WHITE PAPER

How to Align Sales Compensation with Corporate Objectives

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Introduction

Aligning sales compensation plans with corporate objectives is a critical step towards ensuring the financial health of your company. Sales people are more likely to perform activities which support the corporate objectives when their compensation plans are in alignment.

When compensation plans are not aligned with corporate objectives there is a disconnect between what the company is trying to achieve and what the sales people are focusing on. This can manifest in a number of ways and often include increasing or excessive focus on one product, service, or activity while neglect or avoidance of others. Other symptoms can be high turnover and/or low morale with sales people.

Based on assumptions drawn from their compensation plans, sales people will most likely focus their activities and energy on doing what they believe will generate the most commissions for them. In many instances this natural tendency to “work the plan” may actually go against the best interests of the company if the plan is not aligned.

This paper addresses methods and steps to align sales compensation plans with corporate objectives. Key components integral to alignment include:

1. Corporate Objectives
2. Sales Strategy
3. Job Definitions
4. Sales Compensation Plan Design

Each of these components builds upon the foundation established by the one which precedes it starting with corporate objectives. If one component is incomplete or not in sync with its predecessor then subsequent components will be affected.

Corporate Objectives

Corporate objectives are the foundation sales strategy, job definitions and sales compensation plans are based upon. It is crucial that this first step in the alignment process be given adequate attention. There are several categories in which to consider corporate objectives:

- Community
- Financial
- Human Resources
- Operations
- Products and/or Services
- Sales & Marketing

These categories are not a direct overlay for their respective departments. Corporate objectives need to identify and prioritize specific and actionable objectives and delegate them to the relevant departments within the corporation.

Sales Strategy

Sales will have corporate objectives from other categories in addition to the sales & marketing category referenced above. To develop effective sales compensation plans Sales VPs need to have a clear understanding of what corporate leadership expects from the sales department. Some basic objectives to be incorporated in a sales strategy:

- Growth
- Market Penetration & Leadership
- Profit
- Revenue

The Sales VP needs to establish the Sales Model that best supports the corporate objectives. This includes identifying the sales channels and how best to support them. Sales strategies are rarely limited to just revenue targets so it is important to identify the other goals and the related activities required to support the corporate objectives.

For example you may have a sales person selling items at a lower profit margin to increase their commissions at the expense of the company. Another sales person may be content to push one product line and neglect another for one reason or another. If sales people are paid the same commission regardless of what they sell they may choose the easier sale or at least what is most familiar to them.

If Sales is held to a profit margin then this needs to be incorporated in sales compensation plans if sales people have any impact on it. One of the corporate objectives may be to increase the number of new or repeat customers. In each case there are things that can be done to the compensation plans to support these objectives.

Job Definition

Once the sales strategy has been formulated the next step in the process of alignment is the job definition component. Here we take a holistic or macro view of the sales model and identify all the responsibilities prior to assigning or delegating them to individuals. The next step is to select the best job definitions that can effectively support the model.

Many fast growing companies have neglected to update their job definitions to keep pace with changes in their market and how they do business. These gaps can be a source of frustration for sales people and managers as new but yet unassigned responsibilities fall through the cracks. To maintain alignment job definitions should be reassessed on an annual basis and gap analysis performed on the level of existing coverage and the ideal level of coverage based on the current market situation.

Once job definitions are selected they should be further refined and detailed to the point they become job descriptions suitable to provide sales people with an explanation of what is expected from them.

The job description should include:

- Accountability (whom the position reports to)
- Desired Results
- Key Objectives
- Level and Scope of Authority
- Responsibility

Even though some companies may spend the time to define sales jobs they often neglect to provide sales people with a written document describing the position in detail. Coupled with a sales compensation plan that reinforces the expectations, a written job description can help the company clearly communicate their objectives to sales people.

Sales Compensation Plan Design

Communication problems often arise when sales compensation plans and job descriptions espouse different values. In the end the compensation plan usually overrides the job description in terms of influencing sales people's actions. This is because the compensation plan calculates how they are paid, not the job description.

Each step in the process of aligning sales compensation plans with corporate objectives is dependant on the preceding ones so the sales compensation plan should be aligned with the job description. There are generalities in the average job descriptions that often defer specifics to the actual compensation plan and that can be fine in most cases. A disconnect can occur when a job description identifies a goal such as profit margin or expenses and the compensation plan has no mention of either.

If the job description identifies major objectives these need to be supported in the compensation plan in some manner. The most basic sales compensation plans have a revenue or unit quota and a commission pool or target commission amount defined.

In the table that follows are a few scenarios and possible options to address them. First here are some definitions of basic commission calculation terms used in the scenarios.

Commission Pool: The commission to be paid when a sales person meets 100% of their quota or target.

Commission Factor: The multiplier used to calculate commissions. It can be represented as a decimal or percentage which when multiplied by the actual revenue results in the commission amount. To get a basic commission factor you divide the commission pool by the quota. For example: Commission pool \$100,000 and quota \$2,000,000. 100,000/2,000,000 = 0.05 or 5%. If actual revenue is \$500,000 (50% of quota) the commission would be 50,000 * 0.05 = \$25,000 which is also 50% of the commission pool.

Quota: The sales goal or target represented in numerical form. It can be units or currency.

Flat Commission: The application of the commission factor on the actual revenue with no changes to the commission factor.

Accelerators: Mathematical function applied to increase the flat commission rate to result in a higher commission over the flat rate. This is often applied to revenue that exceeds 100% of quota.

Decelerators: The opposite of accelerators. These actually decrease the flat commission rate.

MBO: Management by Objective. This usually encompasses non revenue goals. It often includes specific activities than can be considered binary in that they are either completed or they are not. For example: Make 5 sales presentations a month or attend so many product training sessions.

Sales Compensation Scenarios

Job Description Objectives	Compensation Plan Solutions
Achieve revenue goal for all products AND sell $x amount worth of new part # ABC-123	Split the Commission Pool 75% to 25% between total revenue and part # ABC-123. Apply standard commission factors to both quotas AND on total revenue plan include accelerators at 90% and 110% attainment which only take effect once Part# ABC-123 quota is met.
Achieve revenue goal for all products AND maintain profit margin of 15%	Apply standard commission factors to revenue quota BUT decelerators of 5% kick in and stay in until profit margin exceeds 14% AND accelerators of 5% kick in once profit margin meets 15%.
Achieve revenue goal for all products AND make 3 sales presentations to customers per month and document the events. **Note the sales presentations are considered an MBO.*	Split Commission Pool 75% to 25% between total revenue and a MBO. Apply standard commission factor to revenue quota AND on revenue plan include accelerators at 90% which only take effect once all MBO tasks are achieved. For the MBO commission pool 15% is paid for the 1st presentation, 30% additional for the 2nd and an additional 55% for the 3rd.

Figure 1: These are just a few basic scenarios to give you a general idea of what can be done to influence the activities and results of sales people through their compensation plans.

There are countless alternatives to each aspect of the plans outlined above. The commission pools can be split differently and the secondary goal(s) can be compensated differently.

Ideally you do not want to overburden the sales people with so many components they lose track of their priorities. There are diminishing returns as the number of components increase and this comes on fast once you exceed 3 components. For the compensation plans to be effective they need to be challenging yet attainable and measurable.

Conclusion

By aligning sequentially the corporate objectives, sales strategy, job definitions and sales compensation plans you are helping to ensure the success of your sales organization and the corporation.

Since each of these components builds upon the foundation of the preceding one each one is critical to the success of the process. The system is only as strong as its weakest link. A consistent message needs to make its way down from the corporate objectives to the sales compensation plans.

It is often easier to identify when compensation plans are out of alignment by the symptoms they exhibit than it is to tell if alignment is true. Be aware that when sales people are not doing the activities you want or are not generating the results you want these may be indicators of misalignment.

More Information

To learn how **Gilmore Lewis, LLC** can help your organization align your sales compensation plans with corporate objectives please visit our website or call us at the number below.

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