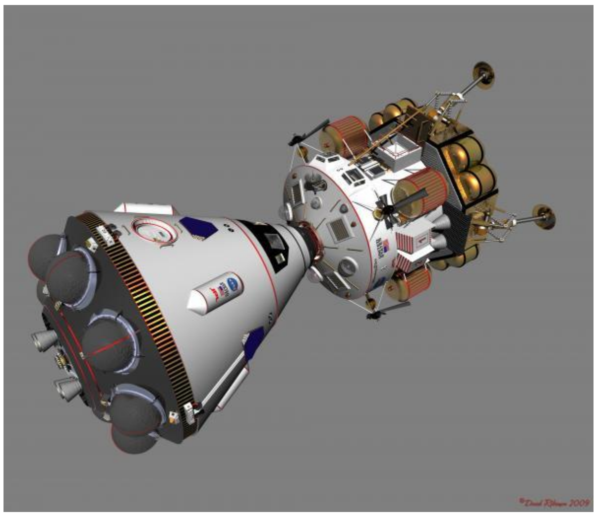
SalesCompInsights: Sales Incentive Design and Administration

Incentive Compensation for Outsourcing: As Cumbersome as the Deals Themselves?

November 4, 2010



By Elliot Scott

"It's not rocket science" is one of the clichés of incentive plan design. For the most part it is true, and when incentive plans start to look like the work of rocket scientists, it's a good bet the sales force is not on board the spaceship…and may be at risk of alien abduction (or at least poaching by competitors). But for companies that sell outsourcing services, the challenge of designing a simple and effective sales incentive plan can seem as daunting and unlikely as the safe return of Apollo 13.

The Fundamental Challenge

Incentive compensation in an outsourcing sales environment involves a fundamental challenge:

☞ On the one hand, the sales talent and type of sales effort required demands a strong, immediate incentive. Selling a large, complex, deal to a new customer, possibly based on a new concept or technology, which may significantly disrupt the customer's business (on the way to enhancing it), is "missionary selling"—hunting of the most challenging sort. Attracting and motivating the necessary sales talent requires very high upside earnings potential and strong line of sight.

☞ On the other hand, uncertainty regarding the ultimate value of the deal at the time of signing creates a risk of misalignment of incentive payments and the real value of the deal.

In my experience, every company selling outsourcing struggles with how to pay their sellers and account managers. There is seldom a consensus among sales, finance, and HR that "we've got it right." For some, the plans are too "sales friendly" and for others too "CFO friendly."

No company wants a cumbersome plan, but the challenges of sales compensation plan design in outsourcing environments generate a dizzying array of complexities: NPV calculations, profitability modifiers, contract length modifiers, deal decelerators, clawbacks, milestone payments, draws, commission pools, complex crediting rules, exception review boards, and *deus-ex-machina* discretionary adjustments. It's one of the few industries where the number of plan document pages routinely exceeds the sales headcount.

Questions to Ask

The plan design choices that each company makes can be as unique as the deals themselves and should be informed by (a) the nature of the outsourcing (e.g., asset acquisition vs. managed service, commodity vs. proprietary technology) and (b) the market position and culture of the company and sales organization. But the questions that outsourcers need to ask along the way to developing their plans are quite consistent:

Pay Mix and Upside

Questions: How do we (a) provide upside earnings that are appropriate for large high-value deals, and (b) maintain cash flow for the seller over a long sales cycle with few deals in the pipeline at any time?

☞ The frequency of deals and payments under the plan should inform your answer. When you analyze how much a seller will earn from a very large deal, consider the likely frequency of those deals. A $300,000 incentive payment may not be excessive if it is unlikely to be repeated for several years. And if payments for deals are stretched out over one or more years, cash flow may be smoother than deal flow, making draws and guarantees less necessary. Nevertheless, it is probably prudent to have a provision in the plan to protect the earnings of effective sellers on an exception basis during a long sales cycle on an important deal.

Performance Measures

Questions: What combination of performance measures balances (a) simplicity and line of sight, (b) alignment to the role of the resource within the sales and account management process, and (c) the financial and strategic interests of the company?

Typical measures include total contract value (TCV), annual contract value (ACV), contract net present value (NPV), actual revenue over a certain period, revenue growth, renewals, new customers, new products or product mix, contract length, and sales process milestones.

☞ Unless TCV is set in stone at the start of the contract, which it seldom is, use ACV with a simple and light modifier for contract length. Where contracts may have escape penalties, and you would like your sales people to write them in, paying on minimum contract value is also an option. And remember that paying on actual revenue received will drive account management behavior, which you may not want from your hunters.

Mechanics

Questions: Given that most outsourcing sales people (as opposed to account managers) are paid using a deal-based commission mechanic, the question becomes not whether to use a commission vs. a bonus plan but whether or how to modify the commission plan to:

- Introduce an element of annual goal attainment, to align sales force performance with company revenue expectations
- Account for large differences in the size, length, and profitability of services and contracts

☞ Although the revenue forecast for an outsourcing company may be predictable, the sales forecast for an individual outsourcing seller seldom is. So tying individual incentive earnings to individual goal attainment may create frustration and under- or over-payment, to say nothing of lobbying for goal adjustments. Keep goal attainment on a team level and/or use it to determine award trip participation. Also, don't be afraid to use higher commission rates for more profitable or strategic services. Although they may appear complex, they are much more easily understood and assimilated than other plan complexities.

Timing of Credit and Payment

Questions: How much tolerance do we have for misalignment between incentive payments for contracts sold this year and the revenue and margin those contracts generate in future years?

Based on the role of the salesperson, how should we divide credit between contract signing, invoicing, customer acceptance, cash received, or revenue booked?

If we pay on contract value and true up on revenue received, how should we structure the true up process so that (a) it seldom if ever results in a clawback, (b) it does not extend payment too far into the future, and (c) both the initial estimate and the true-up calculation are as objective and consistent as possible.

☞ Understand that in a large-deal environment, with some payment at contract signing, there will be misalignment in any given year between incentive payment % of budget and revenue % of goal. And when determining the convention for estimating the value of a deal at signing, it is best to use the most conservative methodology that is reasonable. You will save yourself a lot of trouble if the value of the deal at the true-up point always turns out to be more than the value estimated at signing.

Sharing and Adjusting Credit

Questions: Of the many individuals who can reasonably claim to have been involved in a sale, which ones should participate in the actual commission from the deal, which ones require some recognition or incentive outside of commission, and which can be told, "thank you for doing your job"?

And how if at all should we adjust credit for deals made at the corporate level, with less sales person involvement or influence?

☞ Remember that once you add on incentives it is hard to take them away. Many plans for roles that are not primarily sellers become encumbered with complex add-ons that generate commission and administrative workload but do not drive behavior. And as for corporate deals, while it is seldom necessary to pay a windfall to a seller who did not drive the deal, avoid creating a plan that discourages sellers from involving senior management.

Account Management Incentives

Questions: How much pay at risk is appropriate for our account managers, given the selling vs. operations focus we are trying to drive?

And will specific add-on incentives for account managers drive the right behaviors and results, or should account managers be paid entirely on the revenue growth of their accounts?

☞ There are a wide variety of pay schemes for outsourcing account managers, from straight salary to highly leveraged plans with multiple commissions. It all comes down to what you want your account managers to do. Account managers may envy the high commissions that sales people earn in their accounts (because of the good account management work they do!) but if their primary responsibility is account retention and revenue retention, the pay plan should reflect that.

Beware: It is not easy to get a consensus answer to these questions, and you can be sure the answers will be re-visited frequently. But finding the answers that are right for each company at a given point in time, while keeping complexity to a minimum, is the key to an effective but manageable outsourcing sales incentive plan.

www.salescompinsights.com