

sales compensation

planning for a down economy

With the threat of recession looming, the odds are high that your organization will have to make adjustments to its sales incentive plans within the next several months. As you head into the second half of the year, weaknesses in sales forecast attainment, increases in sales costs as a percent of revenue and margin, and anomalies in sales productivity across channels are likely to become apparent in corporate numbers. These weaknesses will be mirrored by the levels of quota and of target-income attainment across individual performance reports. Do you have a plan for action if adjustments are required?

If you are like many managers, you have contemplated the potential need to revise your plans, but do not have a well-defined game plan. While a frequent occurrence, this is a dangerous position in which to be. Operating without a plan runs the risk of inflated sales costs, reduced motivation and

increased salesforce turnover. However, with a small amount of advanced planning, adjustments that balance the need to motivate and retain salespeople with the need to optimize sales costs can be made rapidly and methodically.

This article highlights three steps to help you develop your game plan: audit compensation costs, assess pay versus performance and evaluate goal setting.

Step 1: Audit Compensation Costs

During down economies, all costs receive greater scrutiny, as companies seek to improve earnings in the face of declining revenue. In many cases, sales costs receive undue emphasis, particularly compensation costs of sales (CCOS = total compensation expense/revenue). While focusing solely on this ratio is useful to gain a macro sense for costs, it reveals little about where sales spending is allocated

QUICK LOOK

- Operating without a plan runs the risk of inflated sales costs, reduced motivation and increased salesforce turnover.
- To assess the allocation of sales costs and the relative level of expense, managers must break out costs along multiple dimensions.
- Resets typically are slow to occur, increase in frequency and magnitude, and take an increasing toll on sales representatives' motivation and management's credibility.

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During a down economy ...

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or the appropriateness of these allocations, making across-the-board cuts in CCOS extremely risky. To assess the allocation of sales costs and the relative level of expense, managers must break out costs along multiple dimensions, including changes in the following areas with a down economy:

- Sales strategies
- Geographies/markets
- Products
- Customer segments
- Sales roles.

Segmenting costs along these lines shifts the nature of the discussion

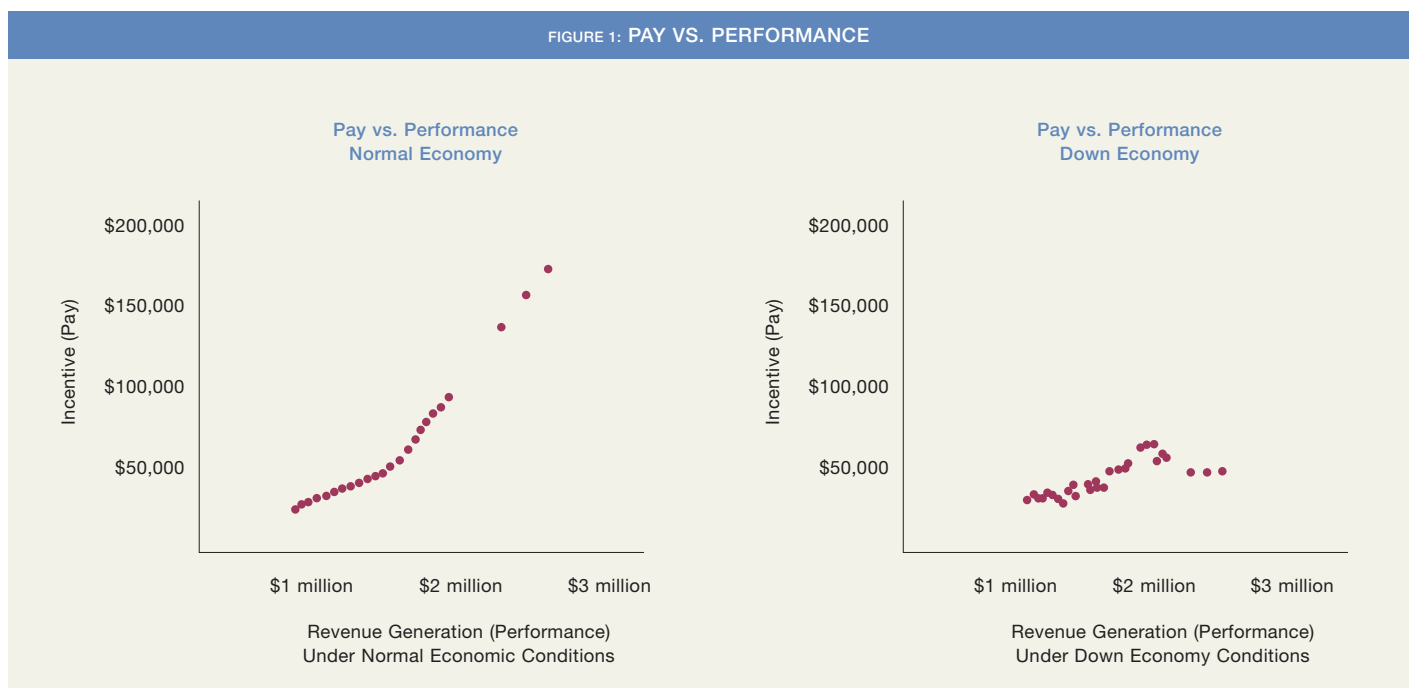
from wholesale cost cutting to cost optimization. A segmented view of CCOS enables managers to debate where and how much cost should be incurred given the changing environment, thereby increasing the odds that strategic objectives are achieved.

For example, an insurance company has just cancelled its plan for across-the-board cost reductions after segmenting its CCOS; the analysis revealed planned cost cuts would reduce the company's ability to motivate new product sales. As a result, managers decided to reallocate costs across several

measures and significantly increase the relative emphasis on new products.

Step 2: Assess Pay vs. Performance

During a down economy, which may upset the relationship between pay and performance by suppressing sales achievement for high performers on an overall basis, it is useful to test different potential performance scenarios in advance and monitor performance on a monthly basis as the year unfolds. This can be done by using a simple X, Y plot of pay and performance, as is shown in Figure 1.



Note: The above examples illustrate two different years of performance on the same plan design. The compensation plan above is a ramped commission plan with two different payout rates below and above an inflection point of \$1.5 million.

Figure 1 shows the distribution of incentive pay versus revenue performance for a 30-person high-tech salesforce across a normal economy and a down economy. The historical review reveals a changing picture. In a normal economy, there is strong relationship between pay and performance in which higher performers make progressively more, and top performers earn significant upside. However, in a down economy, the picture changes, and the relationship between pay and performance weakens — pay becomes compressed, and it appears that top performers make less while lower performers continue to earn similar incentives.

A closer inspection, as shown in Figure 2, shows that revenue performance has decreased virtually across the board, but most significantly in the upper quintile of performance. This decline in revenue performance has caused all but one decile to earn a lower percentage of target income. However, the top three deciles have seen the greatest decrease in the percentage of target earnings earned; performers at or above the excellence point (the 90th percentile

of performance) would earn between 8 percent and 17 percent upside, as opposed to 94 percent and 240 percent upside during a normal economy.

Had the company performed the analysis monthly as the plan year unfolded, it would have been able to make adjustments to spread the decrease in incentive earnings out across the salesforce, reducing the risk of turnover and maintaining motivation among top performers.

Step 3: Evaluate Goal Setting

Even though the motivational potential of compensation plan designs is heavily dependent upon goal accuracy, many companies redesign their compensation plans without assessing or improving their approaches to goal setting. Instead, they assume they will be able to implement a limited number of “timely” resets to goals as market conditions unfold. Unfortunately, this approach rarely plays out well; resets typically are slow to occur, increase in frequency and magnitude, and take an increasing toll on sales representatives’ motivation and management’s credibility.

Alternatively, it is more effective to:

- **Track, report and discuss performance vs. goal frequently:** Frequent tracking, reporting and discussion of performance at the account level ensures that sales and management know where the action is and have the insights necessary to speed up decision-making, which typically languishes in slow periods.
- **Resist across-the-board adjustments:** Across-the-board adjustments to goal are rarely the right answer; they leave revenue on the table and weaken the return on compensation spend. Instead of making across-the-board cuts, managers should make adjustments at the lowest possible level of measurement (i.e., the account or territory level).
- **Set guidelines for intervention in advance:** Setting adjustment guidelines in advance enhances management’s credibility and allows clear management of sales representatives’ expectations. An adjustment threshold of 10 percent to 15 percent is typically a good place to start considering making adjustments to sales goals.


FIGURE 2: REVENUE PERFORMANCE

Percentile of Performance	Revenue Performance (Normal Econ)	Revenue Performance (Down Econ)	Change in Revenue	% of Target Incentive (Normal Econ)	% of Target Incentive (Down Econ)	Change in % of Target Incentive	Upside (Normal Econ)	Upside (Down Econ)	Change in Upside
10th	\$1,002,750	\$1,005,000	\$2,250	67%	67%	0%	(0.4)	(0.3)	0.01
20th	\$1,111,500	\$1,044,000	\$(67,500)	74%	70%	-5%	(0.3)	(0.3)	0.03
30th	\$1,220,250	\$1,120,500	\$(99,750)	81%	75%	-7%	(0.2)	(0.4)	(0.15)
40th	\$1,329,000	\$1,200,000	\$(129,000)	89%	80%	-9%	(0.1)	(0.3)	(0.13)
50th	\$1,437,750	\$1,260,000	\$(177,750)	96%	84%	-12%	(0.1)	(0.2)	(0.10)
60th	\$1,546,500	\$1,413,600	\$(132,900)	111%	94%	-16%	0.1	(0.1)	(0.13)
70th	\$1,655,250	\$1,460,550	\$(194,700)	135%	97%	-38%	0.3	(0.0)	(0.33)
80th	\$1,764,000	\$1,495,200	\$(268,800)	160%	100%	-61%	0.6	0.2	(0.41)
90th	\$1,912,500	\$1,533,000	\$(379,500)	194%	108%	-87%	0.9	0.0	(0.82)
100th	\$2,550,000	\$1,575,000	\$(975,000)	340%	117%	-223%	2.4	(0.0)	(2.42)

- **Assess sales and profit potential:** Conducting account-level assessments of revenue and profit potential, particularly on those accounts that make up 80 percent of the company's revenue and profit, is an invaluable exercise that provides a wealth of insights which can inform goal setting, particularly during recessive periods, when revenue and profit patterns tend to shift.
- **Set year-to-date goals:** Year-to-date goals enable sales representatives to catch up on incentive earnings over the course of the year if their performance improves, providing much more motivation for perseverance than all-or-nothing monthly or quarterly goals. Following these steps allows managers to anticipate changes, make fact-based decisions, set and manage expectations, and maintain motivation, ultimately increasing goal-setting accuracy and ensuring they emerge less scathed from

the downturn. For example, an industrial products manufacturer in 2000 scuttled its plans for an across-the-board reduction in goals in favor of more specific, customer-segment adjustments. This allowed the company to realize a net reduction of 5 percent instead of 11 percent, which was planned under the broad-based adjustment.

Conclusion

Facing the prospect of a recession is clearly no fun. However, as the administrator of the sales compensation plan, HR professionals are uniquely positioned to leverage these insights to develop contingency plans. When designed and executed well, contingency plans not only optimize sales costs, but also motivate and retain sales professionals, thereby enabling the company to emerge stronger and more competitive from a down economy. 

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