Sales Compensation Effectiveness Best Practices & Trends

March 26, 2014

Shawn Rossi, Principal, Sales Performance Practice Leader
Today’s discussion

• Key Context & Trends
• Sales Compensation Design Best Practices
• Appendix: Sales Compensation Effectiveness Assessment Best Practices
• Questions?
Key Context & Trends
Key trend sales compensation is a critical driver for the sales force

**Impact of Levers on Sales Productivity***
(% of surveyed companies who ranked lever within top 4)

- Sales Strategy & Planning: 73%
- Quota/Goal Setting: 51%
- Sales Compensation Design: 41%
- Deal/Pipeline Management: 41%
- Sales Training: 38%
- Sales Productivity Analysis & Reporting: 32%
- Sales Process & Playbook Definition: 24%
- Sales Compensation Administration: 24%
- Territory Definition & Alignment: 22%
- Recruiting & On-boarding: 14%
- Field Communication: 11%
- Account Definition & Maintenance: 8%
- Sales Person Status Changes: 8%
- Sales Coverage/Role/Channel Modeling: 8%
- Customer Segmentation: 5%
- Other: 0%

* Source: Mercer’s Sales Operations Trends Survey of Fortune 1000 companies. The results are from 78 responses.
Best practice: view sales compensation holistically

Aligned, Simple Plans

Fair, Attainable Goals

Effective, Efficient Comp Admin

Clear, Timely Plan & Goal Communication

Effective Program

Separating the Leaders

<table>
<thead>
<tr>
<th>Area</th>
<th>Leaders</th>
<th>Laggards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rated Area Effective or Very Effective*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Design</td>
<td>75%</td>
<td>60%</td>
</tr>
<tr>
<td>Quotas</td>
<td>73%</td>
<td>39%</td>
</tr>
<tr>
<td>Communication</td>
<td>73%</td>
<td>61%</td>
</tr>
<tr>
<td>Administration</td>
<td>70%</td>
<td>57%</td>
</tr>
</tbody>
</table>

* Source: Mercer’s Sales Compensation Practices Survey of Fortune 1000 companies. The results are from 91 responses.
Best practice is to “connect the dots” and align.

1. **Customer Segmentation & Targeting**

2. **Sales & Channel Strategy**

<table>
<thead>
<tr>
<th>Cust. Seg.</th>
<th>Retention</th>
<th>Expansion</th>
<th>Acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>95%</td>
<td>$100M</td>
<td>$10M</td>
</tr>
<tr>
<td>Tier 2</td>
<td>85%</td>
<td>$75M</td>
<td>$100M</td>
</tr>
<tr>
<td>Tier 3</td>
<td>75%</td>
<td>$25M</td>
<td>$40M</td>
</tr>
</tbody>
</table>

3. **Sales Process Definition & Alignment**

4. **Sales Organization & Role Design**

5. **Sales Compensation Design**

6. **Quota Setting**
Simplicity is also a critical best practice
Maximize motivational impact by balancing simplicity and alignment

- Simple incentive plan (minimal metrics)
  - Low Reliance on Incentive Plan
  - Weak Management Processes

- Complex incentive plan (multiple metrics)
  - High Reliance on Incentive Plan
  - Strong Management Processes
Effective sales compensation comes from a sound process

<table>
<thead>
<tr>
<th>Assessment</th>
<th>Design</th>
<th>Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessment: both qualitative and quantitative analysis</td>
<td>Design involves the following key steps</td>
<td>Implementation steps can vary based on the degree of change made to sales incentive programs. Some key activities:</td>
</tr>
<tr>
<td>Qualitative analysis includes:</td>
<td>1. Sales Compensation Philosophy</td>
<td>▪ Confirm systems and administrative capabilities</td>
</tr>
<tr>
<td>– Interviewing key stakeholders to gather historical insight and to provide strategic direction for the future</td>
<td>2. Determine Eligibility</td>
<td>▪ Prepare formal plan documents</td>
</tr>
<tr>
<td>– Understanding current sales compensation plans</td>
<td>3. Set Target TCC Levels</td>
<td>▪ Draft communication materials</td>
</tr>
<tr>
<td>– Reviewing relevant business documentation</td>
<td>4. Choose Mix of Base and Incentive</td>
<td>▪ Train managers on changes to the sales incentive plan</td>
</tr>
<tr>
<td>▪ Quantitative analysis includes:</td>
<td>5. Determine Measures &amp; Weights</td>
<td>▪ Set meetings for managers to communicate changes one-on-one with direct reports</td>
</tr>
<tr>
<td>– Reviewing pay and performance relationships</td>
<td>7. Set Performance Objectives</td>
<td></td>
</tr>
<tr>
<td></td>
<td>8. Select Leverage Ratios</td>
<td></td>
</tr>
<tr>
<td></td>
<td>9. Set Payout Timing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>10. Validate Plans and Make Refinements</td>
<td></td>
</tr>
</tbody>
</table>
Sales Compensation Plan Design Best Practices
Key success criteria for effective sales compensation design

A sales compensation plan should:

- Reinforce and drive behaviors that help meet management’s overall business objectives
- Provide motivating, meaningful and cost-effective rewards to the right people for the right behavior and the right results
- Align with clearly articulated sales and sales management roles and accountabilities
- Align with other key sales management programs and practices and the desired culture of the sales effort
- Be appropriately simple so the plan can be clearly communicated, understood, reinforced, and administered
- Be managed properly to meet the changing needs of the business
Effective sales compensation depends upon role clarity and “what good looks like” in terms of results.
Design all key sales compensation components as a total solution

Step 1: Sales Compensation Philosophy
Step 2: Determine Eligibility
Step 3: Set Target TCC Levels
Step 4: Choose Mix of Base and Incentive
Step 5: Determine Measures & Weights
Step 6: Design Plan Mechanics
Step 7: Set Performance Objectives
Step 8: Select Leverage Ratios
Step 9: Set Payout Timing
Step 10: Validate Plans and Make Refinements
Establish philosophy & supporting global design guidelines

<table>
<thead>
<tr>
<th>PLAN DESIGN GUIDELINES</th>
<th>Keep plans simple</th>
<th>Pay for performance/Differentiate pay</th>
<th>Balance company results with pay</th>
<th>Maximize line of sight</th>
<th>Maximize motivation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum of 3 performance measures per plan, ideally 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum of 3 inflection points/levels in a payout curve/rate table</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum of 2 gates in a plan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximize pay at risk given the role’s influence on sales results</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Performance measures have a minimum of 20% weight</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Soft cap at 300% of payout or large deal &gt; 50% of goal and less than a margin threshold</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pay upside of 3:1 (frontline) or 2:1 (overlay) at the excellence point of performance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Legend:
- Limited support
- Good support
- Strongly supports
Ground total target cash compensation in key talent and role considerations

<table>
<thead>
<tr>
<th>Supply of Talent</th>
<th>Abundant</th>
<th>Adequate</th>
<th>Limited</th>
<th>Scarce</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected Performance</td>
<td>Low</td>
<td>Average</td>
<td>Stretch</td>
<td>Exceptionally High</td>
</tr>
<tr>
<td>Productivity Level</td>
<td>Low</td>
<td>Average</td>
<td>Above Average</td>
<td>Very High</td>
</tr>
<tr>
<td>Employee Mobility</td>
<td>Low</td>
<td>Modest</td>
<td>Some Hiring Away by Competitors</td>
<td>Frequent Hiring Away by Competitors</td>
</tr>
<tr>
<td>Staffing</td>
<td>Excessive</td>
<td>Adequate</td>
<td>Light</td>
<td>Extremely Lean</td>
</tr>
<tr>
<td>Degree of Company Stability</td>
<td>Rock Solid</td>
<td>High</td>
<td>Moderate</td>
<td>Low (Shake Out)</td>
</tr>
</tbody>
</table>

Step 3: Set Target TCC Levels
Determining pay mix

Base Salary and Incentive Mix Alternatives

DIMENSION
Primary Job Focus
Selling Cycle
Sales Force Prominence
Business Strategy
Account Strategy
Entry Barriers (Sales Skill Set)
Management Control
Product Life Cycle
Complexity of Sale
Performance Measures
OVERALL

Incentive
Base

Full Commission
Combination
Full Salary

Step 4: Choose Mix of Base and Incentive
Pay mix as a talent attraction and retention tool
Role specific performance measures are critical

To maximize motivation, no metric should have less than 15% of target pay weighted to it

- Ability to consistently and materially influence
- Within “line-of-sight” and key result for the role

- Supports sales strategy and business objectives
- Consistent with role’s design and key responsibilities

- Data can be accurately tracked
- Data is from a trusted source and available for timely payments

Step 5: Determine Measures & Weights
Commission vs. Bonus

Step 6: Design Plan Mechanics

<table>
<thead>
<tr>
<th>Number of Customers</th>
<th>Sales Cycle</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Long</td>
</tr>
<tr>
<td>Low</td>
<td>Short</td>
</tr>
</tbody>
</table>

- **Commission-Based Plans**
- **Salary/Bonus-Based Plans**
Accurate target setting is key to motivate the field and align with company success.

**Target level equates to 100% of plan**

- **Bottom 10% of Sellers**
- **30-40% of Sellers**
- **100%**
- **60-70% of Sellers**
- **Top 10% of Sellers**

**Performance level requiring minimal effort** – set based on historical performance or fixed costs

**Excellence level allows 10% of sellers to earn upside, it is usually set using historical data**
Payout curves should align pay and performance and motivate

Illustrative

A decelerated slope above (or cap) at Excellence can help to control excessive pay

The slope is accelerated above Target (100%) to set the prize “beyond the finish line” and reward for outstanding performance

Payments begin once a threshold level is achieved

Step 8: Select Leverage Ratios

Sales Leader           First Line Manager           Sales Rep
Pay frequency should be aligned to the other plan design elements

<table>
<thead>
<tr>
<th>Factors</th>
<th>Effect on Payout Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Target Incentive</td>
<td>The higher the Target Incentive, the more frequent the payout</td>
</tr>
<tr>
<td>Pay Mix</td>
<td>The more aggressive the Pay Mix, the more frequent the payout</td>
</tr>
<tr>
<td>Number of Performance Measures</td>
<td>The greater the number of Performance Measures, the less frequent the payout</td>
</tr>
<tr>
<td>Weighting of Performance Measures</td>
<td>The higher the weighting of the Performance Measure, the more frequent the payout</td>
</tr>
</tbody>
</table>

Common payout frequencies are monthly, quarterly or annually and vary based on the factors above

When selecting pay frequency, it is advisable to choose one that:

• Ensures proper cash flow to the salesperson

• Is significant enough to attract the attention of the salesperson

• Is as close as possible to the time of sale

• Is feasible to administer accurately and efficiently
Back test the designs against the principles

1. Maximum line of sight and influence on results that drive pay
   - Meets Principle’s Objectives

2. Maximize motivation of plan but still balance ROI with compensation spend
   - Partially Meets Principle’s Objectives

3. There should be differentiations in compensation for specific products / product lines / product groupings and product mix
   - Meets Principle’s Objectives

4. Better align total production and territory size with pay
   - Fails to Meet Principle’s Objectives

5. Top performers should earn 3x the incentives of an average performer to provide better motivation and drive stronger pay differentiation
   - Meets Principle’s Objectives

6. There should be no caps on incentive payments, though there should be protections against “windfalls”
   - Meets Principle’s Objectives

Step 10: Validate Plans and Make Refinements
Appendix: Sales Compensation Effectiveness Assessment Best Practices
Assessment: understanding the current compensation plans

Key “red flags” include:
1. Plans with high levels of uncapped upside
2. Performance levels with no threshold
3. Performance measures not based on quantifiable results
4. Highly frequent payments
5. Low weightings on performance measures

<table>
<thead>
<tr>
<th>Role</th>
<th>Performance Measure</th>
<th>Weighting</th>
<th>Payout Mechanism</th>
<th>Performance / Payout Level (as a % of Target)</th>
<th>Component Detail</th>
<th>Payout Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Representative</td>
<td>Individual Revenue</td>
<td>60%</td>
<td>Formulaic Bonus</td>
<td>80% / 50% / 100% / 120%</td>
<td>Payments are not capped (i.e., incentives above “excellence” level are paid at “excellence” rate)</td>
<td>Weekly</td>
</tr>
<tr>
<td></td>
<td>Group Revenue</td>
<td>35%</td>
<td>Formulaic Bonus</td>
<td>0% / 0% / 100% / 110%</td>
<td>Payments capped at “excellence”</td>
<td>Monthly</td>
</tr>
<tr>
<td>MBOs (Management by Objectives)</td>
<td>MBOs (Management by Objectives)</td>
<td>5%</td>
<td>Discrete Bonus Payment</td>
<td>Completing a maximum of three objectives / Up to 150% of target</td>
<td>This payout is subject to the completion of objectives</td>
<td>Annually</td>
</tr>
</tbody>
</table>
Competitive compensation analysis
Example of competitive total target cash benchmarking

<table>
<thead>
<tr>
<th>Sales Representative</th>
<th>Sales Manager</th>
</tr>
</thead>
<tbody>
<tr>
<td>n = 27</td>
<td>n = 7</td>
</tr>
</tbody>
</table>

Illustrative
Competitive compensation analysis

The following pay mix exhibit shows how the mix of base and incentives (variable compensation) compares to market benchmarks.
Key effectiveness metric: performance distribution by role

Goal Achievement

FY08 Goal Achievement
FY09 Goal Achievement
FY10 Goal Achievement
Key effectiveness metric: pay composition by role
Key effectiveness metric: pay for performance by key business objective

\[ R^2 = 0.3251 \]

Source: Financial data obtained from Company (Dec 2010)
Key effectiveness metric: pay differentiation

![Graph showing pay differentiation across different earners']
Shawn Rossi is a Principal and the North America Leader for Mercer’s Sales Performance Practice. Based out of Atlanta, he leads engagements with clients to deliver straight forward, aligned, high impact sales effectiveness solutions.

With over eighteen years experience, Shawn has expertise in a variety of industries including technology, distribution, retail, telecommunications, banking, media, insurance, and medical device companies; all with the goal of improving sales and marketing effectiveness.

Shawn’s engagement experiences specifically include working with leading global companies including Apple, Allstate, Bank of America, Microsoft, Halliburton, Aflac, Unisource, Oracle, IBM, United Healthcare, TBC, AT&T, T-Mobile, HP, Verizon, Superpages.com, Lexmark, Randstad, Ryder, NCR, Motorola, FedEx, St. Jude Medical, Smith & Nephew, Red Bull, Sysco, Johnson & Johnson, Ecolab, McKesson, Network Appliance, Samsung, Clear Channel and Vodafone.

Mr. Rossi’s key core competencies include:

- Sales Transformation (spurred by acquisitions, new product launches, going into new markets)
- Sales and Channel Strategy
- Sales Effectiveness Assessment & Dashboards
- Sales Organization and Role Design
- Sales Compensation Design & Administration
- Quota/Goal Setting
- Sales Process Definition/Re-engineering
- Sales Training & Enablement

With over 30 widely published articles, speeches and webinars, Shawn is a recognized thought leader in the sales performance management space. He has had works published in WorldatWork, SHRM and other publications. Additionally, he has spoken at multiple conferences and via the web for World at Work, SPM Solution Provider User Conferences, and the Sales Management Association.

Shawn holds an MS in Physics from Auburn University and graduated Cum Laude from Wake Forest University with a Bachelor of Arts degree in Physics.
Questions &
THANK YOU!