Are Your Salespeople Overpaid

As a sales management consultant I'm often asked, "How much should I be paying my salespeople?" That's a question that I think most sales managers and business owners would like answered. So I'm going to share my concept with you.

The average salesperson, on the other hand, will probably want to lynch me after reading this article. And why would they want to do that? Because a lot of salespeople still believe in many of the timeworn generalisations that apply to the world of selling such as:

- The grass is greener on the other side,
- I have a lousy territory,
- My prices are too high, and
- I'm underpaid.

I'm not saying that these statements are untrue. What I am saying is that many salespeople use these arguments without really confirming their truth. The truth is that sometimes the grass is greener on the other side, some salespeople do have a lousy territory, sometimes their prices are too high, and some salespeople may well be underpaid.

This article is not about paying salespeople what they're worth; it's about how much the business can afford to pay their salespeople.

Disclaimer

The concept I'm about to share is not cast in stone. It is a generalisation, like Pareto's Principle (the 80/20 rule, i.e. 80 percent of your business comes from 20 percent of your customers) that has stood the test of time. Think of what follows as the *"Jeffrey Theory of Direct Sales Compensation"* (i.e. direct sales compensation should be equal to or preferably less than 20 percent of gross profit). As you work out your own numbers, remember this is a generalisation and your mileage may vary.

Sales Efficiency

I'm going to show you how to determine how efficient your sales department is, and I guarantee you'll either be delighted, stunned, or dismayed at the result.

I recommend you do the calculation for the entire sales department, as gross numbers are usually easier to find. If your result is out of whack, you'll probably want to do the calculations on a salesperson-by-salesperson basis to determine where your problem lies. In fact, doing this exercise for each salesperson is an excellent measure of a salesperson's sales efficiency. It will also tell you if you are overpaying for the sales you're getting.

Sales efficiency is a subtle but important factor in running a sales department. Your job is to bring in more money than you spend — a lot more — but you'd be surprised at the number of organizations who are paying too much for their sales. Don't let this happen to you.

There are two ways to determine sales efficiency — the Quick Test and the Bean-counter Method. Most sales managers will prefer the Quick Test but it is wise to go through the Bean-counter Method as well.

Quick Test

Here's the rule for the Quick Test and it's the basic premise of the *"Jeffrey Theory of Direct Sales Compensation"* which 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.

Direct sales compensation includes salaries, commissions, and bonuses. Indirect costs are taken into consideration in the Bean-counter method outlined below.

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

Bean-counter Method

In order to determine your sales efficiency, 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 compensation (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 costs 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.

An Example

Let's take the example of a sales department with five salespeople with a total sales compensation

cost of $367,000. Thirty percent of $367,000 is $110,100 and 15 percent is $55,050. The annual T&E expenses ran $48,500 for a total of $580,650. The annual gross profit was $1,760,000, 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.

The Advantages

Doing this exercise for each salesperson has a number of advantages. It can help with performance reviews. It allows you to rank your people in terms of efficiency so you can see who's giving you the most profit for the least cost. It tells you if the salesperson that's a perpetual pain in the lower part of the anatomy is worth keeping.

Stay Profitable

Your job as a manager is to run a profitable, efficient operation and this exercise will help you determine how close you are to hitting that target. Good luck!