by Dan Apple

Compensating Sales People for Performance

What's the best way to compensate outside sales people? My door dealer clients ask me this question a lot. There are many variables that come into play but ultimately you have to decide what's best for you. I could fill the whole issue of this magazine with information and so called "expert" opinions about this subject. Just Google the subject "best sales compensation methods" and prepare for a truckload of information. Most of the articles outline the differences between the more conventional methods of sales compensation, namely straight salary, salary plus commission, straight commission and the pros and cons of each. If you're the kind of person that loves research, please, Google away. However in this article I will focus only on a single method that worked for me consistently over the years which you may find helpful if you are considering updating your sales compensation program.

Why change?

Like most door dealers we had paid our sales people on a straight salary basis for years. If they had success they got an annual pay raise. If we paid year end bonuses to all employees, they were eligible also. The plan was easy to understand, easy to administer and fair. Or so we thought. The key element we were missing was tying their compensation to sales performance. In many ways our plan was a de-motivator. It did not matter how much you sold in a given month or year, your pay was going to be the same until the next raise came down the pike. So why stretch to do more? While that did not necessarily apply to all of our sales people, it did foster a sense of complacency, which is death to developing a hard charging sales force. So we developed a plan that paid sales people for their performance.

Developing the plan

Our goal for a new sales compensation plan was simple. We wanted a plan to encourage growing our sales at acceptable profit margins that rewarded our sales people accordingly. In the process we had to consider how such a plan would be received by our sales staff.

Not all sales people are the same. They range from superstars to order takers. But we discovered that great sales people are risk takers and are motivated by money, while average sales people are more prone to want to play it safe. The A players love the idea that they have the ability to control their own income through the sales they make. The B players would rather play it safe with their salary and would rather not tie their income to what they sell. You can guess which group would embrace a new pay plan that took off the handcuffs from their earning potential.

We developed a sales compensation program that addressed our goals and was easy to understand. It was a **three-pronged plan consisting of base salary, sales commission and quarterly bonus.** I knew that the more

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complicated the plan was to explain and implement, the harder it would be to "sell" to the sales people. To develop the plan we had to identify our overall sales goal, quotas for each sales person, gross profit margin guidelines by product category and how much we wanted to pay our sales department as an overall percentage of sales. Then we had to establish base pay and commission amounts for each sales person. It was important that we paid the same commission percentage across the board, which allowed us to establish base pay for each sales person which allowed for factors such as products sold, sales territory potential and the sales person's experience and seniority. The quarterly bonus would be paid equally to each sales person for meeting their sales quota and margin guidelines. Here's an example of what this might look like.

XYZ Door Sales, Inc.

Overall sales goal	$4,000,000
Overall sales compensation @ 6.5%	$ 260,000

Sales Staff	Sales Quota	Base Pay	Commission-3%	Bonus	Total Potential Pay
Bob (Commercial New Const & Retro)	$1,500,000	$48,500	$45,000	$4,000	$97,500
Dave (Residential Builder & Retro)	$1,000,000	$31,000	$30,000	$4,000	$65,000
Tom (Entry Doors & Awnings)	$ 700,000	$20,500	$21,000	$4,000	$45,500
Jim (Service)	$ 500,000	$13,500	$15,000	$4,000	$32,500
House Business*	$ 300,000	$15,500	N/A	$4,000	$19,500
Totals	$4,000,000	$129,000	$111,000	$20,000	$260,000

Gross Margin Guidelines	Minimum Margin
Commercial Retrofit	35%
Commercial Service	60%
Public Bid	20%
Residential Builder	32%
Residential Retrofit	40%
Residential Service	65%
Entry Doors and Awnings	45%

• *Sales by inside sales or customer service personnel, not subject to commission, but are subject to quarterly bonus*

The overall sales compensation budget at 6.5% was based on industry averages and did not include things like travel expense or year-end bonuses. We then divided up the sales budget by product category and then by sales person. We then applied the overall sales compensation of 6.5% to each sales person's quota to arrive at the total earnings potential. We chose a commission rate of 3%, which would be a significant amount of the compensation structure but still allow for a solid base pay and bonus potential. We did not believe that a plan based totally on commission would be in the employee's best interest based on our research. Plans based strictly on commission were best suited for outside sales agents rather than employees.

Finally we had to communicate to each sales person the gross profit margin guidelines. While this is understood in all selling circles, it was important that our plan tied commission to profitable sales and we wanted to clearly define what they were, and ensure that the sales person would be held accountable for these. Our program's rules would be clear on

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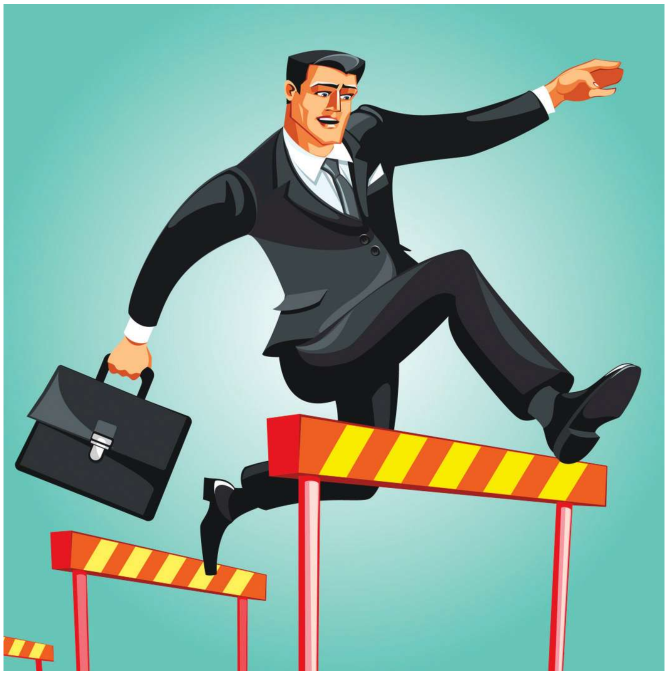
this subject, sales not meeting margin guidelines would not be eligible for commission. Overnight, holding sales profit margins became a much higher priority within the sales group!

Implementing the plan

Once our new sales compensation plan was finished it was time for the most difficult part of the planning….selling it to the sales people. It was my job to show them how this plan creates a greater earning potential, with each person controlling his or her own destiny. In some cases it was an easy sell. But for those who were skeptical or resistant to change, I had to show this as a better deal for them and the company, which consequently would help all employees. The very definition of a good deal is where everyone makes out. We announced the new pay program 60 days prior to the start date. This gave our sales people time to adjust to the idea and allowed me to meet with each person individually to go over it in detail and address their questions or concerns.

Before I approached each sales person personally, I researched their wages for the previous three years to see what they earned and the rate of increase on our salary only plan. I then compared those to their sales for the same period. When I plugged in their sales from prior years to the new pay plan, in most cases their pay would increase, in some cases significantly. For those sales people that fit into this category, the sit down was short and sweet. For those sales people that either remained about the same or even went down, I recognized that their performance would have to improve for them to prosper. Those sit downs were not as much fun and doubled as an interim performance appraisal. This told the sales person the expectations in order for their pay to stay the same or, better yet, increase. All in all, once implemented, most people embraced the new plan and as predicted, their earnings (and our sales and margins) increased. Those that did not take advantage of the new plan were either reassigned to a non-sales job or moved on.



When creating the policy, we naturally had to come up with the program's rules. As mentioned before, maintaining gross margin guidelines was a must. In addition, commissions were tied to the company being paid by the customer. We paid the full commission at the time of billing, assuming the customer would pay us. However, if the sale turned into a bad debt or refund, the commission would be retracted at that time. Finally, we would pay commissions once a month so that a complete monthly sales commission report could be presented to the sales person for review.

Newly hired sales people were given a 6 – 12 month grace period to allow time for training, for his or her territory to develop, and their sales "pipeline" to fill. They would receive a straight salary during this time, and then switch to the commission plan at then end of the grace period.

Monitoring the plan

It was important to monitor the plan on a monthly basis. It was my job to review the sales reports for each sales person to see how they did against quota and how each job's profitability turned out. Fortunately for me, we had great software that gave me a breakdown of each billed sale and its gross margin, by sales person. I would make notes for those jobs that were highly profitable and ask questions about those that did not measure up. I would then share this with the sales person, and give a copy to our accounting department for payment. This gave me an opportunity to discuss the month's performance with each sales person, and was an excellent time to celebrate victories. At year's end I would compare the sales and compensation to the previous year to calculate the rate of change. I would then share this with the sales person during their annual performance appraisal meeting.

Other rewards

In addition to our sales compensation program, I was always a big fan of spiffs (Sales Performance Incentive Fund). While this is more of a marketing expense, it gave me the opportunity to reward sales people for targeted products or services. If we were rolling out a new garage door or opener model and wanted to get them to market in a hurry, we would pay a spiff (cash bonus) for each one sold. Typically the spiff would be in the $25 - $100 range and was limited to highly profitable products or services such as carriage doors or maintenance contracts. Occasionally that would segue into a contest to see who sold the most for the month and a prize such as dinner for two and a movie would be given to the sales person.

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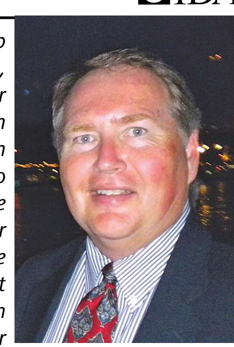
Summary

Compensating sales people should be proportionate to the sales they produce. As I have said before, nothing in business happens until something is sold. That makes sales people the engine that pulls the train. Of course much is expected of them. Typically they work longer hours, have a much higher stress level and are answerable to all departments of the business. They often wear many hats including sales person, administrator, project manager, purchasing agent and often collection agent! That's why they often earn more than employees in other departments. However, their primary responsibility is sales, and that is what their performance is judged on. As the owner, you want to reward this performance accordingly and at the same time grow your business' sales and profits. The rest of the train is counting on them.



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