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"Caps" Is a Four-Letter Word

By Elliot Scott

Sales people hate caps. No incentive plan feature generates more righteous indignation than a cap…even among those who have never and may never hit one. Well before they kick in, caps seem to have an insidious, sedating effect, a psychological brake on productivity. And nobody hates them more than your top performers.

But, as any plan designer who has received a call from the CFO knows, caps and other limiters can be your friend, especially in a time where “risk” is also a four-letter word. Caps can be your loyal guards, protecting the company and your reputation from extreme plan dysfunction.

Avoid the Overall Cap
As long as it remains possible for a seller to earn more, the incentive plan has “uncapped earnings opportunity.” This is a claim worth protecting and trumpeting, and it does guarantee that no caps will appear anywhere in the plan. It is the overall cap that is the most problematic from the motivational standpoint.

It’s worth remembering that even if an outsized payout is driven mainly by luck, the evidence it provides to the sales force that achieving one is possible may be worth more to the company than the award reluctantly paid out.

Reasons for Capping
There may be good reasons to use partial caps and other limiters:

- To discourage individuals from taking unacceptable risks or compromising ethics
- To discourage sales above a certain level if they are not in the best interest of the company
- To avoid overpayment for extreme sales volumes
- To encourage a balance of sales (across products or customers)
- To limit the effects of extreme performance variability

How to Limit Without an Overall Cap
As you consider how to address the situations above, look beyond the idea of an overall cap to these variations on the theme:

- **Cap some of the measures:** It’s often the secondary measures that cry out for a cap. For example, if your goal is to drive attendance at an event with a capacity of 100 people, you don’t want to pay 10x for getting 1,000 people to attend.

Another example: If you have a plan with separate quotas for each product and some of the quotas are very low, you risk extreme levels of goal attainment. It's often best to cap the incentive an individual can earn from a secondary measure with a low quota.

- **Decelerate:** The most common alternative to a cap is a "decelerator." Deceleration controls windfall payments while maintaining incremental pay for incremental results. In most cases, the payout curve should accelerate, not decelerate, above goal, with the deceleration occurring above the "excellence point" where you would expect a 90th percentile performer to come in. This maintains a strong incentive to exceed goal and affects relatively few outliers.

There may be special circumstances where deceleration closer to the goal makes sense. For example, perhaps there are goals the company would like to achieve, but not dramatically exceed (e.g., due to limits in production capacity). Above-goal sales of a particular product may be more profitable than those of another, for example. Or, there may even be public relations or regulatory repercussions if the potential exists for outsized incentive earnings in a particular area.

- **Use a deal decelerator:** The "deal decelerator" is an under-used tool that addresses one of the main reasons for caps: very large sales for which it does not make sense to pay sales people in proportion to the size of the sale. Such "mega" deals may involve less sales effort or produce less profit because they are corporate deals. Or, it could be that the core business will be put at risk if sales people ignore smaller opportunities in order to "elephant hunt."

Here's how it works: The incremental reward for incremental volume decreases above a certain amount (e.g., full quota credit for all sales up to $1 million and 20% for each dollar above that). So, a $2 million sale would be credited as if it were a sale of $1.2 million. The payout would be the same as for making two sales of $600,000 each.

- **Throw in a hurdle:** With a hurdle, full payout on one measure is contingent upon satisfactory performance on a second measure. If the first measure is important, measure two becomes important, but only up to target. The payout is inherently capped. Furthermore, the hurdle can reduce the need for a cap on measure one. For example, if you do not want to pay unlimited upside on a product for fear that sales people will ignore another product entirely, you can make upside on product one contingent on achieving target for product two.

If you cannot avoid having an overall cap, then make sure:

- It's high enough that few, if any, sellers are likely to hit it, and
- It does not preclude an exciting payout. (As a starting point, any overall cap below 2x target incentive is too low.)

Hats-Off to the Uncapped Plan!

With careful use of partial caps and other limiters, companies can bask in the sunshine of "uncapped earnings opportunity" without the sunstroke from egregious windfalls.

About the Author

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