

SALES COMPENSATION GOVERNANCE

SALES COMPENSATION DESIGN PROJECT SERIES • ISSUE #2



Sales Compensation Governance

YOUR SYSTEMATIC APPROACH TO PLAN ACCOUNTABILITY

In order to create a world-class sales compensation program, a number of complementary processes and elements must be integrated. These include target setting, plan design, administration, sales structure, reward philosophy, performance management, and sales compensation principles. When incorporated with business goals and sales strategy, maintaining consistency becomes an essential requirement. This reliability and uniformity does not happen by accident. It is the result of development and compliance with a formal and effective sales compensation governance program.

Considerations

The governance program for Division "A" is specific to XYZ Inc. It is based upon a consensus among sales management and organization stakeholders as to what is "important" to the business rather than just creating a bunch of rules to "control" the sales function across and between divisions. In order to make the governance program relevant to all areas of the business the following components must be identified, agreed upon, documented and communicated to the organization:



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1

Governance Values & Purpose

The rationale for why XYZ has a sales compensation program is expressed in the values and purpose of the program. Why do you pay incentives for sales success? What do you hope to accomplish with the plans? Examples of the values and purpose that can be included are:

1. Create an effective sales compensation program that supports the company goals and objectives.
2. Develop consistent practices that identify customer focused requirements, research-based upon current and future needs.
3. Decision-making must be data driven with a customer centric perspective foremost in the criteria used.
4. Dynamic processes that seek continuous improvement.
5. Plans must be fair, treat participants equitably and be transparent to all in the XYZ sales community.

The development of the values and purpose for the program can be undertaken through a reward strategy workshop or drafted following the stakeholder input process. This would bring together business and sales leaders for a discussion session(s) focused on setting goals for the sales compensation program. Deliverables from the session include performance standards and expectations, eligibility requirements, and the expected return for the company compensation investment.



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Guiding Principles for Sales Compensation

The principles that guide the sales compensation design process are critical to ensure that the boundaries within which the plans are designed are clear and understood by both designers and participants. Examples of the guiding principles that form the basis for plan design are:

- The common sales compensation Framework across the company should support flexible approaches that address specific market, customer and situational needs and opportunities.
- Rewards that result in incremental cost must be self-funding through incremental sales and profitability (based on actual performance – individual/group).
- Plans should achieve greater focus on account management and revenue retention, while driving growth through new customers, account expansion, new products and services and one-time sales opportunities.

These are a few examples of the principles, which can also be defined either in a Reward Strategy Workshop or through development of a draft by the core compensation group with circulation to the business units for their input and discussion followed by the approval of management.

Elements of the Governance Program

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The sales compensation program must support the execution of sales strategy as well as the tactics used. This includes both behaviour and activities associated with sales performance. There are many modules that form the structure of a governance program. These are important for XYZ Inc. to transition Division "A" to effectively compete in the future industry sales environment. Some of the components of the program include:

Sales Roles & Structure

This includes the identification of the sales and management roles that are covered by the governance policies and the standards of performance expected from company specific types of selling. It identifies the alignment of roles with the sales and market strategy, sales channels, customer verticals that are part of the go-to-market strategy for the company. An essential element in this component of the governance program is the expected behavior and ethical selling approach used to represent the company with customers. Too often the plan governance focuses on achievement of sales results and internal priorities. Clarity on what types of behavior and sales tactics are appropriate when selling to customers and more importantly those that are not, is important to delivering sales results that respect the relationship and buyer needs.

Competitive Positioning

To compete effectively for sales talent, it is important that the sales compensation program be targeted at pay levels that will enable XYZ Inc. to attract and retain top performers in the industry talent market. This includes the Base Salary, Incentive component and the Total Target Compensation (total of base plus incentive for 100% achievement of targets). Most often this is expressed as a percentile of the compensation market (e.g.: 50th percentile for base salary and 60th percentile for total compensation). These competitive levels will vary by industry and company pay philosophy.

Mix and Upside Potential

To provide sufficient incentive to create a material and motivational incentive environment, it is critical that the mix of base salary /incentive is appropriate for specific sales roles. This provides the reward potential to drive the desired sales behaviour and results. To support performance that exceeds targets, the reward algorithm for overachievement (leverage) should be set to incent the incremental value of additional sales.

Quota/Target Setting and Allocation

This segment is probably the process that is most difficult. Plans that have poor targets create a negative rather than motivational environment. Essential to making target setting accurate and consistent is the transparency of the process, the method for allocating quota to groups and individuals and the process for distributing unassigned revenue when the top down allocation does not align with the bottom up perceived potential. On-going analysis of performance against individual and team/group quotas/targets is essential. An interdisciplinary team (e.g.: Marketing, Finance, Sales Operations, Sales & HR) are among stakeholders that need to be involved. A quarterly session with an agenda that reviews performance status and trends allows accurate and achievable targets to be set and better results achieved. Communication of the process used and the rationale for changes is also paramount for the credibility of this process.

Plan Design Process

Experience and research has shown that the process for the sales compensation plan design each year is almost as important as the change. Frequently, the organization "reacts" to the sales performance the previous year and makes changes for the coming without the benefit of solid research or well thought out performance metrics. Well executed sales compensation plan design processes align to sales strategy, demonstrate assessment of the plan requirements for the coming year (including well defined targets against which the plans can be evaluated). Using good process, active participation by management, incorporating the different perspectives of stakeholders and costing and testing for acceptance prior to implementation are best practice approaches to design that regularly results in improved plan performance.

Approvals and Implementation

Presentation of the plans to management is more than just a rubber stamp prior to implementation (or at least it should be). It is an essential element of the governance process. The approvals need to be made against defined performance expectations, expected R.O.I. for the compensation spend and management's commitment to manage to the target levels in the plan. Failure to meet annual goals is a failure for the organization, its sales management as well as participants. The cost of sales compensation is equivalent to a capital expenditure and it should be evaluated with the same expectation lenses. The implementation requirements from a governance perspective include an effective communications strategy, clear and concise plan documents, policy terms and conditions. This includes process, training, administrative support systems, timing and feedback mechanisms.

Performance Audits & Adjustments

The sales compensation program is first and foremost a communications tool to tell participants what the organization values and wants to pay them for delivering and where to focus their time and selling effort. It should be a dynamic, on-going evaluation process. Performance against plan should be reported on and managed monthly (or quarterly depending upon the sales cycle), reviewed by a multi-disciplinary team quarterly and changes made to maintain focus and/or respond (not react) to market changes or customer needs at mid-year. Dashboards and compensation statements and reports that reflect individual and group performance should be available in real time or disseminated to management and participants in a timely manner, to ensure that everyone knows where they are at relative to performance expectations and managers have the information that they need to coach, mentor and make good business decisions.

The requirements outlined above may seem like a lot of work. It is. Good governance is a lot of hard work. It does however pay out big benefits. It delivers improved individual and sales group performance. It ensures that salespeople and sales management are held accountable for their performance. It also provides the benchmarks against which the plan designs and the overall program are measured to ensure that the money spent on sales compensation is money well invested.

Recommendations

The following are recommendations that will provide XYZ Inc. with a well-thought-out structure within which sales compensation can be effectively managed and evaluated. Accountability for execution of the governance program needs to be assigned to one group, with the participation of stakeholders from various functions (e.g.: Operations, Sales, H.R., Finance, Marketing) along with the responsibility for administration, target setting and plan design. Finance should be primarily responsible for the program and payout auditing of plans at year end to ensure that payouts are consistent with plan design and performance levels. They also have input to the target setting process to ensure that the company achieves its business goals and has an appropriate Compensation Cost of Sales (CCOS).

Recommendations (continued)

1. Assign governance responsibility to one small diverse group with accountability for creating the processes and documentation outlined above for the business.
2. Establish the committee structure to deliver on processes for design, target setting, audit and administration. Document the processes to be used and responsibility for each step in the process.
3. Develop a communications strategy to ensure that these processes and practices are well communicated to the organization and understood.
4. Secure a commitment from management for compliance with the governance principles. Develop a reporting mechanism to identify and document episodes of non-conformance.
5. Prepare documents (or develop internal digital communications) regarding the governance program, expectations and compliance/reviews as well as responsibilities of new employees and new managers. This will ensure clear expectations when individuals join or begin new roles.
6. Determine roles and responsibilities associated with governance issues including approvals (individual and by level) , change management and target setting.
7. Establish an annual schedule with dates and commitments that must be achieved. ◆

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