

Mid-Year Assessment of a Sales Compensation Plan

By: Jerry Colletti and Mary S. Fiss

As mid-year 2010 approaches, for companies whose fiscal year is the calendar year, it is a common practice to assess the effectiveness of current sales compensation plans. There are three important objectives to accomplish through a mid-year plan assessment, as follows:

- Confirm the message about business direction – strategy and objectives – was received and understood by the sales force
- Validate that behavior and performance are consistent with the sales compensation plan’s objectives
- Identify if there is a need for corrective action; what it might be and who should take action

The purpose of this Short is to discuss three questions that should be asked and addressed through a mid-year analysis of a plan’s effectiveness.

Today many companies are focused on effectively managing the cost of sales compensation within the framework of its compensation philosophy and approved expense budget. With that in mind, at least three questions should be asked and answered through a mid-year plan assessment, as follows:

1. Are sales jobs compensated in excess of established labor market values (e.g., 50th percentile) by design or by chance? And, are the actual target pay levels consistent with the philosophy?

Some companies set their target cash compensation at a level greater than the labor market’s median level and, thus, by design, it is the intent to pay greater than the benchmark. In companies where the goal is to pay at the 50th percentile, too often sales pay levels drift from the labor market benchmark because of inappropriate job pricing practices. Examples of such practices include resetting pay levels based on actual prior year earnings and, mismatching jobs to labor market positions. On an annual basis, analysis is required to confirm

sales jobs’ target pay levels are compared to the appropriate labor market benchmarks.

2. Are unusual pay for performance distributions causing excessive compensation cost?

The optimal performance distribution, for purposes of sales compensation planning, is a normal distribution where 90% of the sales force achieves threshold performance, 60% - 65% achieves or exceeds quota, and 10% to 15% exceeds an excellence/ overachievement performance level. When actual performance compared to target performance produces either bimodal or skewed right distributions, compensation cost is likely to exceed the budget. Often the root cause of this problem is either the annual sales goal (unrealistically high relative to market potential), the allocation of sales quotas (lack of a defined, fact-based process) or both.

3. Are sales reps earning actual incentive pay consistent with the intended design of the plan?

In a plan with more than one performance measure it is a common practice to allocate the opportunity to earn incentive pay across the measures. The challenge, of course, is to insure that a plan’s design directs, motivates and rewards the desired performance outcomes relative to each of the measures. Typically, “linking” mechanics (e.g., hurdles, multipliers) are used to insure that sales reps are performing and, thus, earning incentive pay in a defined, expected manner. To confirm that is the case, analysis of actual earning compared to target incentive is required for each plan measure. The analysis should confirm that actual earnings, by plan measure, are consistent with expectations prescribed by the plan’s design.