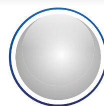
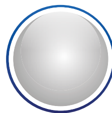
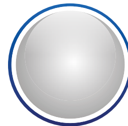
Simplified Compensation Plans That Work

Brian Jeffrey

You can spend thousands of dollars and tons of time developing complex compensation plans only to have them fail. Why go complex when simple works. Find out what the best plan is for your people.

Enjoy the read.

Brian Jeffrey
President
Quintarra Consulting Inc

Quintarra Consulting Inc
1451 Donald Munro Dr | Carp, ON K0A 1L0 Canada
613-839-7355 | Quintarra.com

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Simplified Compensation Plans That Work

by Brian Jeffrey

As you are probably aware, salespeople are not a philanthropic bunch. In fact, they can be downright mercenary when it comes to making money. This can be a problem. Some salespeople are so driven by money that they will say anything, promise anything, and do anything to make a sale no matter how bad the sale is for the customer and/or the company. These people are not sales professionals. In fact, some of them border on being con artists.

Sales professionals usually have personal goals they want to achieve for themselves and their families and they need money to do it. It's up to you to develop remuneration plans that will fairly compensate these people so that both they and you can reach your goals.

Salespeople should be made aware of where and how the organization makes its profit so they can help maximize your return on investment. Too many companies feel margins are none of the sales-

person's business. Then they complain when their salespeople bring in unprofitable sales or seem to spend too much time on unprofitable opportunities. Good salespeople want to know how they can help their employer make the most money, if for no other reason than it affects their income. And this brings us to the subject of sales compensation plans.

Compensation plans should be set up on a win-win basis. I've seen plans where the more a salesperson sells, the less per sale he or she makes. That's not much incentive to sell. Consider making the plan tied to profitability if possible. The more profit the company makes, the more money the salesperson takes home.

A good compensation plan takes a long time to develop. Deciding the pros and cons between salary only, base salary plus commission, commission only and all the combinations in-between can be a real chore. There's no one plan that's right for everyone. What's good for one company is rarely good for another, at least not without some modifications or fine-tuning to meet the specific situation. While there's no need to reinvent the wheel, be cautious about adopting another company's remuneration plan in total. Use it as a guide only for developing your own.

DON'T OVERPAY

As a sales management consultant I'm often asked, "How much should I be paying my salespeople?" Good question. Unless you're running a philanthropic organization or have more money than you know what to do with, you probably have asked the same question. "How much is too much?" is another good question and one I'll try to answer here.

Here's a quick test to see if you're paying too much. I modestly call it the *Jeffrey Theory of Direct Sales Compensation*. The theory states that direct sales compensation should be equal to or (preferably) less than 20 percent of gross profit. The lower the percentage the more efficient your sales operation is from a fiscal point of view.

That's it. I told you it was quick.

Direct sales compensation includes salaries, commissions, and bonuses. Indirect costs are taken into consideration in the more elaborate bean-counter or cost-of-sales method outlined next.

In order to determine whether or not you're overpaying, you'll need to calculate your true cost of sales. Some people do this incorrectly. They neglect to include the hidden costs such as benefits, expenses, and cost of supervision.

If you know your actual numbers, use them in the formula below. Otherwise use the percentages shown, and you'll be pretty close to reality.

The Cost-of-sales Formula

- Start with the total yearly direct sales compensation (see above).
- Add 30 percent for benefits and taxes.
- Add 15 percent for supervision.
- Add in automobile expenses or allowances.
- Add in direct communication costs or allowances (pagers, cell phones, etc).
- Add yearly travel and entertainment (T&E) expenses.
- The total is your annual cost of sales.

Now calculate what percentage your cost of sales is of your annual gross profit. The lower the percentage, the more efficient you are.

If it's less than 30 percent you're running a very efficient sales department. If it's between 30 to 35 percent, you're still okay but you may want to weed out any poor performers who aren't pulling their weight. If it's between 36 to 40 percent, you're running a high-cost, low-efficiency sales department. If your sales costs exceed 40 percent, you're in the danger zone and starting to pay too much for the sales you're getting.

Once your sales costs exceed 50 percent, you're running the business to feed your salespeople while you're probably starving.

Here's an example. Let's consider a sales department with five salespeople:

Total annual direct sales compensation cost	=	$367,000
Benefit and taxes (30 percent of $367,000)	=	110,100
Supervision (15 percent of $367,000)	=	55,050
Auto allowances ($500/month x 5 salespeople x 12)	=	30,000
Cell phones	=	15,500
Annual T&E expenses	=	48,500
Total	=	$626,150

The annual gross profit was $1,897,000, which means the cost of sales was about 33 percent. While that's okay, it's a bit too high for my liking. I'd want to do the calculations for each of the salespeople to see if I have any problem children. If all the salespeople were about equal, I'd take a look at my overall margins to see if they're too low, my costs too high, or if my compensation packages are too generous.

K.I.S.S. (KEEP-IT-SIMPLE-SALES MANAGER)

Whatever plan you devise should be simple and to the point. Salespeople should be able to quickly calculate what they have earned from any particular sale.

I've seen compensation plans that are 15 to 18 pages long and take salespeople weeks to wade through and understand. A complex plan like that will have salespeople stewing for hours trying to figure out what they made on a particular deal when they should be out chasing the next opportunity. You don't want your salespeople spending more time working the plan that they spend working the street.

Remember the elevator rule. If it takes longer than an 11-floor elevator ride to explain your compensation plan, it's too complicated.

Here are some ideas, hints, and tips on sales compensation plans that will help you develop your own plan or fine-tune your existing one.

START AT THE END

The most common approach to developing a compensation plan is to decide how much money you want your salespeople to make at a particular level of sales. For example, you may decide that at $600,000 annual sales, the salesperson should make $60,000. The numbers 600,000 and 60,000 are purely arbitrary, and I have chosen them for the sake of simplicity. Your numbers are likely to be quite different. The type of compensation plan you choose will determine how much the salesperson will make if his or her sales are less than or more than $600,000.

By starting at the end, you have a specific point to build your plan around. The end point is usually determined by what is being paid for similar effort within competitive firms. In other words, the employment market and economic climate will set the potential income level.

If you're not sure what percentage of your gross sales or gross margin you should be allotting for sales compensation, do a mini compensation survey. Talk with several other companies in the same type of business. If you can't find anyone local to talk with, call a few similar companies in other cities. Pick cities where the companies you call don't directly compete. Offer to exchange strategic information with the company president. Progressive companies will be delighted to talk with you because they aren't sure if they're overpaying or underpaying their own people and may welcome some outside input. Offer to share the blind results of your survey with all participants. Make sure the survey results are blind by stripping any identifying information. No company wants its confidential compensation plan spread around.

If you decide to do a mini compensation survey, keep the questions few and simple. For example, you might ask: "What would a typical salesperson's income be at $300,000, $500,000, $700,000 and $900,000 of gross sales?" Notice how the amounts bracket your $600,000 of expected

sales. This allows you to get some idea of what the underachievers as well as the superstars might make.

THE PERFECT PLAN

Brace yourself: There's no perfect plan! Some plans are likely to be better suited for your type of selling than others. There's nothing to say you can't have several types of plans in place if your company has several types of sales situations or product lines. However, each plan should use the K.I.S.S. principle and be simple and easy for the salespeople to relate to.

From a company's point of view, a well-designed compensation plan should have two main purposes:

1. To compensate the salespeople in relationship to the value of their contribution to the company, and;

2. To allow the company to help the salespeople focus their efforts in the direction that will benefit them while helping the company achieve its sales and profitability objectives.

From the salesperson's point of view, the perfect plan would probably contain the following elements:

- Adequate income for adequate performance
- Superior income for superior performance
- Incentives for special achievements
- A base income for security purposes
- No penalty for underperformance
- To be compensated for what they can control
- An open-ended plan for unlimited income opportunities
- Clear ground rules for payment
- A stable plan that doesn't change too often

- Easy to understand and use
- And above all, perceived as being fair to the employee and the company

No matter how fair you make your compensation plan, someone will feel it's unfair!

THE TOP SIX

With the exception of straight salary, most compensation plans will have some portion of the income "at risk." The "at risk" portion has to be "earned" by the salesperson. High-risk plans attract entrepreneurial-type salespeople and those who are motivated by money. No- or low-risk plans attract the more conservative, stable, security-conscious salesperson. Each plan has its place. The six most common compensation plans are:

- Straight commission (high risk)
- Commission plus draw (high risk)
- Straight salary (no risk)
- Salary plus commission (some risk)
- Salary plus bonus (no to low risk)
- Salary, commission and bonus (low risk)

The higher the risk, the larger the reward.

Let's look at each of these plans in detail:

Straight Commission (High Risk)

The highest paid salespeople in North America are paid on straight commission. Only the most confident of salespeople will choose this plan. Many firms will include a guaranteed monthly income for the first three to six months in order to let the new salesperson come up to speed. During this ramp-up period, there's usually no commission paid.

Use straight commission compensation plans when:
- You are in an emerging industry or niche market.
- You are in a weak competitive position.
- You have limited financial resources.
- The sales cycle is short.
- Generally only one salesperson handles a sale.
- Salespeople are expected to be self-managers.

Advantages:
- Appeals to the entrepreneurial-type salesperson.
- Minimum sales costs.
- Easy to calculate and administer.
- Financial motivation is maximized.
- Attractiveness of uncapped earning potential.
- Attracts high performers.

Disadvantages:
- Salespeople may be inclined to make bad sales (in order to get a commission).
- Low or no control over the salespeople.
- Insecure income.
- Discourages cautious but otherwise good salespeople.
- Salespeople are highly susceptible to competitive offers.

In North America, there is a difference in attitude between US and Canadian salespeople. In general, US salespeople are less risk adverse

and are willing to go for the gold by accepting whatever compensation plan will provide them with the greatest income potential.

On the other hand, Canadian salespeople, for the most part, don't like straight commission. Perhaps it's their conservative nature. Being a Canadian, I can say this — we seem to be a nation of risk-adverse people. We don't like to take chances, even on our own abilities. Two of our key national traits are that we have more money in savings accounts and we buy more insurance per capita than any other country.

Straight commission makes the average Canadian salesperson nervous so you're going to have to find some above-average ones if you want to use this type of remuneration plan.

A way to reduce the nervousness is to offer a variation on this plan. Pay a fixed guaranteed monthly income for the first three months and then reduce the guaranteed monthly income by 25 percent a month for the next three months while paying a commission. This has the effect of weaning the new salesperson off the guaranteed monthly income and on to straight commission (Tables 1 and 2).

Table 1: A straight commission plan with a fixed guaranteed monthly income for the first six months.

	Month						
	1	**2**	**3**	**4**	**5**	**6**	**7+**
Guaranteed Income	$2,000	$2,000	$2,000	$1,500	$1,000	$500	$0
Commission ?	No	No	No	Yes	Yes	Yes	Yes

Table 2: If you have the type of business where the salesperson can become productive quickly, you may want to revise the Table 1 format slightly by easing the transition to commission in a manner such as this.

	Month						
	1	**2**	**3**	**4**	**5**	**6**	**7+**
Guaranteed Income	$2,000	$2,000	$2,000	$1,500	$1,000	$500	$0
Commission ?	No	No	No	25%*	50%*	75%*	100%*

*of commission due

Notice that the percentage of commission paid increases as the guaranteed monthly income decreases. This format minimizes the problem of the salesperson who comes up to speed very quickly and collects a large guaranteed monthly income plus commission in month four as would occur in the first example.

The salesperson should be given the option of converting from guaranteed income to straight commission at any time during the six months. However, once he converts to commission, he can't revert to a guaranteed income.

There are four basic types of commission plans:

- Straight commission on gross sales.
- Straight commission on gross margin.
- Progressive commission.
- Regressive commission.

Straight commission on gross sales.

This plan pays a fixed percentage of the gross sale. It's easy to calculate and easy to administer. If the commission rate is 10 percent and the salesperson sells $600,000 in the year, he or she makes $60,000. The best plans are open-ended, in that the more the person sells, the more he or she makes. The plan works best where the gross margins (GM) are similar between products and where management has good control over the GM (Fig. 1).

Straight commission on gross margin.

This plan pays a percentage, usually fixed, of the GM on the sale. Theoretically, this plan encourages the salespeople to sell high-margin products while in practice many salespeople still seem to sell what is easiest to sell, not what makes them the most money.

Make sure everyone understands what constitutes GM. Simply stated, GM is the selling price less the cost of the goods sold. For hard-to-cost-out items such as services, many companies simply assume a GM.

For example, on technical or repair services, the company might assume an across-the-board 35 percent GM for the sake of simplicity. That 35 percent might be adjusted on an annual basis as true costs were determined.

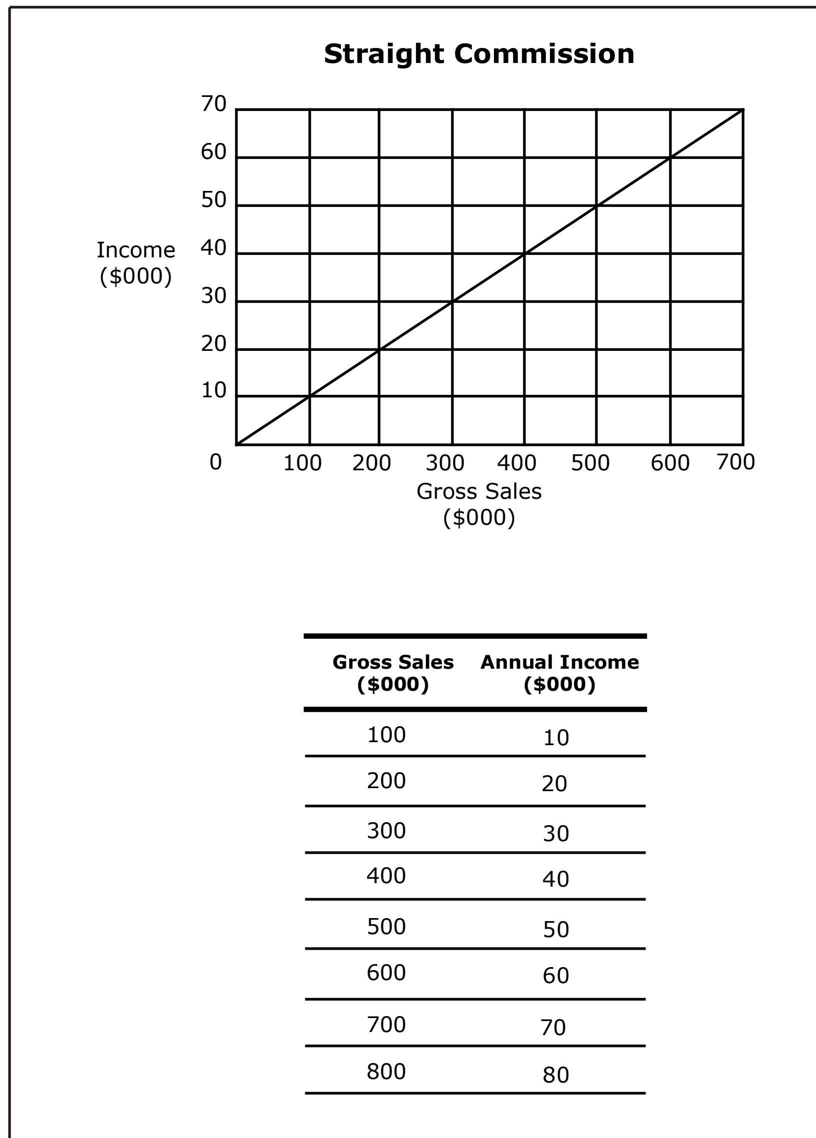
While difficult to administer, this plan is a good one to consider if your products or services have varying gross margins (Fig. 2).

Progressive commission.

The commission rate increases as the total sales volume increases. As shown in the example (Fig. 3), at $600,000 in annual sales the salesperson would make $60,000, the same as if she had been at 10 percent fixed commission. The difference is that there's a financial incentive to push for higher sales. The progressive commission plan can be used with either gross sales or gross margin.

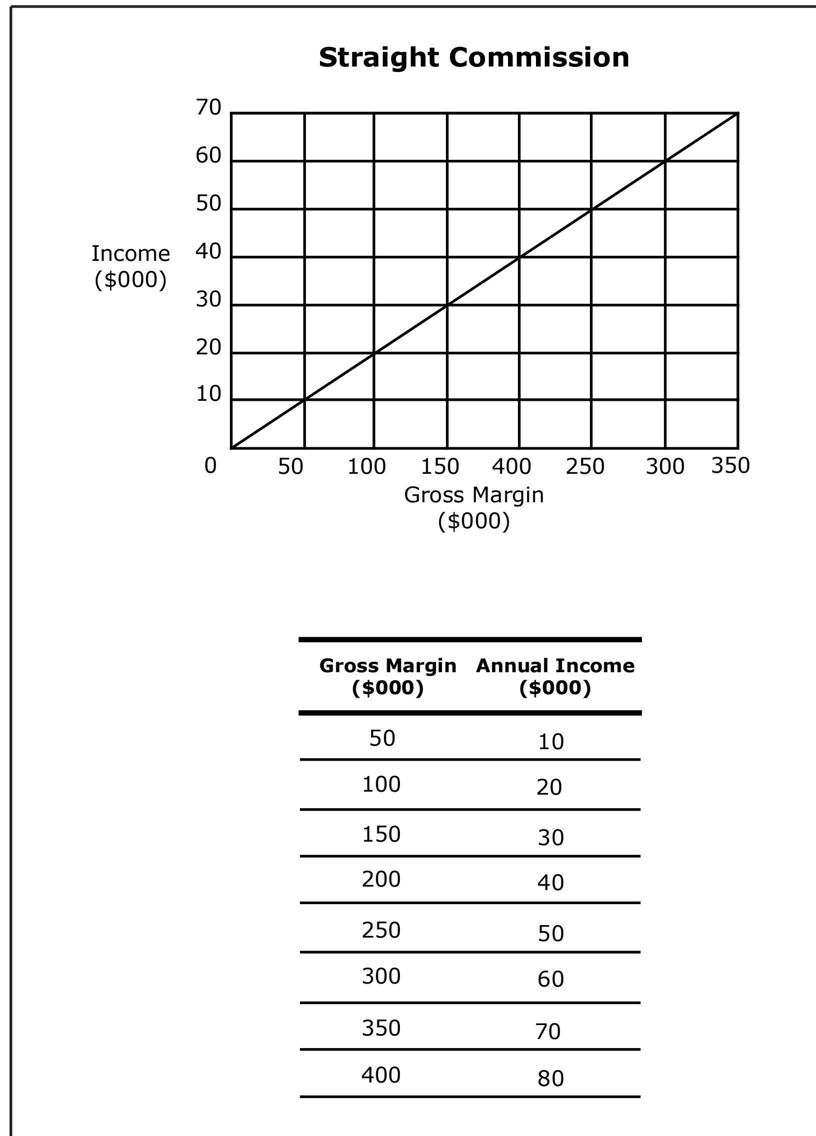
Regressive commission.

Here, the commission decreases as the total sales increase. As shown in the example (Fig. 4), at $600,000 in total sales the salesperson would still make $60,000 but she would make less and less as her sales increased. This plan is often used where the initial sale is difficult but subsequent or repeat sales are easier or even automatic. The regressive commission plan can be used with either gross sales or gross margin.



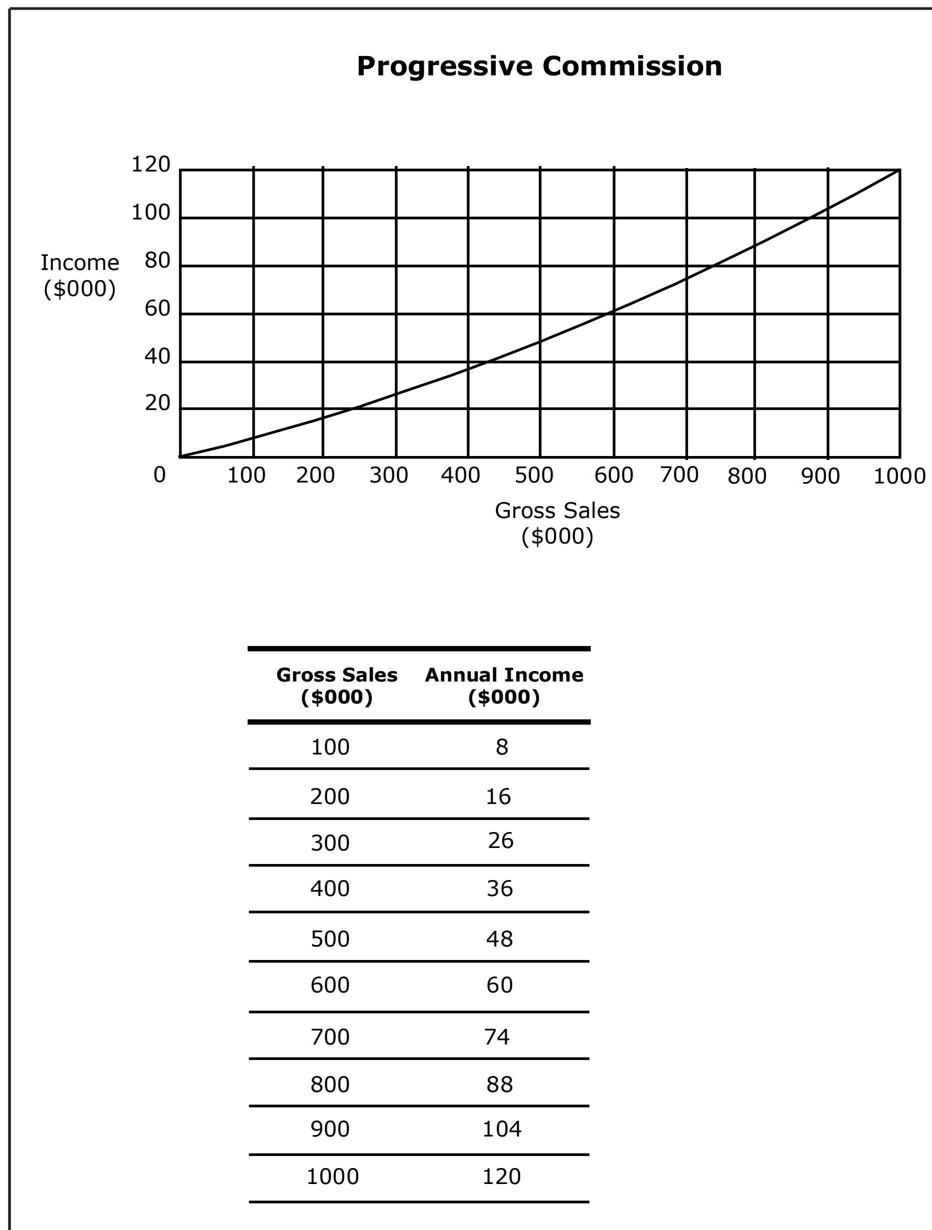
Gross Sales ($000)	Annual Income ($000)
100	10
200	20
300	30
400	40
500	50
600	60
700	70
800	80

Figure 1. A straight commission plan based on 10 percent of gross sales.



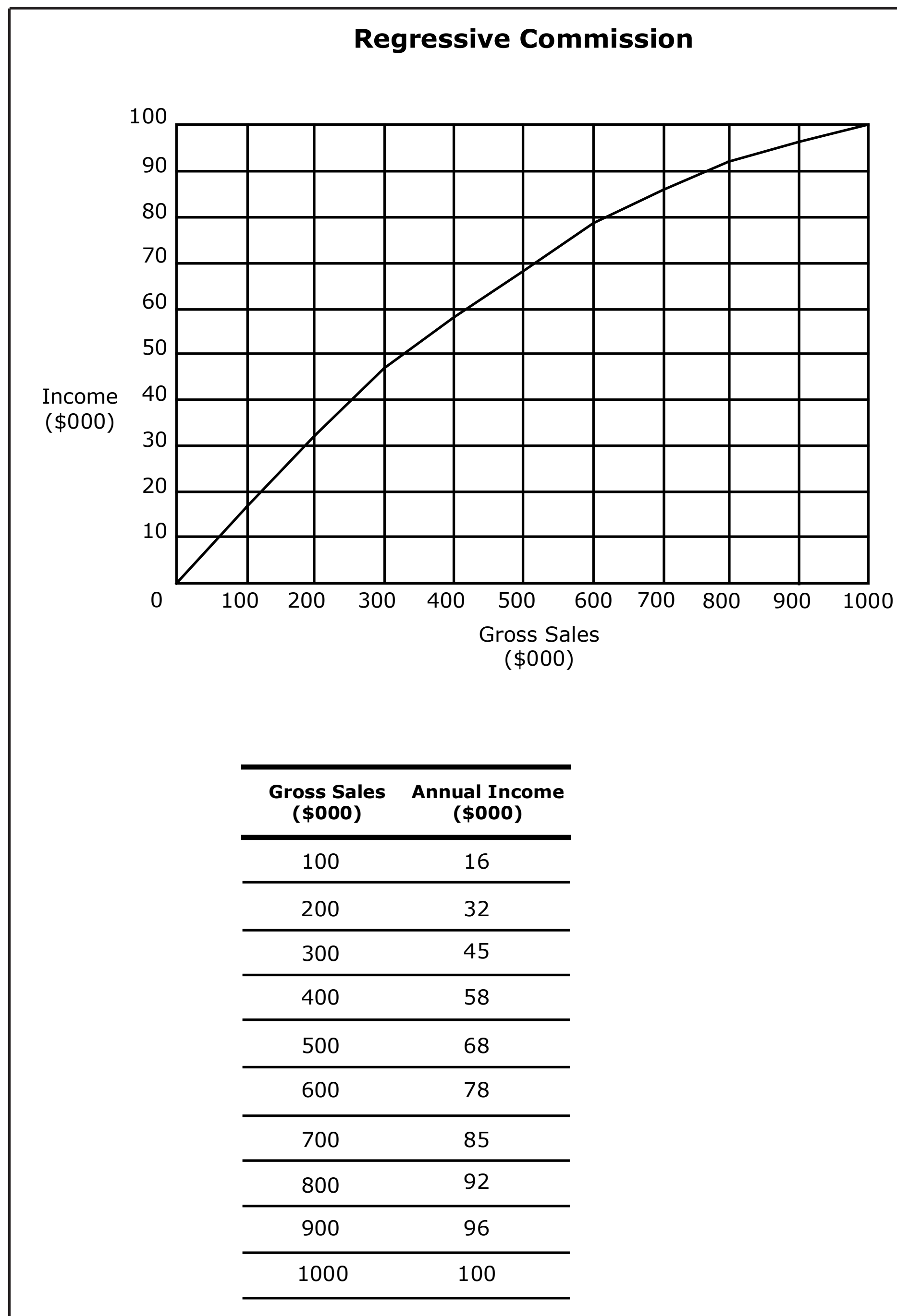
Gross Margin ($000)	Annual Income ($000)
50	10
100	20
150	30
200	40
250	50
300	60
350	70
400	80

Figure 2. A straight commission plan of 20 percent on gross margin.



Gross Sales ($000)	Annual Income ($000)
100	8
200	16
300	26
400	36
500	48
600	60
700	74
800	88
900	104
1000	120

Figure 3. A progressive commission plan based on:
8 percent commission on the first $200,000 of gross sales
10 percent on the next $200,000 (to $400,000)
12 percent on the next $200,000 (to $600,000)
14 percent on the next $200,000 (to $800,000)
16 percent on gross sales over $800,000



Gross Sales ($000)	Annual Income ($000)
100	16
200	32
300	45
400	58
500	68
600	78
700	85
800	92
900	96
1000	100

Figure 4. A regressive commission plan based on:
16 percent commission on the first $200,000 of gross sales
13 percent on the next $200,000 (to $400,000)
10 percent on the next $200,000 (to $600,000)
7 percent on the next $200,000 (to $800,000)
4 percent on gross sales over $800,000

The year end dilemma.

Whenever you have a plan with a varying commission rate, you have to decide what to do when you roll the plan over into the next fiscal year.

Salespeople who operate under a regressive commission plan are delighted to see the new year come and their commission rates go back to a higher rate. In some cases, salespeople have been known to ask customers to delay submitting their orders until the new (higher) commission plan kicks in.

On the other extreme, salespeople on a progressive commission plan are prone to armed revolt if you reduce the commission rates.

You have two major options. One is to simply reset the plan at the beginning of each year and start it over again. What usually happens is that the plans are reviewed and the quotas and commission rates are adjusted to take into consideration current economic conditions. Be very cautious about raising commission rates, even in good times, because it's exceedingly difficult to reduce them later, even when times get bad. Instead, consider some type of bonus plan based on exceeding company profit goals.

The second option is to keep the plan at its current level for as long as the salesperson maintains that level of sales performance. This works only with the progressive commission plan and its variants. For example, using the plan outlined previously (Fig. 3), if your salesperson is consistently performing at an annual sales performance of between $600,000 and $800,000, leave him at a constant 12 percent commission rate. Monitor his performance on at least a quarterly basis to assure yourself that the performance is still there. If it isn't, you can adjust the commission rate downward. If he's performing better than expected, you can be sure he'll soon be on your doorstep trying to negotiate a higher commission rate.

Commission Plus Draw (High Risk)

By providing a draw against commission, the company helps even out the monthly variations in a salesperson's pay envelope. A draw

against commission also allows the salesperson to concentrate on his job, not on how to make his mortgage payment. Financial pressures don't always drive salespeople to be more productive. Sometimes it simply drives them out the door to another job.

A draw can be either recoverable or non-recoverable. A recoverable draw is basically an advance or loan against expected earnings. If the salesperson leaves the firm owing the company money, an attempt will be made to recover it. A non-recoverable draw is like a minimum salary, and failure to cover the draw is usually forgiven at the end of the accounting period. Some firms offer a non-recoverable draw for the first three to six months and then change to a recoverable draw after the salesperson is up to speed.

Use commission plus draw compensation plans when:

- The sales cycle is long.
- Salespeople are expected to take several months to come up to speed.
- You are in an emerging industry or niche market.
- You are in a weak competitive position.
- You have limited financial resources.
- Generally only one salesperson handles a sale.
- Salespeople are expected to be self-managers.

A commission plan with a recoverable draw has the same advantages and disadvantages as the straight commission plan. A commission plan with a non-recoverable draw removes some or much of the risk (depending on the amount of the draw) and gives it the same advantages and disadvantages as the salary-plus-commission plan that we'll look at later.

Whatever plan is used, it's important that an accounting system be in place to closely track sales, draws paid, commissions earned, and balances outstanding.

NOTE: It's important that salespeople understand what type of draw plan they are on, particularly if it's a recoverable draw. It must be made clear to them that the company is "loaning" them money to help them get established and they are expected to pay it back just like any other loan. If they leave, for any reason, and their payroll account is in a negative position, the company expects them to pay it back.

The amount of the draw is usually equal to or less than one-twelfth the expected annual income. Most often it's 15 to 40 percent less. For example, if a salesperson's expected annual income is $50,000 (about $4,167 a month), his or her draw could be in the range of $2,500 to $3,600 a month.

The draw should have an established dollar limit. Limits are usually equal to a one-, two-, or three-month draw. This means a salesperson drawing $2,500 could go to -$2,500, -$5,000 or -$7,500 before the draw is stopped, depending on the limit established. Don't cut off a salesperson's draw without warning and/or discussing it with him beforehand. A more humane approach is to reduce the draw rather than cut it off altogether.

Remember the Rule on Draws: Don't pay more than you're prepared to lose.

When the draw is close to or equal to the expected annual income, some companies don't issue a commission cheque until the commissions earned exceed the draw paid by a predetermined amount. For example, if a salesperson's draw is $2,000 a month, the company wouldn't pay any commissions until the amount owing the salesperson exceeded $6,000 (three months' draw). Any commissions earned over the $6,000 threshold would be paid to the salesperson. In essence, the company is maintaining an internal "bank" account for the salesperson and allows a plus or minus balance of a few months' draw.

NOTE: Beware of the salesperson who has fallen two or three months behind without some valid reason or some high-potential opportunities in the wings. If someone falls so far behind that he doesn't think he can catch up, he may get discouraged and let his performance drop even more. Sometimes a salesperson will do this in the hopes you will fire him and forgive the "loan." Make sure you talk to the individual long before the danger point is reached.

When to pay commissions.

There are four basic times that commissions can be paid:

- On receipt of the customer's order
- On delivery of the product or service
- When the client is invoiced
- When payment has been received

In general, you should reward (pay) salespeople for what you want them to do and for what they have some or complete control over. This usually means paying the commission after they get the commitment from the client (purchase order).

Most salespeople have minimum control over delivery of the product or service or when the accounting department finally gets around to sending the invoice. If you hold onto the commissions until the invoice gets paid, you run the danger of turning the salesperson into a bill collector, which may tarnish the salesperson's relationship with the client.

Straight Salary (No Risk)

This compensation plan is the easiest to administer. It's commonly used for salespeople in:

- Highly seasonal industries
- High-tech industries
- Retail sales

- Route sales
- Missionary or educational sales
- Team or group selling
- Order-taking-type sales
- Highly customer-service-oriented sales
- Long-sales-cycle sales
- When developing new accounts or territories

Use straight salary compensation plans when:

- Your industry is stable and has established buying practices, long sales cycles, and potential for long-term business.
- You are in a secure market position with established repeat clients.
- The sales function is highly service-oriented and/or substantially consultative.
- There is a great deal of pre- and post-sale activity on the part of the salespeople.
- You use team-selling.

Advantages:

- Appeals to the stable, conservative, security-conscious-type salesperson.
- Provides salespeople with a stable, predictable income.
- Allows management to stress team selling.
- Allows salespeople to service the clients without losing income.
- Easy to administer.
- Fixes your sales expenses.
- Makes it easier to assign accounts and territories.

Disadvantages:

- Lack of monetary incentives removes a strong incentive factor.
- Requires skilled sales management to keep staff motivated.
- Makes it difficult to attract and hold top performers.
- Existing staff are vulnerable to better job offers.

Because the salesperson's income is not directly tied to his efforts, many companies fail to monitor performance. This is a big mistake. If a person's sales cannot be determined, then his activities must be monitored to assure performance. A salaried salesperson must be kept as accountable for his results as his commissioned brothers and sisters.

Salary Plus Commission (Some Risk)

This is a variation of the non-recoverable draw against commission plan outlined above except the draw is never recoverable and the commission rate is usually less. Salary plus commission plans come in two flavours — low risk and high risk.

High base salary/low commission (low risk)
Use a low-risk (high base, low commission) compensation plan when:

- Your company and products are established.
- Your customer base is stable and loyal.
- Your advertising and promotional efforts impact sales.
- The salespeople have a low to moderate effect on the outcome of the sale.

Advantages:

- Appeals to security-sensitive salespeople.
- Base salaries can be varied to take into consideration the salesperson's experience.
- Sales expenses are relatively easy to predict.
- Relatively easy to administer.
- Reward for performance.
- Some financial incentive while maintaining the advantages of a straight salary.

Disadvantages:

- Actual financial incentive (motivation) may be low.

High base salaries can cause salespeople to become lazy.

Low base salary/high commission (high risk)

Use a high-risk (low salary, high commission) compensation plan when:

- The salespeople have a considerable impact on the sale.
- Your sales cycle is relatively short.
- You feel a need to financially motivate your salespeople.

Advantages:

- Appeals to entrepreneurial-type salespeople.
- Base salary acts as a guaranteed income.
- Base salaries can be set quite low.
- Base salaries can be varied to take into consideration the salesperson's experience.
- Financial motivation is maximized.
- Attractiveness of uncapped earning potential.
- Attracts high performers.

Disadvantages:

- Salespeople may be inclined to make bad sales (in order to get a commission).
- Reduced control over the salespeople.
- Salespeople are somewhat susceptible to competitive offers.

A typical plan could look something like this:

Base salary:	$30,000 per year
Commission:	5 percent on gross sales
Earnings at $600K sales:	$60,000

The ratio of salary to commission is variable and often negotiable. The higher the base salary, the lower the commission. The lower the salary, the higher the commission.

Examples:

Base salary:	$40,000
Commission:	3.33 percent on gross sales
Earnings at $600K sales:	$60,000
Base salary:	$20,000
Commission:	6.66 percent on gross sales
Earnings at $600K sales:	$60,000

Notice how everything revolves around the $600,000 starting (or end) point discussed earlier.

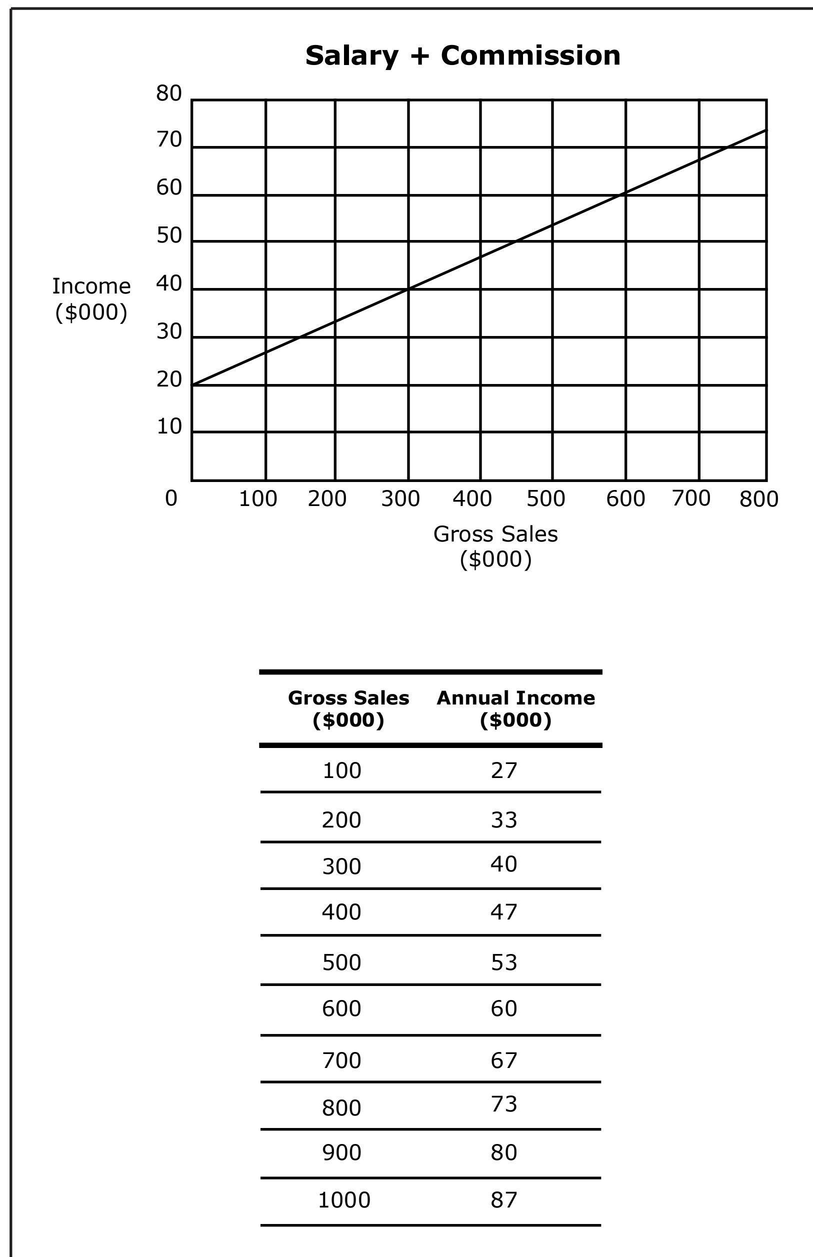
Whether the person gets a $20,000, a $30,000 or a $40,000 base is usually determined by his or her level of experience — or negotiating skills perhaps. Fig. 5 and Fig. 6 illustrate base salary plus commission plans.

Salary Plus Bonus (No to Low Risk)

This plan is usually the least desirable for many salespeople. That's because the bonuses are often discretionary and too many factors outside the salesperson's control can come along to snatch the bonus away.

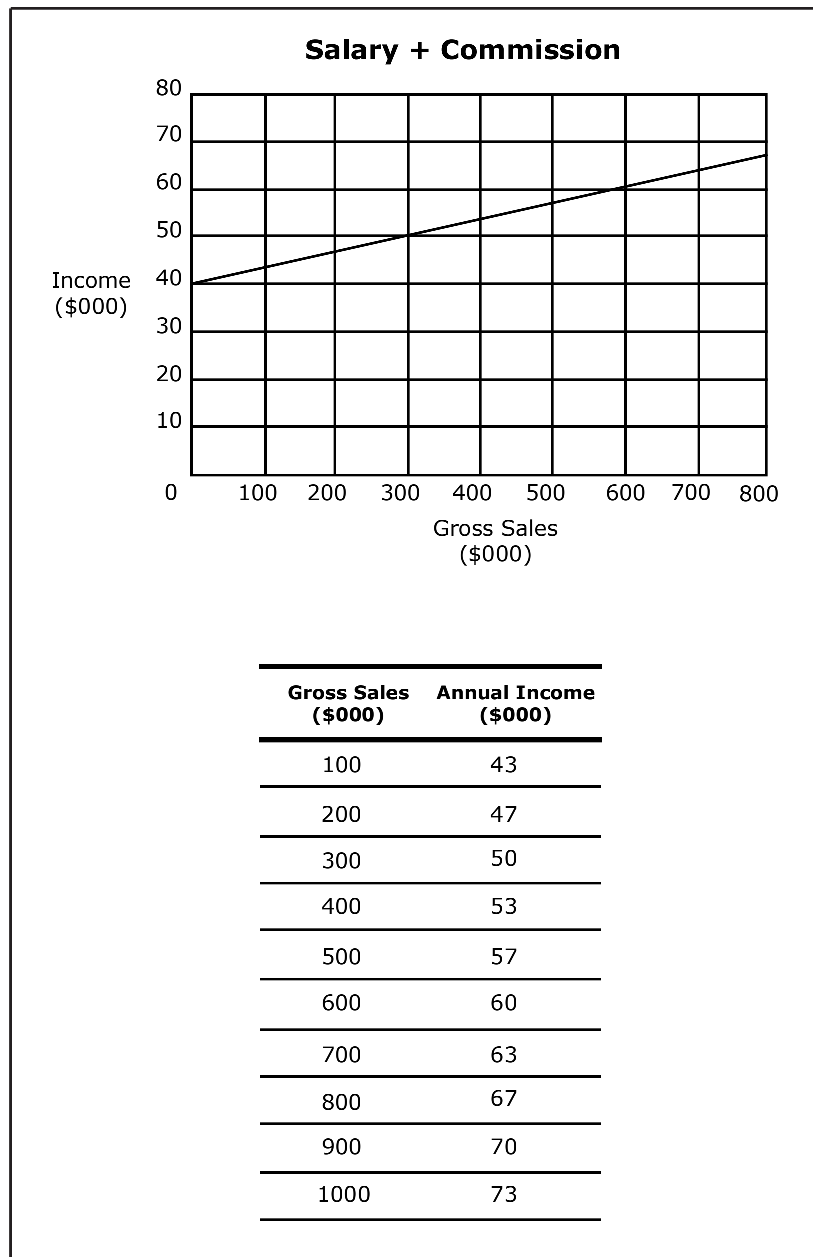
Use a salary plus bonus plan when:

- You have a very long sales cycle.
- Sales volume is not a total indicator of sales effectiveness.
- Salespeople have a low to moderate effect on the outcome of the sale.
- Your customer base is broad and varied.
- Targets and bonuses can be easily set.
- Sales teams rather than individuals are involved in the sale.



Gross Sales ($000)	Annual Income ($000)
100	27
200	33
300	40
400	47
500	53
600	60
700	67
800	73
900	80
1000	87

Figure 5. A compensation plan based on $20,000 base salary plus 6.66 percent commission on gross sales.



Gross Sales ($000)	Annual Income ($000)
100	43
200	47
300	50
400	53
500	57
600	60
700	63
800	67
900	70
1000	73

Figure 6. A compensation plan based on $40,000 base salary plus 3.33 percent commission on gross sales.

Advantages:
- Provides flexibility in performance management.
- Marketing objectives can be translated into financial incentives.
- Both selling and non-selling activities can be rewarded.
- Cost of sales is more predictable.
- Base salary provides income stability.
- Bonus plans allow teams to be rewarded.

Disadvantages:
- Calculations and administration can become complex.
- Bonuses can become "expected" rather than earned.

Bonuses usually range from five to 20 percent of a salesperson's annual expected earnings and should be based on specific, measurable criteria.

Here are a couple of typical plans based on performance targets:

Salary:	$57,000
Bonus @ quota ($600,000):	$2,500
Bonus @ $700,000:	$5,000
Bonus @ $800,000:	$7,500

Salary:	$50,000
Bonus @ quota ($600,000):	$10,000
Bonus @ $700,000:	$10,000
Bonus @ $800,000:	$10,000

The question always arises: If the salesperson sells $799,999, is she eligible for the last $10,000 bonus? While you'd have to be pretty hard-hearted not to pay it, where do you draw the line? You might want to consider a pro rata bonus. For example, if the salesperson sold $750,000 by year end, give her 50 percent of the bonus ($5,000). If you take this approach, however, you lose some of the incentive element that the bonus plan is intended to create.

Whatever you decide, make sure the rules are crystal clear or you'll have a real fight on your hands at year end.

An annual bonus can also be paid on reaching various performance points. For example:

Salary = $55,500
Quota = $600,000

Year-end bonus for reaching

90 percent of quota	=	0.25 percent of gross sales ($1,350)
95 percent of quota	=	0.5 percent of gross sales ($2,850)
100 percent of quota	=	0.75 percent of gross sales ($4,500)
105 percent of quota	=	1.0 percent of gross sales ($6,300)
110 percent of quota	=	1.25 percent of gross sales ($8,250)
115 percent of quota	=	1.5 percent of gross sales ($10,350)

Bonuses can be paid on the company's profitability as well. This plan won't sit well with the salespeople if there's a lot of overhead or high-priced staff who don't contribute directly to the bottom line. Salespeople will perceive the overhead as eating away their potential bonus.

A caution on bonuses, particularly ones tied to the company's profitability. Even when profits are down, some salespeople may exceed their quotas and be anxiously awaiting their bonuses. They will view non-payment of anticipated bonuses with great despair and displeasure and it may prompt them to find employment elsewhere. Even though the rules will have been clear, they will be unhappy and may view non-revenue producing staff members as causing the profits to be down. The drop in morale can be substantial.

When to pay bonuses.

In some firms, bonuses are paid out once a year. Bonuses, like compliments, have a greater impact if they are paid close to the event that warrants them. Semi-annual or quarterly bonuses will have a greater motivating effect on the salespeople. Monthly bonuses are usually

difficult to calculate and may lose their effect of being a "bonus" and become looked upon as simply part of the salary.

One way to minimize the problem of bonuses being taken for granted is to turn the presentation of the cheques into a bit of an event. And a good time to do this is at your sales meetings. Without telling anyone how much another person has made, present the cheques in increasing order of value with the last person obviously getting the largest bonus. Ask the group to give the top bonus receiver a round of applause. It acts as a resounding pat on the back for the person. This approach has the side effect of also putting the spotlight on the person who received the smallest bonus. You can avoid singling out this person by presenting all but the top bonus cheque in random order.

Salary, Commission and Bonus (Low Risk)

This hybrid plan is usually an attempt to be all things to all people and is often very complicated, convoluted and confusing. The plan's merit lies in management's ability to juggle dollars in tight times and to hold onto the discretionary bonus until it absolutely has to be paid out.

Use a combination salary/commission/bonus compensation plan when:

- You have a very long sales cycle.
- Your products have widely ranging profit margins.
- Sales volume is not a total indicator of sales effectiveness.
- More than one salesperson may be involved in the sale.
- Salespeople have a low to moderate effect on the outcome of the sale.
- Your customer base is broad and varied.
- Targets and bonuses can be easily set.

The advantages and disadvantages of this type of plan are similar to those associated with the high base salary/low commission plan noted earlier, but with the added aggravation of being a nightmare to administer.

SPLIT COMMISSIONS

My first bit of advice is to avoid split commissions if you can. Having said that, there are some situations where a commission split is warranted.

A split commission is appropriate if you have a situation where two or more salespeople will be involved in a sales opportunity. A split commission is probably *not* appropriate if you try to split the commission between a salesperson and non-sales personnel such as technical support, telemarketing, customer service, etc. While these people are important to the sale, it's the salesperson who is on the firing line and whose income depends upon making the sale.

A split commission *may* be appropriate in the case where a salesperson is working on a house account and is doing more of an account maintenance function rather than the classic sales role, although this is usually a situation that warrants a reduced commission rather than a split commission.

Define commission splits before the sale, not after.

How to split commissions? There is no easy answer to this question but I have some ideas to share with you.

The key is to divide the sale into some natural occurring events or situations and then applying an appropriate percentage to each part. For example, let's assume the sale can be broken into four parts: lead generation, qualify and sell (I call this probe & prove), close, and post-sale support.

If a salesperson finds the opportunity, qualifies it and makes a sales presentation, closes the sale, and the product is delivered to his area where he is expected to provide after-sale support, then he gets 100 percent commission.

On the other hand, let's suppose Salesperson #1 finds a lead and passes it on to Salesperson #2 who then qualifies, presents and closes the sale. The end product is delivered to Salesperson #3's area and he will be responsible for the after-sale support. Now we have a three-way split on our hands.

Now it's a matter of what percentages to assign to each portion of the sale. One way is to simply divide the commission into four equal parts, giving a 25 percent portion of the commission to Salespeople #1 and #3 and the remainder (50 percent) to Salesperson #2.

Rather than simply dividing the commission in equal parts, it makes more sense to assign percentages in proportion to the effort or difficulty involved. For example, a better split might be:

Lead generation:	10%
Qualify & Present:	50%
Close:	20%
Post-sale support:	20%

A typical three-part sale might be:

Lead generation:	15%
Qualify & Present:	70%
Close:	15%

These percentages are certainly not cast in stone but are presented here as guidelines. You may find that a typical split-commission sale only has two parts or perhaps as many as five to eight.

It doesn't matter how many parts you decide to divide the sale into. What matters is that you decide how many parts and you assign the percentages to each part *before* you have to actually split a commission.

If you wait until you have a bunch of burly salespeople standing in front of you with their hands out, all wanting more than their fair share of the commission for a big sale, you're in trouble… big trouble.

If you're going to have split commissions, make them part of your compensation plan. Spell out the details up front so everyone understands them.

REDUCED COMMISSIONS

If you have situations where a reduced commission is appropriate, make sure they are spelled out in advance and documented in your compensation plan.

Examples of situations that might warrant a reduced commission are:

- Selling into a house account.
- Follow-on sales where the bulk of the selling has already been done.
- Sales of small margin products.
- Sales of end-of-line or inventory clearance items.
- Sales of supplies in support of a major item sale.

Make sure your salespeople know, in advance, that they will not be receiving their full or normal commission for this type of sale. If you don't, you're likely to have some annoyed salespeople to deal with.

DOCUMENTING THE COMPENSATION PLAN

While they are not generally detail oriented, most salespeople will want to know about their compensation plan in detail. Here's a simple template to use in developing your own plan description:

1. *Purpose*

A statement of the importance of the plan, the role of the salesperson in the success of the company, etc.

2. *Plan Overview*
A brief summary of the plan's features.

3. *Eligibility*
Conditions to be met for a person's inclusion in the plan.

4. *Plan Components*
Description of elements of the plan—salary, commission, bonuses.

5. *Plan Qualifiers*
Details of all the qualifiers and conditions such as definition of a sale, payment thresholds, split commissions, house accounts, windfalls, shortfalls, caps, incentive earnings, etc.

6. *Legal Statement*
This section contains any of the usual relevant and/or company-specific statements indicating the right to change the plan and other standard legal gobbledegook.

7. *Appendix*
Put the supporting documentation such as salary ranges, commission rates, product categories in this section. It's wise to include a couple of compensation examples as well.

AVOIDING LAWSUITS

A lot of post-employment aggravation, where either a salesperson leaves you or you leave the salesperson, can be avoided if the compensation plan covers off the items in the checklist below.

Some of this grief is the result of simple misunderstandings and are worked out after tense discussions where both tempers and maturity are tested. Some end up in the courts where a judge will decide what was and wasn't intended by what was written in or left out of your compensation plan.

No checklist can ever cover every eventuality, but if you can cover off some of the major causes of potential grief you may well avoid lawyer's fees and court costs.

Have your salespeople sign off on your compensation plan showing that they have read and understand it.

BE CLEAR WITH YOUR INTENTIONS

As you go through my checklist, avoid the tendency to pooh-pooh what appears to be obvious.

For example, what is a sale? Is a lease a sale? Is a purchase order that has yet to be accepted by the credit department a sale? Is it only considered a sale after it has been invoiced?

What is the value of a multi-year sale with annual call-offs? Does the salesperson get credited with the full value of the contract or just the annual call-offs?

What happens if the product or service gets delivered after the salesperson has left the company? Is he still entitled to remuneration and if so, for how long?

Get the idea? Be clear with your intentions.

COMPENSATION CHECKLIST

Here are some of the key issues that need to be addressed in the compensation plan documentation. The list is by no means complete but it's a great starting point.

- What constitutes a "sale"?
- How are low-margin sales handled? What is the value of a sale for commission purposes or credit towards quota?

- When is the salesperson credited with a sale? Some options are:
  -upon receipt of the purchase order or contract,
  -upon delivery,
  -upon invoicing,
  -upon payment.
- When are commissions due (or owed)? Some options are:
  -when credited with the sale,
  -upon delivery,
  -upon invoicing,
  -upon payment.
- When are commissions paid: weekly, monthly, quarterly, or annually?
  Note: These last three points are particularly important if a salesperson leaves or is terminated.
- Do you provide a draw against commission?
  -If so, how much and under what conditions and terms?
  -What type of draw: recoverable or non-recoverable.
  Note: Draws can be a financial minefield.
- Is there a bonus plan in place? If so, under what terms will a bonus be paid and how much will the bonus be?
- What happens if a salesperson doesn't make his or her monthly/quarterly minimum sales targets?
- Are or should monthly/quarterly minimum sales targets be seasonally adjusted?
- How are bad debts, refunds, or returns handled?
- What happens in the event of a cancelled project, sale, or contract?
- Are assigned territories and/or accounts properly defined?
- Are there any house accounts? What happens on a sale to a house account?
- What happens when a salesperson leaves the company? When do commissions stop being owed?
- What happens when you fire a salesperson?
- Is there a need for split commissions? If so, how will they be split?

- In the case where an account is turned over to a new salesperson, how is the former salesperson compensated for residual business that might occur, and for how long.
- What dispute resolution solutions are available to each party?

FINAL THOUGHT

Your compensation plan should be simple, fair, and competitive. You want your plan to focus your salespeople on the job to be done and to motivate them to want to achieve their personal goals. Nothing to it, right? Yeah, sure!

Good luck!

ABOUT THE AUTHOR

Brian Jeffrey is a sales management consultant and former sales trainer with over 40 year's experience. He's the author of *The Sales Wizard's Secrets of Sales Management, The 5-Minute Sales trainer,* 18 ebooks, and over 100 articles on selling and sales management.

Brian provides sales management consulting, coaching, and mentoring to business owners and sales managers. He has had many sales successes (as well as a few spectacular failures) and has learned what works, what doesn't, and why — information he readily shares with others.

Find out how Brian helps companies maximize their sales at **www.Quintarra.com.**