

How to Harness the Power of Commission

One of the best ways to motivate salespeople is with commission.

The consultants told the CEO that his company had outgrown its commission plan. The plan, which paid 5 percent of sales, had served the company well as it grew but now there were problems. For one thing, some territories were clearly richer than others. The rep in Chattanooga was never going to earn as much as the one in Memphis. And with the

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company sold to investors, hitting the number had become more important than raw growth.

It was time to move from a commission plan that paid a flat percent of sales to a quota-bonus plan for which each rep is paid based on the percent attainment of an annual quota that takes into consideration the sales potential of each territory. The benefits were clear:

- 1 | **The plan would be more fair.** It would level the playing field between large and small territories.
- 2 | **The plan would better align with management's priorities.** "Hitting the number" was management's No. 1 priority and now it would be each rep's, as well. The new plan was much more focused on achieving quota, paying nothing below 50 percent of quota and accelerating sharply above quota.
- 3 | **The plan would be more pay-for-performance oriented.** More pay for top performers, less for low performers.
- 4 | **The plan would reduce unwanted turnover.** With all the upside based on annual performance, top performers would not want to leave and give up the upside they would earn at year end.

What Happened?

To everyone's surprise, it soon became clear that not only was the new plan not the answer to all their problems, it was actually worse. The first thing management noticed was a lot of complaining about quotas. Although quotas were now tailored to each territory based on objective measures of sales potential, with careful manager review and adjustment, somehow the perception was that the playing field was now less level than before.

Second, while the company had expected that the new plan would retain top performers, the opposite happened. Quite a few left, leaving what would have been very good bonus payouts on the table.

And to cap it off, even accounting for the turnover, bookings were down.

What happened? Simply put, the company failed to appreciate a fundamental fact when it moved from commission to quota-bonus: Commission is a powerful motivator.

Why Is Commission So Powerful?

What is it about the practice of paying a percentage of sales (or units, revenue or even gross margin) that gets salespeople out of bed in the morning?

Line of sight

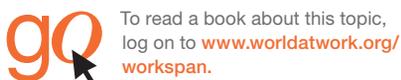
Motivational impact depends on clarity and certainty. If a salesperson

knows with clarity and certainty before making a \$1 million sale that the sale will immediately result in a payout of \$10,000, it may motivate the salesperson to move mountains to make it happen. But any uncertainty about the amount, the timing or the certainty of the payout undermines the motivational force of the plan. What is it about a quota-based incentive scheme that can undermine line of sight?

- **Payout is less clear.** In a quota-based plan, calculation is always more complex than simply multiplying the value of the sale by the rate.
- **Payout is less immediate.** Payout from a quota-based plan will generally have to wait until after the end of the quarter at best, and perhaps until the next year.
- **Payout is less certain.** Salespeople know that a lot can happen between the time of sale and the end of the year. You could end up below threshold and earn as little as \$0 from the sale. Or you might not be around to collect (and not only because you chose to move to a competitor).

Cash is catnip.

It's not just knowing how much you are going to receive for a sale, it's actually receiving it as close to right away as possible. Waiting for quota attainment to be calculated delays the cash and dulls its narcotic effect.



Recognition

Not only is the perceived monetary value of a sale higher when the payout is clearer and more immediate, so is the recognition value of the award. It's great to be recognized for making that \$1 million sale but even better when everyone knows you are \$10,000 richer because of it.

Should Sales Quotas Be Eliminated Entirely?

For most companies, eliminating sales quotas is not sensible. Holding managers accountable to sales forecasts is basic management. But once quotas become part of the sales incentive plan, they move from being a business planning tool to a factor in compensation that can be problematic. Keep in mind two things about quotas:

- Some quotas are better than others. The more predictable the results the more accurate the quota is likely to be. If your quotas are likely to be less accurate, not only should you set your performance ranges differently (i.e., lower threshold, flatter payout curve), you should also consider not tying compensation as tightly to quota attainment.

- Perceived fairness is more important than accuracy. For the most part, managers do their best to set fair and accurate quotas. And the best way to achieve this is to set individualized quotas that take into account:

- Past sales in the territory
- An objective measure of market potential using third-party data
- Size and probability of opportunities in the pipeline
- Manager judgment.

However, each of those things is regarded with skepticism by salespeople.

- Past sales: If my quota is based on my past sales, it's a short jump to the belief that if I significantly exceed quota one year I will be punished for my success with a higher quota next year.

- Market potential: These data are always more accurate at the aggregate level than at the level of individual prospects, so detailed examination of the data by reps tends to discredit it more than is warranted.

- Pipeline data: It can't be ignored, but the clear incentive is for the salesperson to hide or minimize the opportunity to reduce its quota impact.

- Manager judgment: For all its benefits, you will be hard-pressed to find a salesperson who does not believe that subjectivity, favoritism and lobbying do not influence managers.

How to Get the Benefits of Commission in a Quota-Based Plan

Because commission is so powerful, try to go as light as possible on quota attainment measures in your plan and make use of the features of commission that make it so compelling. Here are a four ways that savvy plan designers can accomplish that.

1. Remove certain sales from quotas for commission treatment.

Removing less predictable sales from quotas and paying them on a commission rather than a quota attainment basis can not only tailor emphasis, it can improve the accuracy

of the quotas from which they are removed. Good candidates include:

- New product sales.** Quotas for new products often turn out to be way off base. Even with the best information, you often just don't know how the new product will perform. Furthermore, salespeople are often skeptical of new products, so paying them on a commission basis can provide an immediate taste of success that is key to launch success.

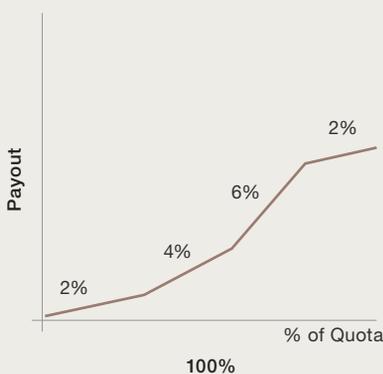
- Sales to new customers.** Sales to new customers require a lot more time and effort than sales to existing customers. Companies frequently overestimate how successful their salesforce will be at attracting new customers, so that portion of the forecast tends to be less accurate. Pulling new-customer sales out of quotas and paying for them with commission can improve quota accuracy and provide a level of reward more aligned with the effort of acquiring new customers.

- Very large deals.** If you expect that a significant portion of your revenue (say, 10 percent or more) will come from a handful of mega deals, but you don't clearly know where those sales will come from, you should avoid allocating that quota out to the salesforce. If you do, what is likely to happen is that the few who land those deals will significantly



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Figure 2 | Ramped Commission



did not require 100x the effort of the \$1 million sale and should not generate 100x the reward. So a good way to pay for mega deals is by commission with a “deal decelerator,” for which the commission rate decelerates based on the size of the deal. (See Figure 1 on page 23.)

Nonrecurring sales. For all the benefits of commission, it is generally not appropriate for recurring revenue sales or sales with a lot of carryover. Those commissions can amount to “phantom base salary.” But when total sales are made up of a combination of recurring revenue and nonrecurring revenue, the nonrecurring sales can be pulled out of quota and paid on a commission basis.

2. Provide commission with ramps based on quota attainment.

This is a dominant scheme in many industries. It is inherently commission-based, but quota is also important. (See Figure 2.)

3. Offer a bonus-commission hybrid.

A common bonus-commission hybrid scheme is “bonus-flip-to-commission.” Sales up to a certain level (usually 100 percent) are paid based on quota attainment, and then all sales above quota are paid on a commission basis. This addresses the complaint, “Because my quota is larger, it is harder for me to exceed it.” (See Figure 3.)

4. Hold managers to quota attainment.

Because quotas are more accurate the larger the number of individual sales included in them, quota-based plans may be more appropriate for first- and second-line managers than for front-line sellers. When salespeople regularly hear from their managers about how important it is to achieve quota, they get the message, even if they are paid on a commission basis. So if your first-line managers are tightly held to quota attainment, there may be less need to do that for your reps.

Conclusion

Commission is a powerful motivator. A simple commission plan is not right for all sales roles, but by harnessing the power of commission in large and small ways you can provide your salespeople with the motivation that drives them to success. **WFS**

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exceed quota and the majority of the salesforce will fall short. And it is demotivating if the organization as a whole makes quota while most reps do not. And because the mega deals themselves tend to range in value widely, it may not be equitable to credit them equally. The \$100 million sale probably