

## Compensation Planning — Our Sins of Commission

Many of the most perplexing questions facing distribution sales managers today have to do with compensation. How much should I pay sales people? How should I structure the compensation? Should inside sales be paid a commission? If so, on what? Should variable compensation be on an individual basis? A team basis? Neither? Both?

This article promises to answer none of those questions. And you probably won't find the answers in a book either. As someone told me in a seminar, compensation plans are like eyeglasses; everybody needs a something different.

That — at least to some degree — is true. Although your pay plan has to consider the pay scale for similar skill sets and levels in your area, its most important reference point is what your company needs — its goals and objectives. And it's doubtful that your goals and objectives are exactly like anyone else's.

There are, however, some things that you can say that are true about compensation generally, and about performance-based compensation specifically. One is that a properly designed performance-based compensation program communicates your company's objectives to your employees in a powerful way. The second is that there is no one in your company who cannot have at least a part of his or her income based on specific performance.

Those are the positive and general truths. Equally important are the following four negative and specific ones. These are the root cause of the failure of many compensation programs. They are the sins of commission.

Experience shows that compensation programs are doomed to failure if we:

- Fail to empower our people for success.
- Pay them for the wrong things.
- Forget that there is more to compensation than money.
- Try to be too thrifty.

We'll look at each of these a little more closely, but first there is one fact of compensation life that is basic. Every successful compensation program must satisfy three constituencies. The first is obvious; it's the employee. The employee must perceive that the compensation program meets his or her security needs and offers at least a chance of prosperity. The second is functional management; the sales manager (or warehouse manager or any other manager) must believe that the compensation program will focus the employee on the goals of the functional area and provide motivation to attempt to reach those goals. And, finally, there's financial management who wants all of this to happen without increasing expenses.

To have a financial plan that works, you have to have the expressed approval, preferably with enthusiasm, of all of the above.

### **1. Failing to empower our people for success.**

The traditional attitude toward compensation in distribution was "a day's work for a day's pay." The most forward-looking objective was to set the pay scale where it would attract and retain good employees. Management set the pay scale, and if an employee got a raise, management gave it to him. Financial success was squarely in the hands of management.

Less than 30 years ago Fredrick Herzberg was writing that money was a “hygiene” factor, and not a motivator. But even 30 years ago that was contrary to the experience of many of us who worked as or with commissioned salespeople. It seems more likely that money is not a motivator if there is not a direct connection between the efforts of the employee and the monetary reward. We make money a motivator when we empower our people to create their own financial success. In other words, their success is in their hands, not management’s.

This means that the compensation program has to be *perceived by the employee* (note the emphasis) to be understandable, doable, and potentially successful on a personal level. This immediately eliminates compensation plans that take a dozen single-spaced pages to explain or that set the bar for reward so high that nobody sees the possibility of reaching it. It also eliminates those programs, common to distribution, where the incentive is so small and payday is so far away that nobody takes it seriously.

## **2. Paying them for the wrong thing.**

Probably the most important question you have to answer in creating a successful compensation plan — even more important than “how much” — is “what do I pay them for.” Performance-based compensation, the only kind that really motivates employees, has to deal with the type of performance that moves your company toward its goals.

One client created performance-based compensation for his inside salespeople based on orders entered; they were paid a small commission based on the dollar totals of the orders they entered during the pay period. The result was an emphasis on entering orders and those things that most efficiently got the inside salespeople orders to enter. They hovered around the fax machine like vultures. And they certainly didn’t want to talk to an actual customer

who might or might not place an order. The plan, though well intentioned, was actually detrimental to customer service.

For more than a hundred years we have paid most of our people a salary, essentially paying them to show up. And too many of our people do just that; they show up, do what they have to, collect their pay and go home.

The first question you need to answer when you are creating a compensation plan is “what do I want these people to do?”

One company focused its compensation plan on increasing gross profit and emphasizing a number of new lines. Another wanted to focus on growing business with current customers. And still another wanted the salespeople to stop babysitting current customers and find new business.

Keep in mind that people do what you pay them to do. And unless we develop our plan carefully, that may be the worst thing that can happen to us.

## **3. Forget that it’s more than the money.**

Several years ago, a large distributor rolled out an outside sales compensation plan that was by almost any measure generous to a fault. It was going to increase selling expense significantly. But less than two months later, they had to roll it back in. The sales force wouldn’t buy it; in fact they lost several good salespeople. Simple math would have told the salespeople that the new plan paid them more money for the same effort. But they never did the math. They focused on a single point; the new plan eliminated their expense accounts. It didn’t matter that they could have paid for their customer’s lunch and bought their own gas, and still had a larger net. What mattered was that the company had taken away something that they considered important

Another company spent a considerable amount of money creating a compensation plan, but refused to give it to the employees in writing. The branch managers presented it in the sales meeting, and if they were asked for a written explanation, they had to refuse. Nobody knows whether this plan was a good one or not. It didn't last that long.

There are two points to keep in mind here. The first is that employees should be included in some stages of the planning to prevent management from making obviously dumb mistakes. The second is that the rollout of the plan is as important as the numbers in the plan. It should be a full and enthusiastic explanation of how this new plan gives them even greater opportunities for success.

#### **4. Being too thrifty**

Good compensation planning involves reconciling two seemingly contradictory objectives. The first is to pay our employees such that they can achieve even greater financial success. The second is to do that without increasing our expenses.

Actually, this can be done. If we're paying them for the right things and in the right way, their increasing success will result in even greater success for the company.

Unfortunately some people enthusiastically agree with that — up to a point.

The distribution industry is full of plans with commission caps, decreasing commissions on increasing sales, and the vigilant eyes of management checking to make sure that nobody below them makes more than they do. There are also true stories of territories being cut or accounts being reassigned just because somebody was making too much money.

In technical terms, these measures are called demotivators or disincentives. In non-technical terms, they are called stupid.

Keep this in mind: if you have designed your compensation plan properly, *there is no such thing as too much money*. If salespeople through their skills and efforts make more than the owner of the company, don't attempt to cut their commission, territory, or income. Give him a bonus, and put a plaque in the lobby. That's the type of thing that makes money a motivator.

One of the great rules of compensation is that you can make more money worrying about how your people can make more money than worrying about how you can make more money.

You may want to retain a compensation specialist to create your new plan for performance-based compensation for the sales force or the warehouse staff or inside sales. Or you may want to tackle it yourself. If you decide to do it yourself, be careful not to sin against your employees' paychecks. They probably won't forgive you.

#### **Making Pay Pay: A Fictional Scenario**

After only two weeks Jim Friday was already wishing he had never taken the job. He had wanted to be a sales manager, and Oakly Supply was a good mid-sized, well-established distributor in a nice mid-sized city. It looked good from the outside.

However, the view was different from the inside.

As Friday went over the sales reports he saw several things, none of them good. One was that the sales volume was gradually declining and had been for the last several years. The second was that the salespeople weren't bringing in new business. The third was that several of the salespeople were in the precarious position of having a single account that made up a third or more of their gross profit. If one of them took a hit on his

big account, neither the salesman nor the company would live nearly so well.

At the end of the first week Friday had held a sales meeting and tried to generate some enthusiasm for actually selling and letting the experienced inside sales staff deal with most of the day-to-day orders. He had asked for the sales staff's input and had received some half-hearted responses. The only useful thing that came out of the meeting was a passing comment made by one of the senior salesmen. As he left, he stopped and shook Friday's hand. "Good luck," he said, "I just can't get real excited about working more for less. I'm doing all right."

That was a clue. Back in his office, Friday discovered two things. The first was that most of the salespeople were "doing all right." They were achieving their financial objectives without worrying about the company's. The second was that the complicated pay plan actually included diminishing commission percentages as gross profits increased. Theoretically it appeared that a salesman could sell so much that he wouldn't make any money on the sale at all.

As he stared at the sales reports and at the six single-spaced pages that explained the sales compensation, he began to get the beginnings of an idea. He took out his legal pad and began to make notes. First, he would have to fix it so that nobody did "all right" if they weren't contributing to the company's objectives — which probably hadn't been communicated very well anyway. Second, their reward should be in direct proportion to their contribution with maybe a generous bump when they contributed real well. Third, he had to make sure that they had the skills and tools to succeed under the new plan.

For the first time in two weeks, he had a glimmer of hope. Compensation could focus them on what the company needed.

Now all he had to do was determine exactly what he needed them to do and how to pay them to do it. And he had to make sure that whatever he did, he could sell it. The ultimate goal was not to change the plan. It was to change the behaviors of the sales force.

*Chuck Holmes is president of Corporate Strategies, Inc, a company specializing in helping manufacturers and distributors grow their businesses.*