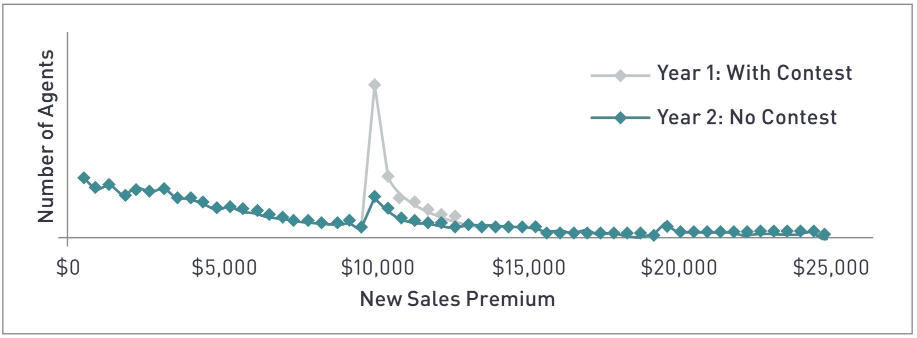
For example, consider credit card customers who spend precisely the dollars needed to reach their airline mile bonus then cancel their card. Or the insurance agent who writes new business with one carrier in order to win a president's club trip, and then shifts that business to another carrier the next year in order to do the same. Milestone-based bonuses are designed based on the average value of those who reach the target thresholds, but there are always individuals who meet the mark and nothing more, ever.

I am referring specifically to "incentive gaming," or the practice of artificially or unnaturally pushing to reach a milestone in order to "win," with no intent of continued spend or participation. We see this behavior all the time in our work with financial companies and insurers, and in general it is something we work hard to minimize through our design and tracking work.

But is all gaming bad? This is a question we were able to explore with an insurer over a period of years during which contests were added and then removed.

Agents who "play the game" were worth less on average

The insurance company knew that it was important to get new agents producing quickly, since agents who ramp up fast tend to stay longer and have more productive careers. With that in mind, managers instituted a bonus program that paid agents and sales leaders extra incentives for hitting specific production milestones in a short time period—a matter of weeks—from when the agents start. They ran this program for a year and then cancelled it the year later (shifting funds to other agent-centric programs).



In the graphic above, can you figure out where the company set the milestone target? It was pretty clearly set at $10,000, as evidenced by the massive number of agents who achieved that specific threshold during the contest period in year one.

In assessing this program, we looked at the go-forward value of all the agents who produced during the contest year, and compared that with a comparable cohort of agents who produced in the following year, during which there was no contest. Not surprisingly, we found significant evidence of the detrimental impact of gaming:

+ Agents in the contest year were twice as likely to never again produce for this carrier—generating no future value and rendering the bonus payment a net loss.
+ Agents in the contest year in general had 15% lower retention than those who were developed in the following year, when no bonus milestone was set.

This meant that, on average, an agent who was developed during the contest period (year one) was worth less than an equivalent-producing agent developed outside of the contest (year two). So in this instance, gaming was clearly bad, right? Maybe not.

The game itself may create value in aggregate

When looking at individuals—say, two agents who each produced $12,000 during the periods in question—it's hard to show that the contest added value. But when looking across the agent population as a whole, a different story emerges.

When we studied the two cohorts in totality, we found that agents during the contest period (year one) produced more value in aggregate—both in the short term and over the long term. This was the case for a few reasons:

+ Agents produced more during the period. This can clearly be seen by the shift in the curves above. And this excess production has value in the short term.
+ So many agents produced more during the contest period that, even with lower retention, the future production of those agents significantly exceeded that of the comparison group.
+ In general, many more agents were brought through the system, which can be attributed at least in part to the appeal of the contest for agents and managers.

So while there unquestionably was gaming in this program, the net results for the carrier were still positive and the contest investment delivered significant return on investment.

Lessons learned

There were several lessons learned from this exercise that should be considered whenever designing a milestone-based program:

+ Accept that gaming will happen, and design with gaming in mind.
+ Be careful where you put the milestone: Too low, and negative gaming will become extreme; too high, and engagement will be insufficient to drive any action.
+ Work to counterbalance the impact of gaming, for example, through direct outreach and intensive tracking to identify and address bad behaviors.

Ultimately, the carrier reinstated the bonus program with a few tweaks aimed at retaining its overall value but mitigating the negative impact of gaming. And that’s probably a good approach to follow in general. ■

What Insurance Agents Do (and Don't) Have in Common with Taxi Drivers

By Peter Manoogian

Ever try to hail a cab in New York on a rainy day (especially before ride-sharing apps came along)? It's nearly impossible because taxi drivers—whose payouts are 100% fare-based—achieved their income target sooner in the day because of high demand. Research demonstrates that drivers will work the least on rainy days and the most on nice days when fares are hard to find.

A similar productivity phenomenon occurs in the insurance industry. Commission-based pay makes up the vast majority of earnings. However, this structure has a flaw. It often leads to stagnant or declining productivity. The agents who are best positioned to drive growth—those with the most tenure who have the most expertise about the insurance carriers' products—are no longer incented to acquire new customers. Like taxi drivers, their productivity drops once they reach their income target.

If you're reading this blog, you're likely familiar with agents' compensation models, but just to ensure that we're all on the same page, and to set the stage for the points discussed below, I'll offer this brief summary: Whether the agent is captive or independent, incentives are the primary lever to direct behavior and spur sales. The motivational "system" tends to include three types of compensation:

1. A commission payment for sales of new policies (for example, if your family auto insurance policy is $1,000, your agent may earn 15% in first-year commissions, or $150)

2. A second (and most commonly lower) commission payment (or "trail") when the policy renews each year (and is paid in perpetuity so long as it renews)
3. Other forms of pay to encourage specific types of sales or recognize high performance (think annual trips for the top 10% of agents by sales volume)

This structure has a lot going for it: It's simple, it pays quickly and close to the sale, and it pays more when the greatest level of "selling" occurs (the initial sale). And then there's the flaw mentioned above.

During their first few years, the most effective agents build up a strong book of business by acquiring new clients. Their pay starts out heavily weighted toward "type one" earnings. As time goes on, they may continue acquiring new customers, but their existing customers also renew their policies, and the ratio of new clients versus existing clients typically tilts in favor of the latter.

The commissions from renewed policies become a powerful annuity. In most instances, maintaining clients requires far less effort than acquiring new ones, but agent pay usually increases from the prior year. That'd be like a cabbie making more by picking up easy fares on a rainy day.

This situation often comes at the expense of the carrier, as their top agents with large client bases don't sustain high levels of new customer acquisition over time, or they may not up-sell or cross-sell to their existing customers as much as they could.

The below chart shows the total pay and mix for a population of agents we studied over the first 10-plus years of their production. There are typically three tenure "ranges." Growth years usually occur during years three to six before reaching the peak productivity years. Typically, beyond year 10, productivity declines relative to the peak years, but total earnings increase because "type two" earnings build like the annuity described earlier (shown in the far right column). This concept is representative across many carriers: While the values and length of tenure at each phase may vary, the story remains similar.

Agent Tenure	Productivity (Indexed to max.)	Total Pay (Indexed to max)	% of Total Pay from renewals
Growth Years	80%	75%	8%
Peak Productivity	100% (max)	88%	20%
Decline	66%	100% (max)	55%

Figure 1: Comparing agent productivity and earnings by tenure. (Figure 1 is a representative sample across multiple firms.)

This demonstrates the challenge of building a growth model when agent productivity is usually highest within the first five years, but the agents stay around and keep their clients for much longer.

Carrier incentives can encourage stasis in production, and income targeting likely is the culprit in many cases. However, carriers can more directly impact how they distribute and motivate their agent channel than how Mother Nature affects taxi demand in New York. Here are a few suggestions to help break out of this productivity gap:

+ Know your independent agents better so that you can motivate them to higher levels of production. Otherwise, they won't realize their full potential. For instance, not all agents have the same income objectives or disposition to insurance sales: Knowing this may help carriers optimize marketing lead allocation.
+ Motivate your agents to sell additional lines of coverage. We've found strong evidence that, all else being equal, agents who sell a broader number of lines are more likely to be retained and grow production than agents who don't.
+ Adjust how you motivate agents in an attempt to reverse this phenomenon—and at least consider replacing commission payments with more performance-based retention bonuses.
+ Shift accountability for customer retention to other roles or functions. Some carriers have successfully deployed a "white glove" approach, meaning that headquarters steps in and relieves some of the agents' ongoing servicing tasks for existing clients. As a result, agents are freed up to focus more on acquiring new clients.

Amid all of the talk about the rise of e-commerce in insurance sales, the vast majority of insurers still rely heavily on their agent force as a key distribution channel. However, around 20% of active agents are expected to hit retirement age in the next several years, so carriers need to be focused on efforts to improve agent productivity. Doing so will help your salespeople—and your company—reverse those "rainy day" productivity problems. ■

Kicked Out of the Club: The Case for Increased Personalization

By Peter Manoogian

Confession: I used to frequent dance clubs fairly regularly in my early 20s. The atmosphere and music energized me. I loved hitting the dance floor and even had a signature move. (It's true. Ask my friends.)

These days, the only club I frequent is at an airport. While they both serve alcohol, they're very different experiences. I mostly go "clubbing" when I travel overseas because my gold frequent flier status grants me access to partner airline lounges.

Last week, while traveling through Europe, a bouncer—I mean, attendant—denied me access to one of these airline clubs. I was mortified. It must have been an error because I had exceeded the required qualifying miles during that year. I made it fair and square, right? Wrong.

Bewilderment and stress washed over me as I clicked the digital loyalty card in my mobile app. The card showed that I was downgraded to silver status for the next year. I was $600 short of the minimum spending required to achieve gold status. I learned that this needed to be met in combination with the miles requirement.

Maybe it's shame on me for failing to understand the fine print or track my progress during the year, though I think that it's also shame on the airline for missing a chance to increase my spending. The only communication that I received during the year was a standard monthly email statement, a message that failed to break through my cluttered personal inbox.

This airline sends me text alerts regarding delays and cancellations; couldn't those extend to notifications around my elite qualification status? Had I known that I was "falling behind" on maintaining gold status, I would have changed my behavior and flown with this airline a few more times by year's end. This would have generated more revenue for the airline and enabled me to maintain my status. That's a win-win.

This premise of personalizing outreach also holds many win-win opportunities for firms looking to better engage their sales reps (and customers). Most sales rep engagement programs, in particular, are similar to the email statements that I described above: They're generic in design and delivered at times scheduled by the company, which aren't necessarily the times most meaningful to the individual.

While this applies across all industries, the stakes are higher for industries with intermediary channels where variable incentives carry an outsized influence (and sometimes the only influence) on selling behaviors.

One recent example from an insurance carrier shows how putting this idea into practice drives impact. During a two-month contest, we selected two equal groups of agents. The first (test) group received personalized weekly update emails charting progress. Each communication contained agent-specific information about the revenue remaining before achieving the next prize tier, the value of that prize, and the time remaining in the contest. The second group served as a control and didn't receive emails.

The results were convincing: The average agent in the test group sold 30% more than that of the control group during the time period after communications were sent. Also, the only agents who earned elevated prize tiers resided in the test group. This organization is now expanding this personalized approach to other agent incentive programs based on this success.

We've known for a long time that all sales reps don't share the same communication and motivation preferences, but, as mentioned above, most programs are standardized.

Personalization, if not already the present, is absolutely the future as it relates to sales rep engagement and can extend well beyond dashboards and incentives. Any effective program should have these three features at a minimum:

1. The right message that's action-oriented, through
2. The right channel that's preferred by the sales rep, at
3. The right time, to maximize impact

Where does your organization fall regarding its sophistication in personalizing its outreach to the distribution (sales) channel? As always, I'm curious to hear.

And as for my experience being denied access to the airport lounge, I still managed to get into the club after all. My colleague (who still has active gold status) added me as his "plus one" after I was denied. ■

Compensation Season Forecast: Conditions Right for Radical Change

By Jason Brown

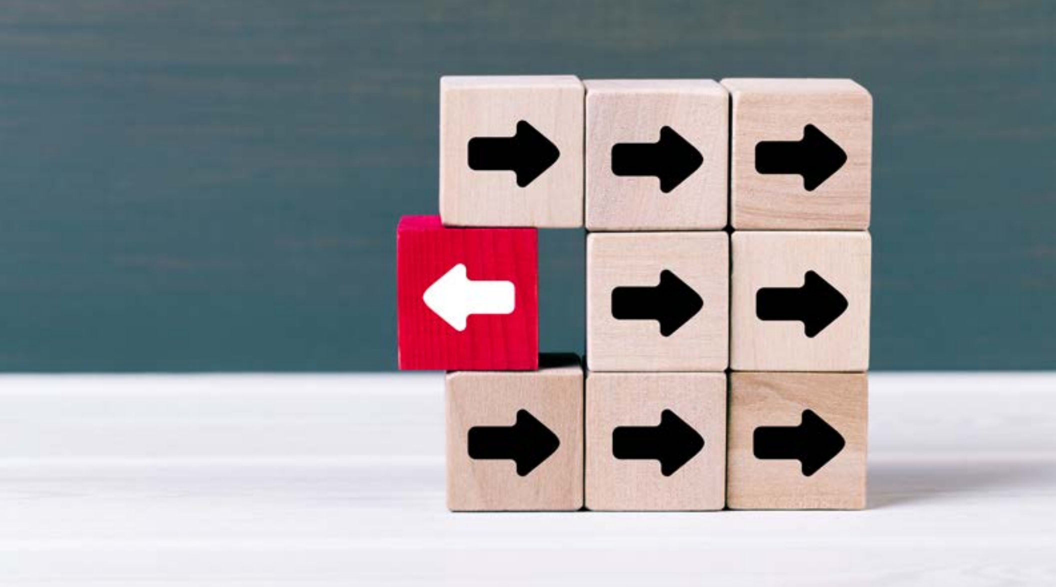
For most, compensation season, when companies prepare for the upcoming sales year, means examining incentive pay levels and mix, defining pay metrics that align with the company's new goals and adjusting pay-for-performance relationships to make sure the right salespeople are rewarded. These housekeeping steps are necessary to maintain a healthy culture and productive sales organization.

But sometimes, more radical change is needed: For example, when competitive dynamics shift, profit models change or new information comes to light. All that and more is happening right now in the asset management industry, and we believe the time is right for a major change.

In an *Ignites* opinion piece, my colleague Peter Manoogian and I advocate for a shift from asset-based compensation (gross or net) to market-share based compensation. We think that market share does a better job of capturing the current competitive dynamics in the industry—and it also reflects the new, improved state of industry data.

Our argument in support of tying compensation to market share performance is fourfold:

1. Market-share-based compensation aligns the goals of the firm and the wholesaler;
2. It controls for market fluctuation;
3. It reduces wholesalers' urge to hoard territory; and
4. It provides an avenue for long-term cost control. ■



Changing Up Wholesaler Compensation: Four Alternatives to Paying on Net Sales

By Jason Brown

Distribution leaders and industry consultants have been talking about the need for change in wholesaler compensation for the past decade, if not longer. Their reasoning has been sound: (a) compensation represents a significant fraction of distribution costs, and should be used effectively, and (b) the industry-standard plan (commission on gross sales) is not terribly effective.

Recently, the proposed solution has been to compensate on net sales, rather than gross sales, under the premise that net is better aligned with company profitability. Companies have been slowly making this shift.

However, there are three key reasons to believe that paying basis points (BPS) on net flows will not solve the industry's problems:

+ **Market volatility:** One long-standing concern has been the degree to which wholesaler compensation rises or falls with the market or with the popularity of certain fund classes. Paying on net sales does nothing to address this volatility, and if anything, exacerbates it.
+ **Pay for performance:** A wholesaler impacts only a fraction of all the assets that flow through a territory in a given year. Net sales, however, are substantially dependent on "carryover," or momentum in the territory, which can be outside the wholesaler's control. With net (or gross), the company is, in part, paying for results that occurred independent of the wholesaler's actions.

+ **Little link to company goals:** A commission plan—gross or net—provides limited leverage to the company. If a fund is looking to achieve 10% growth and achieves only 8%, the year might be considered a disappointment, but the wholesaler still earns 80% of his or her target pay.

If commission on net sales is not the answer, then what is? One thing that we can say for certain is that the answer should differ by company: A firm with new products and big growth aspirations should not use the same compensation plan as an established firm that is nurturing a large base. Depending on the situation, firms may want to consider the following:

1. **Pay on market share.** The industry is one of few with viable market share data. Could the industry use share as a metric, as many companies in other industries do?
2. **Use gated or variable commission rates.** Rather than paying a flat BPS share from "first dollar," companies could get more leverage from their incentives by focusing pay on sales beyond what might be expected from natural carryover in the territory.
3. **Link pay to sales goal attainment.** Sales goals, if done well, represent an opportunity for the industry to align pay with performance and to reinforce company objectives. Note that goals would need to account for market volatility—which is feasible, if not easy.
4. **Use performance measures beyond assets under management (AUM).** Measurable outcomes like broadening distribution—for example, reaching and developing new financial advisor relationships—are viable alternatives to an incentive plan based solely on AUM. Objective-based incentives are the norm for firms that lack sales data, but they can also be relevant even when AUM information is available.

None of the above is a foolproof solution, and each comes with significant change management challenges. But any of these ideas could represent a step in the right direction for asset managers and insurers who are looking to truly change the wholesaler compensation paradigm. ■

Unlock the Remaining 85% of Your Sales Potential: Engage “Average” Performers, Too

By Jason Brown

An insurance executive confronted me a few weeks ago with this brainteaser: “How can we engage and motivate a seemingly unlimited number of independent agents with a limited amount of resources?”

Insurance carriers who distribute through independent agents know this challenge all too well: Carriers need to engage top producers, who, though small in number, may be responsible for a large amount of total sales; carriers also need to engage the middle of the population, as this group often shows the greatest potential for near-term growth; and carriers can’t ignore the smallest producers, especially those who are new agents at the outset of their careers—or carriers risk the long-term growth of the agent population.

In the face of this conundrum, carriers often respond with an incomplete solution. Top performers are typically well-engaged through bonuses, contests and other programs that reward high levels of production. But the remainder of the agents—often 80% or more of the total population—see far less attention.

Often, carriers promote their “top performer” programs to all agents, only to be met with low participation rates and high levels of agent apathy. A few agents may actually achieve the top-performer goals, but even then, the outcome may not have been motivated by the program. We often hear of agents who are surprised to receive an award for a contest they didn’t know existed. As a result, a significant portion of the carrier’s investment is wasted.

To illustrate this point in greater detail, we conducted a survey of more than 500 first-line agency managers (individuals who both sell insurance and manage others). In the survey, we asked agents to state their preference among two bonus options:

+ $50,000 bonus paid to the top 5% of producers
+ $5,000 bonus paid to the top 50% of producers

These two programs have the same economic cost to the carrier, and the same theoretical expected value to an agent. However, the actual value of the program differs significantly depending on each agent's expectation for future production.

About 15% of the agents we surveyed chose option A. Not surprisingly, these agents tended to have strong historical sales production, exceeding the other group—those who chose option B—by about 25% on average. But the agents who chose option B were not unimportant. In fact, they accounted for 75% of overall sales production.

Interestingly, historical sales production alone did not explain agents' choice of bonus programs: past goal attainment, personal risk aversion and even geography contributed to agents' preferences. Our findings suggest that carriers need to dig deep into agent profiles—beyond just sales results—if they want to better tailor their programs and drive engagement.

In the end, many carrier programs resemble option A. And those programs often do an excellent job of engaging a small, valuable fraction of the agent population. But to optimally drive sales results, carriers need to think about engagement more broadly. The best answer may be to use multiple, targeted (or tiered) programs to reduce waste and increase appeal. Otherwise, carriers might miss out on the other 85% of agents—and on the sales growth opportunity they represent.

Three Guidelines for Forecasting Sales Growth During Uncertain Markets

By Jason Brown

Retirement services companies frequently ask us how to forecast growth and establish sales goals in times of market uncertainty. Growing assets under management (AUM) is, of course, of primary interest to providers of 401(k)s and other retirement services.

But when the market swings widely, as in the past five years, establishing AUM forecasts can be difficult.

Case in point: We were working with a retirement services provider that had experienced several years of widely varying AUM growth. In one year, new plan acquisition and AUM gathering was well below expectations. Total assets in the market shrank substantially. On top of that, plan sponsors may have been less willing to switch 401(k) providers for fear of "locking in" their losses.

The company lowered its expectations coming off those down years. And wouldn't you know it: In the next two years, employees didn't just meet goal, they blew it out, with record new AUM sales. Did the distribution organization make an abrupt turnaround, going from underperformance to over-performance in the span of a year? Or was market growth responsible for the improvement?

When we looked beneath the AUM at the underlying customer dynamics, we saw a much less volatile story. While the firm's AUM acquisition swung wildly during the period, its market share of new retirement plans and AUM was quite stable. A case could be made that the distribution organization had become slightly more competitive over time—winning at a higher rate—but the overall market volatility overwhelmed the trend.

Reflecting on this example, we see three key considerations for retirement services companies looking to forecast sales and evaluate performance in volatile markets:

1. **Build a customer-focused model.**
   Any good forecast starts with an understanding of the underlying customer dynamics. Expectations for plan turnover rates, plan participation rates and investment growth form a foundation for setting forecasts and goals that are aligned with sales opportunity. And this type of modeling is increasingly easy for 401(k) providers, thanks to third-party sources like PensionPlanet and BrightScope.

2. **Incorporate market share as a performance metric.**
   Market share is generally a more stable sales metric than total assets. It is also a better measure of distribution performance: Did we "win" or "lose" compared with our competitors?

3. **Consider adjusting AUM goals based on market growth.**
   While AUM still pays the bills, asset acquisition should be viewed in the context of overall market growth. Adjustments can be made quantitatively through goal setting or via qualitative management oversight.

   Ultimately, retirement services providers can and should set AUM growth expectations for their distribution organizations. But building those expectations based on a foundation of market and customer insight, and knowing when and how to adapt expectations as the market changes will lead to better forecasts over the long run. ■

Can You 'Nudge' Salespeople Toward Higher Performance?

By Jason Brown

We're on a continual search with our financial services clients for new ways to elevate sales performance through means other than incentives. These efforts take many forms, from the traditional—such as training, coaching and territory management—to newer ideas, like data-directed selling. Often, efforts in the latter category come in the form of "nudges": discreet attempts to change behavior, such as approaching one conversation differently, making one more sales call, or pursuing one more lead.

We recently had an opportunity to put this idea of a behavioral "nudge" to the test, to find out how—if at all—a simple notice or suggestion could impact sales behavior. What we found was both disappointing and exciting.

A Digital Nudge

We worked with a Fortune 500 financial services company to change the way that it managed and communicated performance to its thousands of salespeople. A big part of this work included converting static reports—like those used for sales compensation and contests—into more engaging, digital tools. In one such example, we built a custom mobile application for the company's incentive programs. With this application, salespeople could check their performance quickly and easily, compare themselves to their peers and perform a number of other functions. We also created functionality that allowed the company to send updates to users through notifications.

The mobile application probably warrants a whole blog on its own, but my interest here is in the notifications because that's where we were able to run a live experiment with "digital nudges." First, we devised a framework for notifications based on the salesperson's standing in a quarterly sales contest: a user who was close to qualifying might get a notice to "push to the finish" with detail about how far they were from the sales goal; a user who was deficient in some goal would get messages that focused on that gap ("Don't forget about Product A in order to qualify"); and so on. These notifications followed an established structure, but the specific messages were individually customized based on up-to-the-moment performance.

After developing the messages and targeting plan, we deployed the notifications to hundreds of users over a one-month period. In addition, we ran a controlled experiment and held out a comparable set of users from receiving any notifications at all. What we wanted to learn was, Could these notifications alone improve sales performance?

What We Learned

Our first finding was very simple: No, the notifications on their own did not drive people to sell more. Our test and control groups generated nearly identical amounts of total sales during the period of study. While that finding was disappointing, the story doesn't end there.

Although our notification program didn't hit its *biggest* goal, we discovered three very valuable things relating to digital pushes with this sales organization:

1. **Mobile app users performed exceptionally well.**
   Not all salespeople downloaded the mobile app or used it during the period of study. Because of this, we were able to compare non-users and users, controlling for all other variables (like past sales, tenure and geography). We found that mobile app users had far greater sales during the period than non-users. While the app didn't cause greater success, it was very predictive of success. This finding was consistent with other studies we've done, which reinforces the idea that digital engagement can be a useful gauge of overall engagement and a predictor of future production.

2. **Notifications didn't drive volume, but did drive the mix.**
   The quarterly contest was focused on total production, but it was also concerned with how that production was generated—emphasizing, say, specific products. What we found was that users who received notifications were more likely to achieve success with the specific product mix encouraged by the contest. So while the digital nudges didn't necessarily expand total productivity, they appear to have shaped the form of that activity: They didn't cause salespeople to work harder, but they changed what the salesperson worked on.

3. **First-line sales managers can be deeply influential.**
   When we looked at salesperson adoption and use of the mobile application, we found some striking correlations with sales manager usage. For example, if a sales manager was an active user of the mobile application, it was more than five times as likely that their salespeople would be active users. *When* the manager engaged mattered, too: If the manager registered before her salesperson, the salesperson was 30% more likely to be an active user than not. In this age of individual choice and direct, targeted outreach, it turns out that the manager still has an outsized influence on sales behaviors. The next time we run notification campaigns, we are likely to focus more attention on the first-line sales managers.

While next-best-action planning and digital engagement are all the rage these days, the truth is that very few organizations have actually applied these models to salespeople or other stakeholders in complex distribution environments, such as B-to-B or B-to-B-to-C. We had the luxury of working with an organization that was not only bold enough to do so, but also brave enough to create a true experiment with a hold-out population. Experiments like these help refine and improve these techniques to make them viable for the real world—while also showing us that we still have a lot to learn. ■

Laws of Attraction: Three Ways to Lure Top Producers to Your Firm

By Jason Brown

The insurance and financial advisory industries are facing significant declines in producer headcount. Whether due to issues of demographics, economics or personal preference, the declines in insurance agents and financial advisors are clear. Robo-advisors or other alternatives may arise as future solutions, but in the medium term, distribution organizations are left to fight over a diminishing resource—licensed producers—in search of growth.

With a declining population, not all firms can be winners in the producer growth game. But those that take a disciplined approach will have a leg up. Here are four factors to consider:

Attracting Producers

A firm's first step in growing its producer base is getting qualified candidates to show interest in joining. Before a firm deploys its recruiting engine, it first needs to understand what types of candidates to target and how to attract them. Whether looking for greenhorns who are new to broker or advisory roles or experienced producers, most firms rely upon the promise of future earnings as the primary attractor.

Some firms explicitly lay out earnings expectations as the core of their promise to recruits—as in this example from Edward Jones—while others use pay benchmarks, compensation calculators, commission grid comparisons or other tools to illustrate the competitiveness of their offering. Whatever the method, firms often lead (and close) with compensation as the foundation of their recruiting efforts. But should this be the case?

To better understand what motivates financial advisors (FAs) to choose a particular firm during the recruiting process, we surveyed over 150 financial advisors who were relatively early in their careers (all had less than 10 years in the business). In our survey we asked FAs: Why did you choose to join your most recent firm? Not surprisingly, "great earnings potential" came out as the number one factor (see Figure 1).

However, we did find it surprising that the nature of the work and the firm's reputation trailed very closely to earnings potential as key drivers of choice. Furthermore, when we examined responses only from producers who had switched firms, we found those two areas and "high probability of achieving success" actually outranked earnings potential as key drivers. The experienced producers were more interested in reality than in the "potential" for greatness.

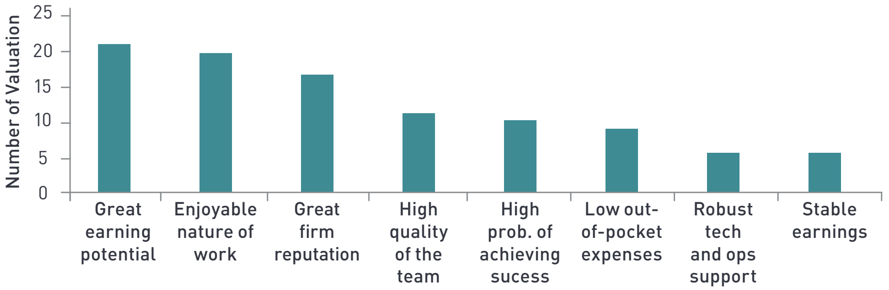


Figure 1: Why did you pick your firm?

We also dug a bit deeper into "earnings potential" by asking FAs how they determined the earnings potential with a specific firm. Their answers (shown in Figure 2) surprised us: The firm's reputation and product set outpaced the compensation plan as keys to assessing potential. Here again, we saw that FAs placed a premium on being able to realize their potential—and not just being shown enticing commissions at unattainable levels of production.

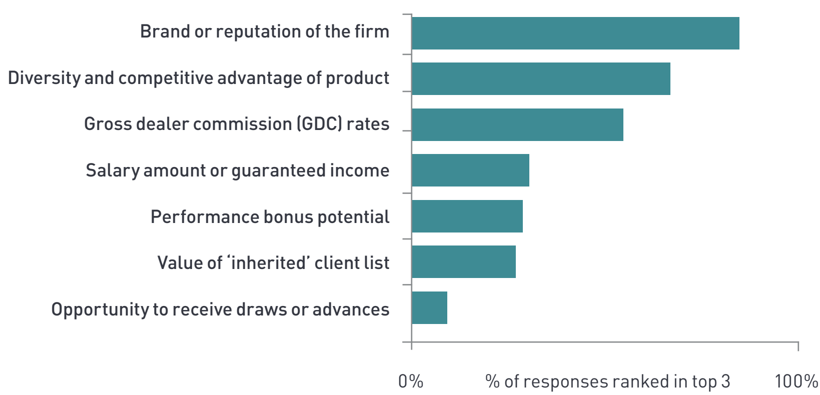


Figure 2: How do you detemine earnings potential?

What does this all mean for brokers and advisory firms? We would advise three things for firms looking to attract more producers:

1. **Test your full offer on the market**
   Look beyond compensation benchmarks to gain insight into how your brand, customers and products position you to compete for producer talent. An easy way to start is to test from within your own organization. Lay out the distinct component of your offer to producers and ask your current producers to allocate importance points to each component.

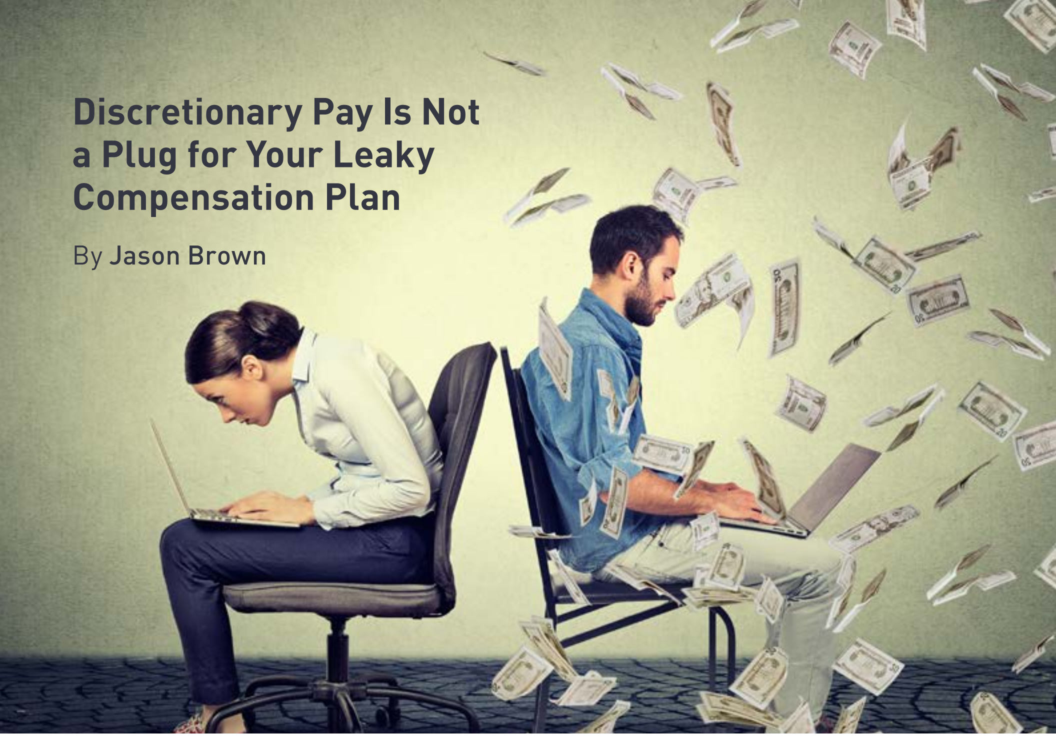
2. **Strike a differentiated position**
   Know where your offer is strong (and where it is not), and seek out candidates who value your strengths. This will require at least some market insight. A good way to start is to begin tracking loss information for candidates who did not join your firm. What about your offer did not compel them to join?

3. **Make your offer 'real'**
   Commission grids and pay benchmarks are insufficient to convince candidates of the opportunity at your firm; to the extent possible, aim to convey the experience of working at your firm, and how that experience translates into financial success.

Firms that are able to clearly communicate a differentiated and robust offer will be in the best position to succeed in the battle to organically grow their producer ranks. ■

Discretionary Pay Is Not a Plug for Your Leaky Compensation Plan

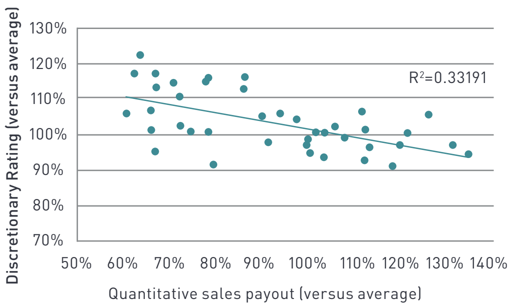
By Jason Brown



The other day I was speaking with a sales compensation director who had observed a peculiar correlation in her sales comp data. She compared the payouts that salespeople received for their quantitative bonuses—measures of direct sales results—to the discretionary payouts those same individuals received. Like many asset managers, this company uses a framework for determining discretionary pay but provides significant latitude to sales managers in deciding the actual rating for each individual.

What she found was not unusual. In fact, I've spoken with two other firms just this month that have observed this exact same phenomenon, but I think it's worth discussing. Here's a masked summary of what she saw in her compensation data:

COMPARISON OF SALES AND DISCRETIONARY BONUSES



What she observed was a negative correlation between the manager-directed discretionary bonuses and the quantitative sales bonuses (that is, salespeople who earned more results-based pay earned lower discretionary pay, and vice versa). This correlation was significant and persistent as she found similar results in prior periods.

Why was this happening? Sales leadership was most likely using discretionary pay to buffer the impact of the quantitative sales plan. Sometimes this was done to correct perceived unfairness: for example, data that couldn't be trusted or a short-term result that wasn't reflective of the salesperson's true contributions. Less often, it was done explicitly to ensure that a certain pay level was reached to "keep the person whole" according to their earnings expectations. And in many cases it may not have been a conscious decision at all but just a bias toward giving extra consideration to those who seemed to be viewed unfavorably by "the numbers."

I told the compensation director that this was a classic issue with discretionary pay, but not the kind of "classic" you want to preserve. My take is that there are three things she could do, depending on the main source of the problem:

1. **If discretionary pay is plugging a hole in the performance measure, then fix the measure.**
   It may be that the quantitative results really aren't capturing the contributions of individual salespeople. If that's the case, then look for more representative measures, or consider changing the amount of pay tied to the existing measures.

2. **If discretionary pay is plugging a hole in pay distribution, then reconsider the pay distribution.**
   Perhaps the sales organization (or leadership) is more risk averse than originally thought, or perhaps payouts swing further period-to-period than they should. That could mean that the incentive plan needs to be recalibrated (longer horizons, lower volatility), or it could mean the sales team needs to change.

3. **If discretionary pay is being driven by an unconscious bias toward leveling, then address it openly and consider restructuring the calibration process.**
   Sometimes simply creating awareness is enough to correct any underlying problems. In other instances, firms might benefit from rethinking how discretionary pay is determined: for example, moving it off-cycle from the quantitative pay process, or adding more governance.

Negative correlation between discretionary and quantitative pay should be an outlier in your compensation program. It really shouldn't happen unless you have a small sample size, and it only happens in a single year (that is, it's a true anomaly). But over long periods of time, we would expect salespeople who approach the business the right way to be those who generate the best quantitative results. If that's not what you are seeing, then you might want to ask why. ■

SECTION 3:

Plan Design Best Practices

Should You Globalize Sales Compensation?

By Chad Albrecht

In a webinar on sales compensation, we polled the audience, asking about the biggest issues facing sales compensation professionals today. Out of several hundred responses, globalizing sales compensation was one of the top issues faced by more than 50% of participants. Let's help you think through whether you should globalize your sales compensation plan designs.

What does it mean to globalize?

Not everyone has the same vision when they hear the words "plan design globalization." In fact, there are multiple levels of plan design globalization. Level 1 involves merely establishing guiding principles for all countries or regions in the world to follow. For example, all regions must have a profitability component in the plan and a maximum of three metrics. Plan designs in all parts of the world must follow the guiding principles, but the details of the design, relative weights, etc. are left to the local countries or regions.

Level 2 globalization involves a single global plan design for every role, with minimal exceptions based on local need. This is more directive to all regions of the world than the Level 1 globalization. Take an account manager role, for example, that is defined the same way globally. With Level 2 globalization, a sales incentive plan will be established for that role that is to be used universally. For example, a quota bonus based on revenue that is weighted at 70% and a commission on new sales that is weighted at 30%. Exceptions are allowed, but must be approved by a regional and global sales compensation committee.

Level 3 globalization means a single plan design for each role globally with no exceptions. Essentially this is the same as Level 2, without exceptions. This is much rarer, due to the differences that exist across countries (legal, regulatory, cultural, etc.) that usually require the need for additional consideration.

Should you globalize?

So what are some of the key considerations that will help determine whether you should consider globalizing? There are three primary situations when you should strongly consider globalizing your sales incentive plans.

1. **Global sales process**
   Some organizations, particularly large organizations and companies in the tech space, have a global sales process. They are selling to companies that are buying products that will be installed globally (software, for instance), and as such, they have salespeople all over the globe playing some role in the sales process. They may have a single "quarterback" calling on headquarters locations, but they also have local salespeople deployed to help with the buying cycle at the local level.

   If you have a global sales process and common roles in varying locations, you should consider establishing a global sales incentive plan.

2. **Desire for increased control**
   Even when there is no global sales process, we have seen more instances of senior executives wanting a greater degree of control over sales incentives and how they're used. Tales of far-away countries using subjective measures to overpay salespeople for underperformance have led some executives to put more controls in place around what metrics countries or regions can use in their plans. Another reason is legislation requiring CFOs to sign off that the company's financial statements are accurate, auditable, etc.

3. **Need to drive incentive compensation effectiveness**
   The last reason some companies have tried to globalize is a recognition that there is no local sales compensation expertise in the regions of the world in which they have salespeople. Putting some sort of global design framework in place ensures that plan design best practices are implemented worldwide.

Can you globalize?

Even if the mandate is to globalize your sales incentive plans, the key question is *can you* globalize? Have you invested in the global systems necessary to administer plans across different countries, regions, etc.? The advent of systems that can manage global sales compensation (such as Cognos SPM or Xactly) has made it possible. ■

How 'Balanced' Is Your Sales Incentive Plan?

By Chad Albrecht

Many companies have inserted "balanced selling" mechanisms into their sales incentive plans to encourage their sales forces to sell multiple products—and penalize them if they don't. Yet these same companies often scrap the balanced selling incentive because it doesn't work, is overly complicated or, in some cases, actually reduces sales.

So should you even consider incorporating a balanced selling component into your plan? What are the considerations and complications of such a move? What should you avoid? And for companies that already have a balanced selling component in their plans, they need to ask themselves if the component is working and how they can improve it.

The need for balanced selling

Let's first define what we mean by balanced selling. Imagine a sales force that sells Products A and B. Each product is measured and incentive is paid separately based on performance to the respective product goals. The concept of balanced selling simply says salespeople have to perform well in both Product A and B to be considered successful and to maximize their sales compensation earnings. Through the lens of a balanced mechanism, blowing out the quota for Product A and being at 50% of the Product B quota would be considered failure.

Companies pursue balanced selling incentives for many reasons. Some pursue it for purely political reasons. For instance, a product marketing manager may have a portion of the sales force cost allocated back to his or her budget, and in return, the product manager expects to have a specific mechanism in the sales incentive plan that emphasizes the product. Or perhaps the CEO has put his or her career on the line by purchasing a company or product line, and now needs the acquired product to perform—or he or she is headed for the unemployment line. In this case, you can be sure that there will be a component in the sales incentive plan to help ensure the CEO keeps his or her job.

Unintended consequences

Balanced selling incentive structures can go wrong in several ways. The most common is when salespeople accept a lower level of *total* sales to earn the balanced selling incentive. For instance, salespeople selling Products A and B earn a large bonus at year-end if they hit both quotas. Most have achieved their Product A quota by Nov. 1, but are far behind for Product B. Inevitably, they will drop Product A and focus exclusively on selling Product B if their ROI is higher for selling Product B. In most situations, the sales force will end up with lower overall sales than if it had continued selling the way it had been until November.

A second way we have seen balanced incentives go wrong is when they are impossible to achieve. We worked with a client that set up a system that rewarded a sizable bonus when a salesperson hit quota for five product buckets. When we saw this incentive, we pointed out that for each product, approximately half of salespeople will achieve their quota. The percentage of the sales force that can be expected to meet all five product quotas is just 3% (0.5 x 0.5 x 0.5 x 0.5 x 0.5). Indeed, when we did the analysis, we discovered only 3% had hit all five buckets. Most of the remaining 97% had given up early on.

The third situation when these incentives go bad is when they are too complicated. A dominant trend in sales incentive design is to strive for simplicity, but adding a balanced selling component will add complexity to the plan. You have to be sure beforehand that improved business results brought about by the balanced component in the sales incentive plan will more than offset its increased complexity.

Doing it right

When the discussion turns to the need for balanced selling in your organization, be prepared to push back and ask pointed questions: What's the benefit of balanced selling? Do we really need it? What are its unintended consequences?

If upper management presses ahead, test certain scenarios and share the results with senior leaders. For example, a scenario can determine the best outcome when Product A and B both have a national quota of 100:

1. **Product A is at 102, Product B at 103, total sales of 205.**
   Both products meet quota, but we have the lowest total sales of all three scenarios.
2. **Product A is at 115, Product B at 95, total sales of 210.**
   Only Product A achieves quota, but we have the max sales of all three scenarios.
3. **Product A is at 95, Product B is at 112, total sales of 207.**
   Only Product B achieves quota, but we outperformed Scenario 1 in total sales.

If upper management chooses Scenario 2, then you likely should not put a balanced selling component in place—total sales is what matters most. If they choose Scenario 1, clearly balanced selling is worth more than the highest total sales and a balanced selling component is worthwhile.

With these insights, you have the necessary information to construct the plan. You can structure the balanced selling linkages based on the relative importance illustrated in the example above. These incentives can include linking the products together, linking together the upside opportunity only or paying bonuses for multiproduct achievement.

Balanced selling incentives can be extremely effective but must be done the right way, for the right reasons and with the right level of complexity. ■

Do Your Managers Understand the Sales Compensation Plan?

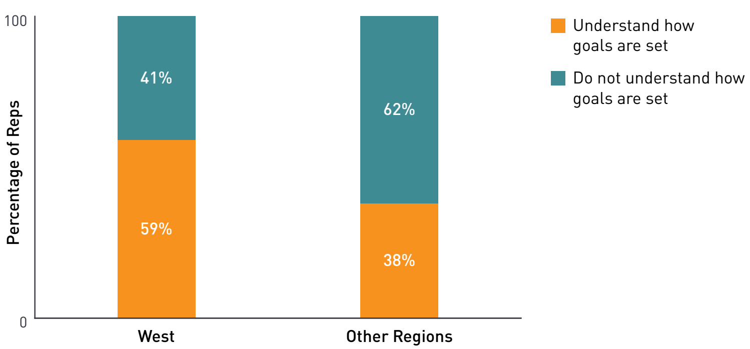
By Mike Martin

There's a point in the year when new sales compensation plans have been rolled out, but we are still a month or two from understanding how they are working. We do not have enough sales results yet to judge the incentive plans' impact, so what can we do during this so-called downtime?

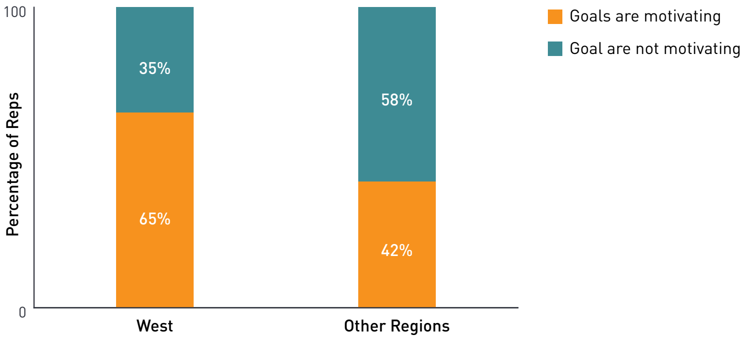
In my opinion, the No.1 thing we can be doing right now is ensure that first-line managers understand the plan.

One company I work with surveyed its field force and found something interesting that supports this recommendation:

+ Of the three regions surveyed, 59% of reps in the West responded that they "Understand how my goals are set." In the other two regions, about 38% of reps responded the same.



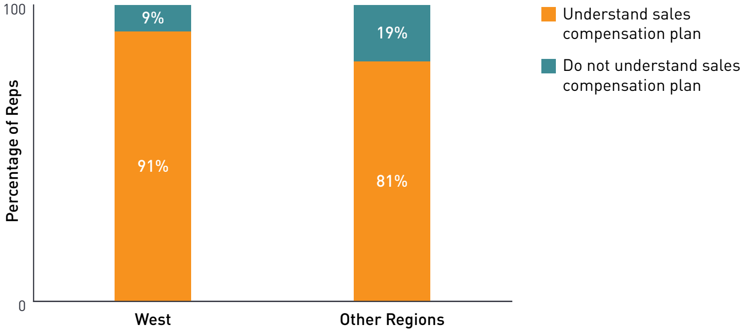
+ The survey then asked if the goal motivates the rep. 65% of the west's reps responded yes, whereas only 42% of the other regions' reps responded yes.



The insight here is that reps who understand their goals (and by extension their compensation plans) are more motivated.

The study went on to ask reps if they felt their managers understood the sales compensation plan.

+ Of the West's reps, 91% responded yes, compared with 81% of reps in other regions.



Again, the West region was coming out on top. A very simple correlation can be assumed:

Managers who understand the plan → Reps who understand the plan → Reps who are motivated by the plan

Based on this relationship, spending more time with managers to repeat the plan rollout from early January or conducting a Q&A could be very productive and help to ensure all the work we did at the turn of the year pays off.

Don’t Compensate Every Salesperson the Same

By Chad Albrecht

Most large companies segment their customers to determine whom to target and how best to serve them. Criteria for segmenting customers often include factors such as company size, whether they are a current customer, their industry or other factors. Analytics help segment these customers into groups, and the groups are then treated alike for the purposes of a go-to-market strategy.

Research in the area of sales compensation suggests companies should consider segmenting their salespeople as well to determine which incentive plan might serve them best. The study, conducted by Mike Ahearne from the University of Houston and published in a 2012 *Harvard Business Review* article, shows that not all salespeople are equally influenced by the same performance incentives.

Mike’s research shows that for the lowest 20% of performers, more frequent measurement periods drive higher performance—to the tune of 10% higher performance. For example, this can include quarterly goal setting, instead of just a single annual objective, and holding people accountable for their number every quarter. But the more frequent objectives have little effect on the highest performers—they are already self-managing well and don’t need the more frequent objectives to drive them year-round.

For the high performers (top 20%), the elimination of caps and the availability of significant upside opportunity is what drives them. In fact, the study showed that the lack of overachievement accelerators in a plan resulted in a 17% reduction in revenue performance among the stars. The existence of overachievement accelerators also had an impact on lower performers, but significantly less than the impact on higher performers.

For the middle 60%, the research shows that "tiered targets," stepping-stones in the heart of the payout curve, had a significant impact on performance. The hypothesis is that the more tiers that exist, the more likely a core performer was to have the next tier clearly within reach. Interestingly, the tiered targets had no impact on the top and bottom performers.

So how do we take all of these facts and design a simple incentive plan that appeals to all three segments of salespeople? Since the addition of the features described is not *negatively* impacting any of the other segments, consider adding them all into the same plan.

For instance, you may decide to set quarterly milestone targets, make the plan uncapped and have some tiered payouts in the heart of the core performer performance range. You get the positive outcomes from all three segments, while not incurring any negative consequences from the other segments.

If you find that adding all of these factors results in an overly complicated incentive plan, you can perhaps create multiple plans and find ways to have salespeople sign up for the appropriate plan.

For example, if you have a career path culminating in "executive sales rep" and this role tends to have mostly high performers, you could design a plan for that role with the features designed for top performers. Similarly, for the entry-level sales role, you could assume that a higher percentage of them will fall into the "low performer" category and you could design a plan with the components designated for the bottom performers. As the best performers in the lowest groups move up the organization, they move into roles with features designed to their performance group. ■

Are You Giving Away Free Sales Incentive Pay?

By Chad Albrecht

Companies invest in creating incentive structures that motivate their sales force. However, when incentives are not driving incremental sales, they can lead to wasted money and lower sales force engagement. This can be especially damaging for companies with slimming margins that are trying to spend every incentive dollar efficiently.

Before delving into ways a company can effectively adjust its incentive plan, it's important to note how incentives can become ineffective—despite a company's best intentions.

Free Sales = Free Incentives

It may sound counterintuitive, but many companies pay their salespeople incentives for sales that required little or no effort. For example, some customers make purchases based on ingrained buying habits, while other sales come as a result of a prior sale (think of a razor/razor blade model on a larger scale). In these instances, the sales today don't result from efforts made today. These "carryover" or "free" sales can distort incentive payments and create a sales force that is not motivated to maximize sales.

The amount of carryover depends on several things, but most notably, the salesperson's investment required on every sale of an item. Products that require less ongoing sales effort once the product is adopted, such as soft drinks or pharmaceuticals, have very *high* carryover. Other products that require intense salesperson effort with each and every sale, such as capital equipment products, have very *low* (or even zero) carryover. Many products fall in the middle of these two extremes.

Paying for sales below the carryover level of sales results in wasted incentive dollars that essentially become "hidden base salary." In other words, since the variable pay is guaranteed for these sales, it is no longer an "incentive."

For example, one company aimed to keep its sales force "hungry" by giving salespeople 45% of their pay in base salary and tying 55% to sales performance and earned incentives. Upon closer inspection, however, the company discovered a moderately high carryover level for its product sales. This meant that a large part of its incentive was guaranteed. When this hidden base salary was factored into the mix, the new salary-incentive mix was closer to 75-25.

Unfortunately, this is not an isolated example. The good news, however, is that there are strategies companies can use to ensure that their incentives drive sales force performance.

Making the Incentive Plan Work

Companies can change their incentive payout curve or add thresholds below which no incentive is paid to account for the carryover rates in their products.

1. **Change the payout curve.** For example, if a company determines that the first 60% of sales are "free," it can put a lower rate on the first 60% of sales (perhaps a 1% commission rate) and a higher rate on the portion of sales that a salesperson actually influences (perhaps a 4% commission rate). This helps the company provide higher pay to those who are truly selling more and lower pay for those simply sitting on a large territory.

2. **Add a threshold.** If the first 60% of sales is truly "free," then a company can choose to also add a "threshold" into its plan at 60% of quota, so that its salespeople get no incentive below that level. Doing this allows the company to pay an even higher rate above the threshold, which encourages better performance. This is not a one-size-fits-all solution, however. Roles that have little or no carryover ("hunter" roles such as capital equipment specialists) should not have any threshold.

These strategies are built on the premise and realization that the salesperson is not driving all sales and therefore should be paid less incentive for sales he or she did not work to secure today. The most appropriate choice between adding a payout curve and adding a threshold depends on many factors, such as the amount of pay at risk, the length of the performance period and the amount of complexity senior management will allow in the incentive plan.

For some companies, the best solution may be to do nothing to account for carryover. These companies know that there is less pay "at risk" than what their salary/incentive mix suggests, and they want to keep it that way. For example, a sales force on 100% commission may consider themselves on a 0-100 plan, but if no one has ever received less than 40% of his or her pay, it is more like a 40-60 plan. Some companies like the perception of higher risk or the increased flexibility of a higher-leverage plan and prefer to keep it that way.

Now's the Time

Today is when executives must challenge commonly held beliefs about salary-incentive mix and about how much incentive pay is truly at risk. Companies that haven't considered the impact of carryover in their incentive plan are likely giving away free money.

Incorporating a threshold into the sales incentive plan, or lowering the pay rate for carryover sales, will allow companies to ensure that salespeople have rightfully earned every incentive dollar they are being paid. It also allows firms to pay more incentive dollars on the sales their salespeople truly influence, driving incremental results when companies need it most. ■

Is Dollar-One Commission Plan Limiting Sales Growth?

By Chad Albrecht

Companies that have "grown up" on highly leveraged commission plans are running into a dilemma: They can change the plan and risk alienating some of their highest-grossing salespeople, or do nothing and risk lower overall sales growth. The situation is more common than some realize, and demands solutions that can balance sales growth with retaining salespeople.

How Did We Get Here?

Many start-up and fast-growth companies have highly leveraged commission plans that begin paying from "dollar one," giving the sales force a percentage of the sale starting with the first deal they close. Such plans can be effective in the early stages of a business and product lifecycle, as they attract aggressive salespeople. And start-ups need aggressive salespeople, if only because an unknown brand name can't sell the product—so start-ups must rely heavily on their sales forces to build the brand.

But at some point, high-growth companies become mature, low-growth companies. At this stage, many of these companies employ salespeople who have done extremely well over time and are sitting on large territories, earning enormous commissions and not growing their territories due to the number of accounts they already cover. When a company has enough of these mega-territories with flat revenues, overall growth grinds to a halt. The dollar-one commission plan that served the company so well for so long has begun to limit growth.

But despite the limitations of dollar-one plans, many companies find it terrifying to even think of changing an incentive plan that made them so successful in the first place. In many cases, a salesperson has effective control of his or her territory and accounts. Moving from a dollar-one plan to one that pays based on quota performance may spark a revolt in the field. And in fact, many companies that have tried changing have backed down based on the field's reaction.

A Tale of Two Industries

So what can companies do in this situation? In part, the answer depends on whether customers "buy the rep" or "buy the brand." Reviewing the history of the high-tech and medical devices industries illustrates these situations well.

In the formative years of the high-tech industry, salespeople were usually paid 100% from commissions (some received a token base salary). Companies had little free cash, and as a result, salespeople were paid only when the company was paid. This was a highly successful strategy and helped propel many companies to great profits.

But as tech companies matured, they faced a choice: Change the commission plan to fuel growth or stay with the status quo. Salespeople who had been successful over time were sitting on large territories, and were usually not growing as fast as the rest of their company. Maximizing growth would entail evenly allocating a combination of existing and potential accounts, thus optimizing territories. Companies had to fundamentally change the plan and move away from commissions or develop plans that allowed movement of accounts.

Over time, the majority of high-tech firms switched their plans: The most common plan designs used to be commission plans, but eventually, "quota bonus" plans became more common (quota bonus plans set a quota for all territories, and everyone in the same role is paid the same for hitting quota). In moving to quota bonus plans, tech companies made growth their clear focus.

High-end medical device companies (makers of cardiac implants and orthopedics, for instance) started out on a similar path as high tech. However, when it came time to decide whether to change their incentive plans, most firms stayed with a dollar-one commission-based plan. Why? Because for many high-end medical devices, physicians were "buying" the salesperson, not the brand. Physicians wanted someone they could trust in the operating room during delicate procedures, and for many product categories, physician's trust in the salesperson far outweighed any perceived brand differences.

Studies have shown that in some categories, over half of an individual's sales leave when that salesperson departs for a competitor. Since physicians were buying the rep and not the brand, most high-end medical device companies left the 100% commission plan in place and sought growth through other sales force drivers.

What Now?

So how should companies reinvigorate growth when their salespeople are accustomed to a 100% commission plan? First, a company must test if its customers are buying the brand or the rep. Discussions with sales managers and examining territory sales for salespeople who have left can help identify what, precisely, customers are "buying."

If your customers are "buying the rep" and you decide to realign territories for growth anyway, it is important to develop a transition plan for salespeople who may lose accounts. The transition strategy can be completely compensation focused, and could include strategies such as slowly reducing sales credit on accounts that are leaving them, or guaranteeing their pay for a period of time.

The strategy can also include elements that do not involve compensation, such as changing the sales force coverage model to reduce the likelihood that a rep will leave with his or her accounts in hand. This may include moving the account over time to another salesperson and double-paying both salespeople. It can also include adding less-senior personnel—who generally are less likely to leave—to assist with the account.

If your company has a dollar-one commission plan and is concerned about below-market growth, it may be time to take a hard look at your incentive plan. Do you have enormous territories that are growing slower than the national average? What might happen if you change the plan to promote growth? You may realize that your incentive plan is inhibiting growth—and is paying people largely for the business they developed in the past. ■

Should You Pay Your Salespeople on Profit?

By Chad Albrecht

In a webinar on sales compensation, we polled the audience, asking about the biggest issues facing sales compensation professionals today. Out of several hundred responses, consideration of moving the sales force away from revenue toward paying on profit was one of the top issues faced by more than four in 10 participants. We will help you think through whether you should consider shifting the metric in your incentive plan to pay on profit.

Should you pay on profit?

The first question to ask is whether shifting the metric to profitability is a strategic priority for your organization. Some companies are not (yet) focused on their margins—they are focused on growing as quickly as possible or growing share at all costs. Strategic goals like these are likely at odds with switching your primary sales compensation metric to profit (from revenue or sales). However, companies whose strategic goals include increasing their average selling price or improving the overall profitability of their product mix should consider shifting the primary incentive compensation metric to profit.

If paying on profit or margins is indeed a strategic goal, it still doesn't mean it is a metric that *should* be in the salesperson's sales incentive plan. We need to ensure that salespeople *control* profit. The primary ways salespeople control profitability of their territories is by:

+ **Controlling the price:** If salespeople can grant price discounts to the customers, then consider switching the metric from revenue to margin. This is often the top reason companies seek to switch to paying on profit: to prevent salespeople from immediately dropping to the bottom of the allowable discount range to ensure they secure the deal.

- **Controlling the costs:** This may seem like an odd category to include, but in many industries, salespeople can control the costs by how many deal freebies are given away. For example, while salespeople don't control the cost of goods sold, they can inflate the costs of service by giving away free shipping, expedited shipping, free service upgrades, etc. If this is the case, and these elements are trackable in some sort of margin metric, then consider switching away from revenue.
- **Impacting the product mix:** If salespeople are selling products that have widely different margin percentages and the organization wants to drive them to sell the higher-profit-margin items, switching the metric to gross margin will help encourage them to focus on the more profitable products.

Can you pay on profit?

Assuming at least one of the conditions is true, then a case could be made to pay salespeople on profit. The next question is, can we actually do it? There are two important aspects to whether you can pay on profit: the ability to measure profit at a territory level, and the willingness to share gross profit details with salespeople.

1. **Measuring**
   Many organizations have either never tried, or simply can't, measure territory- or account-level profitability. Their systems were simply not designed to measure and report gross margin at that level. In this case, investigate what it would take to develop the systems, data and processes to measure and report margin at a territory level.
2. **Willingness to report**
   Even when the system is in place to measure and report on profitability at an account or territory level, some companies are unwilling to communicate their margins to salespeople. They consider their margin information highly confidential and may not want salespeople (and their customers) to know their margins. In this case, companies measure on margin "proxies" that impact the gross margin without divulging the actual gross margin percentages to the sales force.

Paying on profit

The 2008-2010 global financial crisis forced many companies to evaluate whether they should switch their primary sales compensation metric from revenue to profit. It is important to first determine whether salespeople have adequate influence over profit to consider placing it in the incentive plan. If so, the measurement systems should be evaluated to ensure they can measure and report on territory-level gross margins. Finally, if you are switching your sales compensation metric to margin, it is best practice to measure and report on the new metric for three to six months prior to compensating on the metric to allow the salespeople to become accustomed to the metric and also to work out any bugs with the calculation. ■

Two Questions You Should Be Asking Your Sales Force About Their Goals

By Mike Martin

I can't help but look ahead to the early fall sales compensation plan design season. I am in no rush to get there, but thinking ahead does nicely remind us that before planning begins in earnest is the time to collect feedback from the sales force on the current incentive program and goals. Over time, I have found that getting answers to just two questions can provide a wealth of feedback into what should be refined, added or removed from the goal-setting process.

Question 1: What percent-to-goal do you *want* to achieve this coming cycle?

Question 2: What percent-to-goal do you *think you will* achieve this coming cycle?

They seem pretty simple, right? In fact, you may even get a few quizzical looks when asking both questions, but let's dig deeper.

Question 1 aims to understand the *motivational* aspects of the current design. Once when I asked this question about goal attainments, I saw a bimodal distribution in responses around 100% and 110%. The 110% was the more interesting and was the result of a cap on payouts that kicked in at 110% attainment, effectively ending any motivation to perform higher. When plan design came around, the company decided to remove the cap in order to boost motivation. The ideal distribution of answers to this question would be a spike at 100%, tapering off as you go higher, with very few responses below 100%.

Question 2 can help to understand multiple facets of the plan, including the confidence of the rep, perceived fairness and local knowledge. The ideal answer here would be everyone believes they will achieve 100% of goal. If you were to find the average was located above 100%, then you may want to look into whether the forecast is too easy. Similarly, if the average is below 100%, there may be a history of unachievable forecasts that are putting the sales force in a mental hole before the cycle even starts. You may also find different results for different parts of the country. On one study, we found a collection of reps who expected to achieve about 80% attainment. When we dug into why, we found that all of those reps mentioned a similar market event that only occurred in their pockets of the country. By adjusting the goal methodology to account for this type of market event, we fixed some real bias in the plan prior to the next year.

Hopefully these two questions help spark some other things you would like to investigate. Whether you use these specific questions or not, the important thing is that you take the time to collect some feedback on the current plan before designing the new one. This way, you will be ahead of the curve. ■

Six Ways to Design Your MBOs to Have an IMPACT

By Mike Martin

Management by objective (MBO) plans can be very useful additions to any incentive plan for a variety of reasons:

+ Lack of "comp-grade" sales data
+ Long selling cycle
+ Company philosophy dictates it

However, many sales teams face challenges when working under an MBO plan. Common complaints include: "Everyone is paid the same" and "They are too subjective." The question we would all like to answer is: "How can we build an MBO-based incentive compensation program that drives the business, rewards appropriate behaviors/results and is not a drain on internal resources?" In other words, how can we *design our MBOs to have an* IMPACT?

Individualized: Start by customizing objectives to each rep. It will increase ownership and buy-in into the program. Customization can range from completely different objectives to simply different payout weights.

Motivational: Next, be sure to put enough target sales bonus against each objective to ensure reps pay attention. I typically use $1,000 per objective per payout period as the minimum amount.

Purposeful: Objectives should be tied to business objectives as much as possible.

Actionable: Objectives also need to be such that reps can make significant progress during the time period being measured.

Communicated clearly: Rollout of the objectives is as important as the objectives themselves due to high reliance on first-line sales managers for success. A smooth rollout will save time during the rating phase because managers will have a starting point and already be more calibrated.

Tracked: Once the objectives are set and communicated, progress should be tracked on an ongoing basis, ideally through a transparent and automated process.

MBO programs that follow the IMPACT framework can help to avoid many of the pitfalls that you may have experienced in the past and better ensure positive results in the business that we ultimately want to drive. ■

Would Sales Leaders Like MBOs More if We Changed the Name?

By Mike Martin

A couple times I have written about management by objectives (MBOs), such as how to improve them by focusing on quality over quantity and using the IMPACT framework to create more *impactful* objectives. However, I still find that the name "MBO" carries a lot of baggage.

Regardless of how effective we are at creating them, as soon as incentive compensation plans are communicated and the sales force leaders see "MBO," they immediately have a negative reaction and assume the plan is "too subjective" or "too soft." Some companies have changed the name slightly to "KBO" (key business objectives) or "KSO" (key strategic objectives), but I think that the result is still the same. So far, the most effective approach I have seen is to drop the MBO/KBO name altogether and focus on the desired outcomes.

Here are some examples where MBOs have been rolled up into a non-sales goal:

+ If the MBO is focused on profiling customers, working with other internal stakeholders to develop a plan, and creating the implementation steps needed to achieve the account goal, then call this incentive component "the business planning goal."
+ If the MBO is focused on meeting with the top five customers monthly or ensuring that 60% of tier-one customers enroll in the latest online marketing campaign, then call this incentive component "the marketing and promotion goal."

By changing the MBO names, you have essentially created new goals in your goal-setting strategy and provided an opportunity to change the sales compensation plan communication. Instead of saying that the plan is 75% sales and 25% MBO, you would instead communicate to the sales force that their sales bonus plan is tied to two goals: 75% of target on a "sales goal" and 25% on a "business planning goal."

Could this simple idea help with rolling out non-sales objectives in your compensation plans? ■

How Much Does Money Matter to Get a Rep's Attention for a Short-Term Promotion?

By Mike Martin

The U.S. Treasury announced that it will be changing the face on the $10 bill to include a woman. This exciting news reminded me of some trivia I looked up regarding the $1,000 bill. Did you know that Grover Cleveland was on $1,000 bills and that they were pulled from circulation back in the 1960s?

Now, you may be asking yourself, Why is he talking about $1,000-bill trivia? Beyond the fact that sales compensation relates to money, I was specifically researching the $1,000 bill with regard to *what amount* of money matters.

This is a question that comes up often in sales compensation design. Whether the company is thinking about a smaller product in the portfolio or about a short-term SPIF (special promotional incentive fund), people will want to know how much money they need to pay out to get people's attention. With all of the different promotions and requests vying for sales rep attention, this is an important question.

I would propose $1,000 is the magic number. Here is why:

1. It just feels right. Sorry, I do not have anything quantitative to back that up, but round numbers matter, simple numbers matter and more digits matter when it comes to prizes.
2. Others agree. I have held a number of seminars and asked the group to come up with the minimum target amount on their own and then discuss as a group. I have done this four times, and all four times, the answer was $1,000.
3. Lastly, I do have some data that backs it up from various benchmark studies on SPIF payouts. One such study from 2014 of pharmaceutical reps stated that the average contest payout was $2,000, with the lower end of responses around the $1,000 mark.

Revamp Your Recognition Programs to Motivate Top Sales Performers

By Chad Albrecht

Sales incentive programs are designed to motivate salespeople to excel. But how do you motivate your top performers when they've already exceeded their quota and have made plenty of incentive dollars? Even the best salespeople need an extra boost to maintain a high level of performance. According to ZS's annual incentive practices research (IPR) study, the best way to provide this boost is to complement the sales incentive plan with an annual recognition program.

Relative Effectiveness of Incentive Vehicles

While most supplemental incentives can be effective motivators and often work in concert with one another, the use of recognition programs is widely considered the most effective. Here's how IPR survey participants rated the relative effectiveness of three common supplemental incentives on a seven-point scale:

+ Recognition plan 5.9
+ SPIFs or contests 5.1
+ Long-term incentives 4.6

The reason for the effectiveness of recognition programs lies in Abraham Maslow's hierarchy of needs. This theory of human motivation states that once an individual satisfies basic food and safety needs, he or she progresses to a higher level of needs and strives for self-esteem and recognition.

This means that once salespeople have earned enough money to provide for their family and keep them safe, they are driven by a need to raise their self-esteem—not just their earnings. Recognition programs provide the confidence and sense of achievement that financial incentives alone fail to provide.

Guidelines for Recognition Programs

There is no question that annual contests that offer winners highly sought-after awards, visible recognition and public commendation are effective. Still, implementing an effective recognition program is a multifaceted process. Here are three guidelines that companies should follow when designing their annual program.

1. **Make it selective but not impossible.**
   The results of the IPR study show that most best-in-class companies set up their annual recognition programs so that approximately 5% to 15% of salespeople win the award. This means that 20% to 30% of salespeople are competing for the award for much of the year, which ensures that top sales performers are constantly motivated to achieve better results. This contrasts with recognition programs that are limited to the top 3% to 5% of the sales force. A majority of salespeople give up on winning these exclusive recognition programs before the year even begins.

2. **Make the award highly valuable.**
   Send winners on a trip that they would never (or perhaps could never) go on their own. Many companies already do this. Eighty-seven percent of companies in the IPR study that had recognition programs rewarded the winners with trips that can cost upward of $20,000, and 85% reward them with a memento such as a commemorative plaque. Offering mementos in addition to a “flashy” prize such as a luxurious trip provides salespeople with a constant reminder of the reward and recognition. This ensures the positive effects and value of the reward last well beyond the short trip.

3. **Offer public acclaim.**
   Companies need to communicate a “scoreboard” of performance on a regular basis to foster competition among the sales team. They should also announce the awards publicly at the end of the year. The public recognition of their accomplishment not only boosts winners’ self-esteem, but also establishes them as role models for the rest of the sales force.

The Best Way to Improve Results Today

As companies are forced to do more with less, sales executives need to ensure their top performers are motivated and continue to deliver results. If funds are low, managers must get creative and find ways to supplement their incentives arsenal with relatively low-cost, yet effective, awards such as public accolades and mementos.

An effective annual recognition program will increase the engagement and loyalty of top salespeople today and pay dividends for the company in the future. ■

Three Ways to Ensure Reps Understand Their Sales Compensation Plan

By Mike Martin

Over time, I have run into a few litmus tests that companies use to gauge the simplicity of their sales compensation plan communications:

+ The rule of three: A comp plan should be able to be communicated through three key points.
+ The comp plan should be explainable on a cocktail napkin.
+ Every rep should know what he or she needs to do in order to make money.
+ A sixth grader should be able to understand the plan.

Unfortunately, in the spirit of fairness or due to multiple stakeholders providing input into plan design, the ideals of communication described above are not often achieved. However, a few common aspects emerge that can help to bridge the gap:

1. The description should be brief: In many companies, the compensation plan document is part plan descriptor and part legal document. As such, brevity is nearly impossible. One idea to counter this is to include a one-page summary at the front of the document that hits on the key points but leaves the details for the longer document.

2. A few key points should stand out: Building off the previous point, the summary should include the key messages that you want the sales force to remember long after the plan rollout. This could be that they are rewarded for driving sales dollars, or it could be that the richness of the plan kicks in after achieving 95% of goal. Whatever it is should be agreed to by the core design team and then highlighted clearly in any communication.
3. The language and descriptions should be easy to interpret and remember: Visuals and examples always help when communicating calculations or processes. Try to build these into the compensation summary. They will also help your first-line managers when they answer future questions because they will have an example on hand.

This should help, but I believe that the struggle with simplicity of communication will continue for sales compensation into the future. ■

The Benefits of Centralizing Sales Compensation Administration

By Steve Marley

My colleague Chad Albrecht has mentioned in a previous sales compensation piece the great deal of interest in the topic of globalization we observed during a webinar. Chad touched on the globalization of the plan design function; in this article, I'd like to discuss why companies are choosing to globalize the administration and operations of sales compensation. I prefer, however, to refer to this as "centralization" rather than "globalization" to avoid confusion.

In almost every global sales compensation administration assessment I have performed, I've found that companies tend to be highly fragmented and fractionalized, particularly outside of the United States. Countries in Europe, Latin America and the APAC region often have less than one person, or one full-time equivalent (FTE), supporting sales compensation administration per geography. Often, these people fall between the cracks when determining the total effort required to support performance and payout processing for two reasons: First, they are supporting these processes part-time, and second, they often roll up to finance or HR functions, rather than a sales or ops function. I have worked with companies where 10 FTEs supported global sales compensation administration, which was comprised of many, many people spending 10% to 50% of their time on this. However, the company was adamant that it only had three FTEs supporting the compensation administration: the three people who had "sales compensation" in their job titles.

This fractionalized approach has two critical problems, which can be addressed via centralization.

Problem 1: Your decentralized administration will be inefficient.

Although the exact efficiency gains from centralization will vary based on a number of different factors, a group of seven or eight dedicated people may be able to perform the same functions as 10 FTE resources that are fragmented across 20 different individuals. (I should clarify that when I describe centralization, I am not referring solely to a collection of people in a shared physical location; centralized functions can be geographically dispersed.) Efficiency comes, in part, through the familiarity with the operational processes. All other things being equal, a person who works on operational processes one week in a month will not work as quickly or seamlessly as someone who does it all the time. A full-time dedication to sales operations also enables people to focus on implementing process improvements or quality controls during downtime. In a decentralized model, people work on (or return to) their other functions, and fewer overall improvements to operational efficiency.

Problem 2: Your decentralized administration is not as effective as it could be.

In multinational companies with decentralized operations, different regions or countries often use different tools or processes to administer the performance and payouts. I worked with one global company where the global platform was Excel. However, every region (and, in some cases, every country) had a different file that was created and modified by the (fractional) individual who was responsible for the calculations. I was helping this company assess a global ICM platform to replace its current Excel processes.

As part of the assessment, I interviewed, separately, the vice president of global sales and the people supporting the administration. I asked the VP if he was getting reports that helped him make better business decisions. He would generally request some reports on aggregate performance, sometimes cut by country or by product, and he didn't think any major problems existed with the current processes. His only complaint was that it sometimes took a few days for the people to get the reports back to him, and he hoped a solution could reduce that time. The administration team told a different story. When the VP called with a report request, a fire drill broke out. An ops person would call each regional administrator—the person who owned the Excel file—and requested information necessary to complete the VP's report. As the files and information came back in different formats, someone would cut and paste data into a master Excel copy, identify and resolve data gaps, and then paste charts and graphs into PowerPoint.

Centralizing administration ensures that every region collects and reports data in a more consistent manner and that operational best practices are being created and followed consistently. These benefits are realized because it is one global team performing all the calculations.

When I discuss the centralization of administration, I tend to segment it into three different levels. (Level 0 is the base case, where all administration is done at the local, country or regional level.)

Level 1: Globally consistent system or ICM tools

Rather than using different platforms (Excel, SAS, purpose-built ICM, etc.) in different areas, every region or country is moved to a globally consistent platform. The tools and system can still be administered at a local or regional level (and may be administered by the same fractionalized people who were previously running disparate tools).

Level 2: Centralized administration and reporting

Leveraging the Level 1 system, this could be a geographically concentrated team (a center of excellence, or COE) that is focused on the sales compensation processing, or it could be a virtual team of geographically disperse but functionally dedicated people.

Level 3: Centralized inquiries and dispute management

Level 3 is typically the least common and most difficult to implement because while companies may desire a consistent response and resolution to questions or issues, local language barriers sometimes arise. The most common resolution is to leverage local sales management as the intermediary between the compensation administration team and the sales force.

ZS has helped a number of companies transition between levels. A large global healthcare company leveraged our Javelin™ ICM software to centralize its sales compensation operations. In a phased approach, ZS initially provided managed services support, which has transitioned back to the company's own service center in Hyderabad, India, where its centralized COE team administers performance and payouts for more than 45 countries. ■

Meet the Experts

Chad Albrecht is a principal at ZS in Chicago, and the leader of the firm's B-to-B sales compensation practice. Chad, a Certified Sales Compensation Professional (CSCP), has 15 years of consulting experience with Hewitt Associates and ZS. During that time, he has consulted with clients to create and implement motivational sales incentive plans and to set fair and challenging sales quotas. Chad has worked with clients in many industries, including software, business services, medical devices, telecom, distribution and manufacturing.

Chad is the author of several articles in publications such as *Compensation and Benefits Review, WorldatWork Journal, Sales and Marketing Management* and *Workspan*. In addition, he is a regular speaker on sales compensation topics at multiple conferences. Chad holds a bachelor's degree in computer science from the University of Iowa and an MBA with distinction from the University of Michigan.

Jason Brown is a principal in ZS's Boston office and the leader of the firm's financial services practice. He has helped numerous clients define and install successful marketing and sales strategies, and his diverse experience spans many industries, including insurance, banking and asset management. Jason has extensive project experience in go-to-market strategy and implementation, market research, sales process design, compensation design, and sales force sizing and deployment. He has contributed to several financial services and sales management publications, and has facilitated workshops at LIMRA Marketing and Sales conferences.

Jason holds a B.A. in economics and statistics from the University of Chicago and an MBA from the MIT Sloan School of Management.

Steve Marley is a principal at ZS in Chicago, and a member of ZS's sales compensation leadership team. Steve holds the Certified Sales Compensation Professional (CSCP) designation and has more than eight years of sales compensation consulting experience spanning a variety of industries, including software, distribution, financial services, nonprofits, pharmaceuticals and medical devices. He has helped companies design effective compensation plans, set motivating quotas and implement efficient compensation administration programs.

Steve is a regular speaker at compensation conferences and the author of several articles regarding quota setting and plan design. He holds a bachelor's degree in psychology from the University of Waterloo and an MBA with distinction from the Richard Ivey School of Business at the University of Western Ontario.

Mike Martin is a ZS principal in Princeton, N.J., and a key member of the firm's sales compensation leadership team. Mike has worked with numerous clients on incentive plan design, goal setting and incentive program administration. In addition, Mike has advised clients on sales strategy, forecasting and market research.

Mike is a frequent speaker at sales compensation conferences and the director of ZS's Compensation Conference. He has published several articles on best practices and emerging trends for incentive plan design.

Rubesh Jacobs is an associate principal based in ZS's Boston office. Rubesh leads the asset management consulting practice, bringing his deep knowledge of marketing and sales in the asset management and insurance industry. He partners with a strong team to deliver advice to clients, develop new, customer-centric insights based on ZS's rich heritage of research and innovation, and grow the business.

Rubesh joined ZS in 2017. He holds a bachelor's degree in computer science and economics from Ohio Wesleyan University and an MBA from Fisher College of Business at Ohio State University.

Peter Manoogian is an associate principal based in ZS's Boston office. He has advised global and regional companies across many financial services industries, including insurance, asset management, credit cards and lending.

Peter works with clients to size and structure sales organizations, develop strategic plans, build marketing campaign capabilities, and design fair and motivating sales incentive plans and quotas. Peter has written articles for the *Financial Times* and presented for WorldatWork.

Peter joined ZS in 2005. He holds a bachelor's degree in industrial and management engineering from Rensselaer Polytechnic Institute and an MBA from the Kellogg School of Management at Northwestern University.

Brian Keating is a manager in ZS's Boston office. Brian's focus area is advising financial services organizations on sales force effectiveness, sales compensation plan design, goal setting, areas of sales performance analytics, forecasting operations, and business intelligence and reporting. Brian has more than eight years of compensation and goal setting consulting experience with ZS.

He has redesigned sales compensation plans for more than 80,000 sales professionals across the asset management, insurance and wealth management industries.

Brian holds a B.S. and M.S. in industrial and management engineering from Rensselaer Polytechnic Institute.

About ZS

ZS is the world's largest firm focused exclusively on improving business performance through sales and marketing solutions, from customer insights and strategy to analytics, operations and technology. More than 5,500 ZS professionals in 22 offices worldwide draw on deep industry and domain expertise to deliver impact where it matters for clients across multiple industries. To learn more, visit www.zs.com or follow us on Twitter and LinkedIn.

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