WorldatWork 2015 spotlight on sales compensation

The Why's and How's of Commission

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Why is commission so motivational?

Clear Line of Sight

- The link between the result (the sale) and the reward is much clearer with commission than with quota-bonus
  - Calculation is very simple: sale value X rate = payment
  - You know exactly what you will be paid…immediately

The Narcotic Effect of Cash

- With commission, you can be paid NOW…or close to it
  - The closer the payment to the sales event, the stronger the incentive
  - By contrast, bonus can feel like "that other part of pay that comes (hopefully) at the end of the period"

Enhanced Recognition Value

- It's great to be recognized for making a $1 million sale
- …But the recognition is enhanced by the knowledge that you earned $10,000 for the sale

If you <u>can</u> use it, you <u>should</u> use it!

What is “commission”?

Commission is one of two “incentive forms”

- An incentive that is paid as $ per unit or % of sales
- There is a commission <u>rate</u>, e.g., $5/unit or 5% of sales

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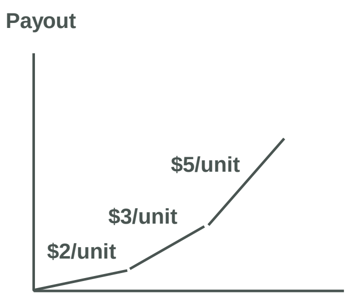
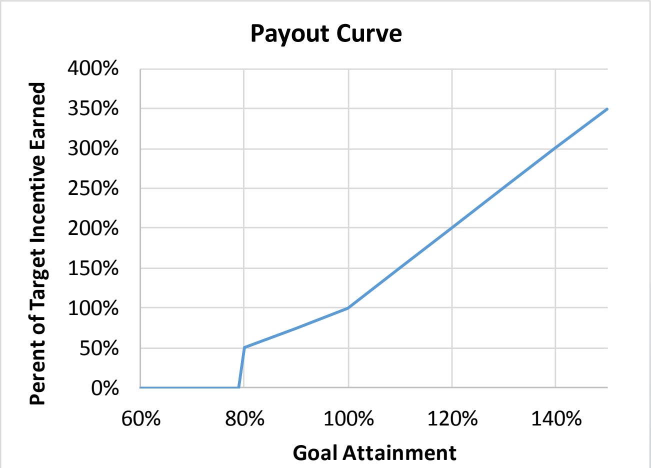
- The other incentive form is “quota-bonus,” or “goal-based bonus,” or just “bonus”
- With the quota-bonus incentive form, incentive is earned based on the percentage attainment of a goal, e.g.,
  - Earn 50% of target IC at a “threshold” of 80% of goal
  - Earn 100% of target at 100% of goal
  - Earn 200% of target at 120% of goal



Commission

Quota-Bonus

Goal Attainment	% of Target Incentive Earned
0%	0%
79%	0%
80%	50%
90%	75%
100%	100%
110%	150%
120%	200%
130%	250%
140%	300%
150%	350%



How to calculate commission rates

Flat Commission

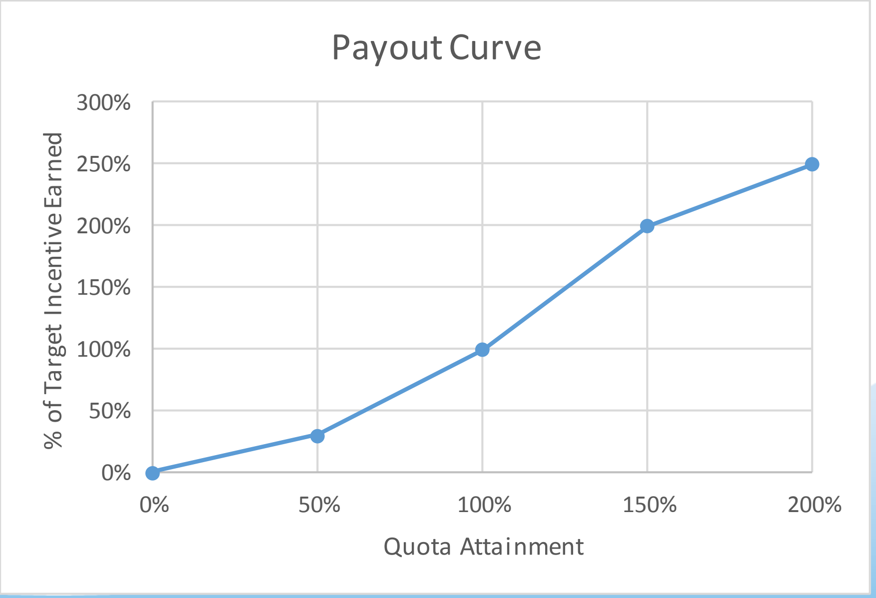
Rate = Target Incentive / Expected Sales

A	Sales Forecast	$10,000,000
B	# of Reps	10
C	Forecast per Rep (A/B)	$1,000,000
D	Rep Total Target Cash	$120,000
E	% Base Pay at Target	60%
F	Rep Target Incentive (D*(1-E))	$48,000
G	Commission Rate (F/C)	4.8%

Ramped Commission tied to Quota Attainment

(with one inflection point below 100% and one above)

A	Quota	$1,000,000
B	Target Incentive	$48,000
C	Inflection Point Below 100%	50%
D	% of Target IC to Pay at Inflection Point 1	30%
E	Inflection Point Above 100%	150%
F	% of Target IC to Pay at Inflection Point 2	200%
G	Acceleration or Deceleration Above Inflection Point 2	50%
H	Rate from 0% to 50% of Quota (D*B)/(A*C)	2.9%
I	Rate from 50% to 100% of Quota ((1-D)*B)/(A*(1-C))	6.7%
J	Rate from to 100% to 150% of Quota (B*(F-1))/(A*(E-1))	9.6%
K	Rate above 150% of Quota (J*G)	4.8%



When to use quota-bonus vs. commission

1. When territory potential is uneven, or not unlimited
   - And the plan becomes less “fair and equitable” because of that
2. When achieving the forecast is as important as absolute growth
3. When there is a base of installed business or recurring revenue
4. For sales managers

These things happen as sales forces mature, so companies tend to move from commission plans to quota-based plans over time

- But because commission is so powerful, companies should look for ways to preserve it
  - By not over-estimating the value of “fairness”
    - And appreciating that sales people may perceive fairness differently
  - By mitigating the limitations of the commission form

News Flash: Quotas are not perceived as fair

- Most companies take care to develop quotas that are fair and equitable (while adding up to a top-down number)
  - But sales people are skeptical…at best

Best-practice factors for quota allocation	Why they improve the accuracy and fairness of the quotas	Why the sales force regards them with skepticism
Past sales in the territory	▪ Generally the best predictor of future sales	▪ Penalty for having done well in the past
Market potential (third-party data)	▪ Reduces the “penalty” for those who have done well	▪ Detailed examination of the market data can discredit it
Size and probability of sales in the pipeline	▪ Where sales are few and large, this is the best predictor	▪ Rewards those who understate opportunities
Manager judgment	▪ Brings in first-hand knowledge of market and rep ▪ Adjusts for anomalies	▪ Fear of subjectivity, favoritism, squeaky wheel syndrome

Heavy reliance on quotas may actually <u>reduce</u> the perception of fairness

Options for linking payout to quota

- Completely eliminating quotas is not practical
  - Managers need to be accountable to the forecast
- But there are a range of choices in how closely to link front-line incentive pay to individual quota attainment
  - And the tighter the link between quota attainment and payout, the greater the anxiety about the quotas

Tight link to incentive plan ⟷ **Loose link to incentive plan**

Pure quota-bonus form, where payout is based entirely on quota attainment	Quota bonus form for some measures, but commission for others (e.g., new products)	Commission form where rates are determined in part by quota attainment	Commission form not linked to quotas, but contests (e.g., President's Club) are determined based on quota attainment	Quota attainment does not factor into incentive payout, but may be used for performance management

How to get the benefits of commission…

…even when you need to use quotas

1. **Remove certain types of sales from quotas (and quota attainment calculations), and pay for them using a commission form**

Benefits	Risks	Types of Sales One Might Exclude
▪ Quotas become more accurate and fair when less predictable sales are excluded ▪ Allows different emphasis between sale types	▪ It must be clear and unambiguous from the start which sales are included/excluded from quotas	▪ New product sales ▪ Sales to new customers ▪ Very large deals ▪ Nonrecurring sales — E.g., equipment vs. consumables ▪ (Sale types that are unpredictable or lumpy)

How to get the benefits of commission…

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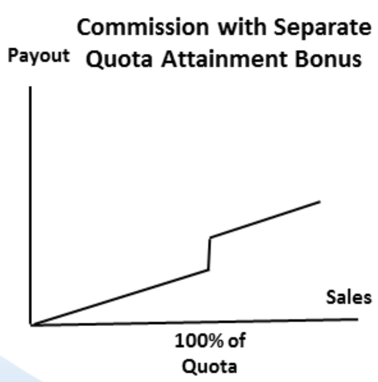
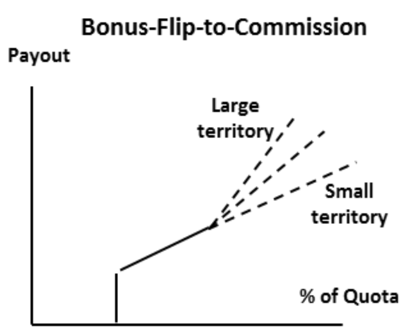
2. Use a "bonus commission hybrid" form

- Commission with separate bonus for quota attainment
- "Bonus flip to commission"
- Different commission rates based on quota size
  - Territories with larger quotas have lower rates but higher payout at 100%





Tiered Commission Rates by Quota Size*

	Quota		
% of Quota	<$1M	$1M to $3M	>$3M
<50%	3.00%	2.25%	1.50%
50% to 100%	5.00%	3.75%	2.50%
>100%	8.00%	6.00%	4.00%

Commission rates in cells

* Also illustrates rates that ramp based on quota attainment

How to get the benefits of commission…

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3. Individual commission rate (“ICR”) form

- Essentially a bonus expressed as commission
- Optics of giving everyone different rates are not optimal, but the immediacy of commission is preserved

Example

Salesperson>	**A**	**B**	**C**
Quota	$1,000,000	$1,500,000	$2,000,000
Target Incentive	$25,000	$25,000	$25,000
Base Rate	**2.50%**	**1.67%**	**1.25%**

Ramped Rates

% of Quota	**Rates**		
<50%	1.88%	1.25%	0.94%
50% to 100%	3.13%	2.08%	1.56%
>100%	5.00%	3.33%	2.50%

How to get the benefits of commission…

…even when you need to use quotas

4. **Pay front-line sellers with commission, but pay managers with quota-bonus**
   - Commission (or commission override) is problematic for managers
     - Less need for immediacy, particularly when managers are primarily managing and not selling
     - “Phantom base salary” lowers effective pay mix
     - Payout differentiation may be too low at the manager level
       - Because performance variability is lower
   - Quotas are more accurate, and perceived to be more fair at the manager level than at the rep level
     - “Law of large numbers”
     - Opportunity may be more even at the manager level than at the rep level

In conclusion…

- Commission is a powerful motivator!
- Try to find ways to include it in your plans

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