Setting Sales Targets & Commissions

10 Top Tips for both Targets & Commission

"Motivate – Perform –Recognition/Reward"

I am frequently asked what is the best way to structure targets and commissions for Sales people? And the answer is usually "it depends". There are many variables depending on the business context but the one constant is the goal, "To achieve the best sales performance from the individual at or above the target". The other important consideration is that it's a continuous process not a periodic event.

Target Considerations

- What does the business need to achieve?
  - Total units sold, total revenues, revenue run rate, total profit, profit run rate
  - How does it all add up as regards Sales people and channels?
- Sales person motivation focus (Units, Sales, Revenues, Gross Margin, Net margin etc.)
  - Is it one of the above or a mix? There is no point in having great unit or revenue performance if the price does not deliver the target profit.
- What flexibility does the Sales person have in pricing?
  - Have they the skill, structure and controls to allow flexibility in structuring a deal, while still achieving the targets.
- What is the cost of the sale? Is it low cost? Perhaps it's standard product on-line selling , or potentially high cost custom selling with long cycles and needs pre- sales support people?
  - Can the sales person control the cost of the sale?
- What is the starting situation for the target period for the Sales person? and overall
  - Backlog:- contracted and to be recognised
  - Named, Quantified & Closing
  - Qualified
  - Un-named and un identified at present
  - Run rates and historical profile
- What is the performance history for the individual?
  - Against previous targets
  - Relative to peers and others
- Belief
  - Do you believe the target is ambitious, achievable, and appropriate?
  - Does the Sales Person believe?
  - Do other stakeholders believe?
- Involvement, Engagement & Commitment
  - We all know that the more ownership and accountability the individual has in setting and meeting targets, the higher the motivation and the more chance of success.
  - That said there is a need to ensure alignment of the individual's goals and the needs of the organisation.
- Management of expectations

    - It’s a two way process, experienced sales people will want to please and perform and will use the target setting process to control and manage expectations. That said management will also be using the process to set and manage expectations. So long as the process is open, transparent and based on facts a positive outcome is likely.
- Setting of targets is a reasonably scientific process, create the evidence that science was used.
    - Base it on sales drivers and engineer up to the target financial numbers.
    - Sales & Marketing activities create leads, sales activity/process qualifies leads, qualified opportunities convert to sales contracts and revenues, conversion rates can always be improved.
    - Frequent measurement and review
- Get the targets sorted before finalising the commission and commission structure

The same thought process applies to the eBusiness/on-line world. Of course you have to consider the roles that the sales person carries out. The level of self service and automation will determine the nature and type of human interventions, relative targets and commission structure?

eBusiness considerations

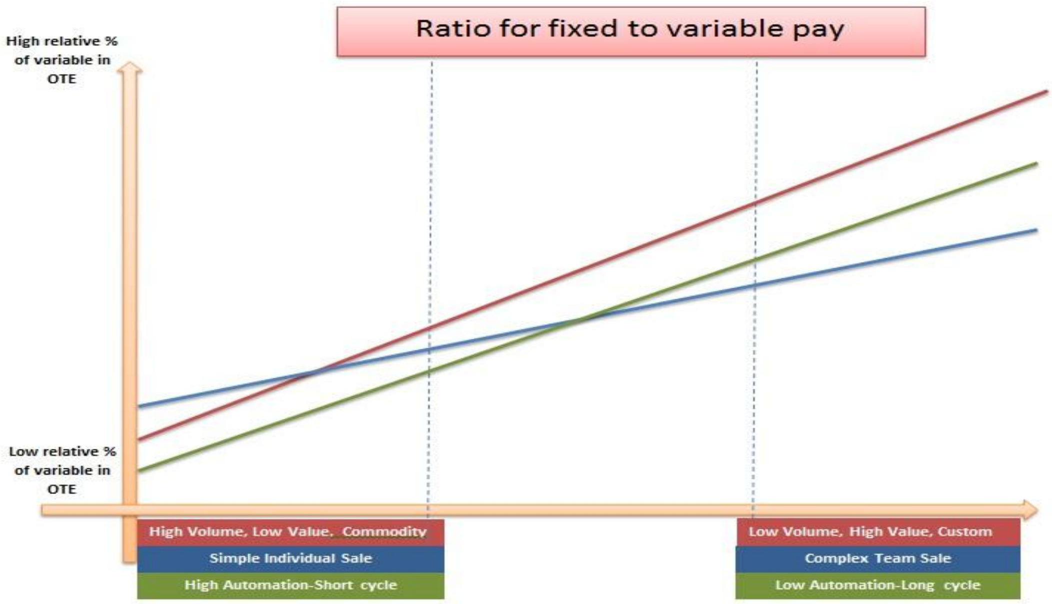
- Marketing interventions will be designed to drive traffic to the Web-site, these are the leads, so here are some related metrics that might need to be considered:
    - Visits to pages, number of pages, time on site, navigation, enquiries
    - Source of traffic and performance of interventions in driving the right traffic
    - Conversion rates.
- Once someone lands on the site, the Sales objective is to help them make a positive purchase decision, qualify them in/out and ensure they have a good experience. Depending on the scope and role of the Sales person, there will be different influences
    - Changes to web site that lead to increased sales and conversions, these can be calls to action, navigation content.
    - Live chat and help which are real-time support for the client to make the purchase decision. (Knowing there are real people behind a web site improves the buyer experience)
- Again some of the drivers and target KPI’s may slightly differ, but the end result will be the same customer revenue and profit, where customers could be subscribers, advertisers, affiliates etc.
- Depending on the nature of the eBusiness model , volume, price and standardisation, there could be a daily , hourly focus on activity and performance, with commission plans linked to the different purchase type’s e.g. standard service versus premium subscriptions. Contact centre type eBusiness sales structures will often have high volume , repetitive processes that can adopt this type of approach.
- Where there is a human sales intervention such as a live chat, you can directly relate specific sales performance to the sale and conversions can use more traditional sales targets and commissions.
- As you move up the value chain in eBusiness, often the model on-line is designed to focus on creating qualified prospects and the commercial engagement and exchange only starts once there has been a capture of information and then there is human intervention. This

intervention may be from a remote office/centre but requires customer proposal and selling to each client. Again the more traditional Target and commission model may be best.

Commission Considerations

There are several considerations when looking at the variable pay element.

- Not all individuals are motivated by the same things, its often assumed for sales people all they need is a good commission, though in general many roles and individuals require that money drives and motivates , it's not always the case, many sale people are driven to be recognised internally and externally for their success as much as the financial rewards.
- Variable pay influences behaviours
    - You need to ensure they are the correct behaviours when setting the structure and the amounts.
- Fixed versus variable pay ratio.
    - Normally I recommend that the fixed element must as a minimum provide a basic living capacity for the individual if they are a permanent employee, it must be sufficient that there are no distractions caused by the level of fixed income apart from those normal labour market forces
    - Variable can be up to 60% of OTE, where the fixed and OTE are the market norm at least.



- Commission & Business Model
    - Your business model describes how you make money at a unit and organisation level, you must take into account commission/variable pay when considering both to ensure you achieve the target margins after all costs.
    - Setting the commission rates must include the deduction of commission as a direct cost of sale to ensure that after commission the gross margin for the sale is within range.

    - Financially you need to accrue for commission regardless of when it is paid.
    - Analysis of Gross Margin will influence the level you set for commission rates
    - Beware of commissions that wipe out margins, I have seen this happen
- What should I commission Volume, Revenue or Margins?
    - This really all comes down to how your business and business model are structured, coupled with your pricing model.
    - Volume is often used where there is well controlled prices and unit margins and the sales person has limited influence on the financial performance other than to move volume, it can also be used as a tactic to clear stock, use up capacity or accelerate market penetration.
    - Revenue is most often used where the sales person can influence the price for the sale but has limited impact on the direct costs.
    - Gross margin is most suited to situations where there is flexibility for the sales person on pricing and where also the deals they do can influence direct and/or indirect costs (Though Loaded cost GM is best if indirect costs are impacted)
    - There are situations where some combination is required to achieve balance in the overall performance, or trigger points and scales of commission, for example unless the GM hits a threshold regardless of revenues no commission is paid, above a threshold a defined % of revenue commission is paid, and/or a sliding scale depending on the GM.
    - Use thresholds, there is always a minimum performance standard, until that is achieved the individual should not be rewarded, above it sliding scales can be considered or just standard commission plans.
    - Good sales people also have to meet certain business and organisation performance standards, we often make exceptions here "He/She is a great seller, closes the most deals", but she/he may be poor at administration or CRM and that presents a long term risk for the business. I have indicated earlier that Targets and Commissions should be an integral part of the overall performance management system in the business, so for example grades, base salary scales and the annual appraisal may be the tool to motivate the sales person performance in the other non-commercial performance areas.
- Commission only
    - A commission only structure has a very high motivational value for certain individuals and circumstances, however as a long term sales strategy it can have detrimental effects in that peaks and troughs in sales success for the sales person can lead to income insecurity. Of course the advantage for the business is that they only incur Sales costs when sales are closed.
    - They can be used when looking at short term sales capacity increases for contract sales persons, or perhaps in trial or probationary periods.
- Commission Reviews
    - As mentioned at the start, the Sales incentive and target activity is a process , not a periodic event, so it is necessary to have scheduled and frequent reviews of performance against targets, and commission earned, and/or paid.
    - One important feature of every review is alignment, most sales people will know exactly what they have earned and are due and will bring that information to review

meetings. Management must also have independent, objective and detailed records of commission earned and paid and often there will be differences of opinion. Use the process to help the sales people proactively come to alignment and eliminate these different opinions.
    - Sometimes there is a need to adjust a variable pay/commission plan within a period, it can be a significant shift in the business, role, and focus, be willing to consider this but it must be exceptional and/or justified.
- Document performance and payment plans
    - A good performance management process will align the Sales Targets and commission plans with the annual performance management process for the business.
    - The Sales payment structure will also need to be integrated and aligned with company pay and benefits policy
    - Ensure the policy, process, metrics are documented and well understood, and review periodically.
    - Business strategy and context is dynamic , so be prepared to adjust the policies , procedures and formulae periodically. The best time is annually and in line with annual planning. This recognises that the market conditions may have changed and/or goals for the organisation adjusted, perhaps a move from revenue to profit focus or from hunting to farming.
    - Document in detail the specific variable pay plan for each individual for the period, normally annually.
    - Targets & commissions have a strong link between the sales process and the financial process, there needs to be one keeper of the standard and process. I normally look to the CFO and his finance department to be the keeper of the record, reports and final arbitrator for payments of commission. Their job is well regulated and they are experts in accounting , they are also supposed to be independent financial experts supporting a business and therefore they provide the financial information for all decisions including commission earned and paid. So it is important that they are a stakeholder in the overall process and the sales people accept that their information and accounts are the basis for any commission payment , not arbitrary spread sheets provided by anyone else in the process.
- When do I pay commission
    - Again this will depend on the nature of the business but in most cases the following should be the main considerations.
        - Commission cycles, can be from weekly to annually, the nature of the business and the Sales role will determine. Large deal, long cycle sales usually have longer payment cycles and also higher variable pay percentages. In this scenario you must also consider the relative amount of the fixed guaranteed salary, quarterly commission payment are not unusual. Short sales cycle, normally with low value, high volume will often have more frequent payments usually monthly. Telesales is an example where this may be the case where the base sales person experience and salary are relatively low as is the percentage commission.

- The commission cycle must allow for accurate calculation and validation of commission , so there will be time required after the sales accounting period to calculate. Some organisations just offset periods , so it's a payment in arrears.
- When is commission due?
  - The Sales person has not completed their performance until the cash has been received to the organisations bank accounts, so I usually have this as criteria for payment of commission. It also motivates the sales person to ensure the quality and creditworthiness of customers is well considered and bad sales are avoided.
  - Again there are circumstances where it would be unfair to base payment on cash received, particularly where terms and conditions or contracts have payment cycle that do not align with value created.
  - eBusiness related commissions can usually be paid promptly and on a more frequent basis as most business models are cash based , in that the product/service is not delivered until the on-line payment is received.
  - The primary commission period is often the annual business cycle, but sometimes it may be more frequent. The target goals are usually to achieve some Sales financial targets over a year, however these targets may be broken down into shorter periods (recommended), such as weekly or monthly, sometimes daily in high volume repetitive selling for low value commodities. The overall Sales plan for a sales person will take into account the context and nature of the business to build up to achieving the overall annual(period targets).
  - The primary target and commission period is important, because that is the key performance and payment goal. That said you are probably paying commission more frequently, therefore the commission plan/contract needs to be clear that the final commission for the year/period will be paid on the basis of reconciliation once the period has been completed. This means that there is a balancing adjustment integrated into any final commission period payment. This could be a deduction or in worst case a repayment, in the circumstances where the final commission payment performance was poor and earlier periods were reasonable but overall primary period performance when reconciled requires adjustment or repayment.
- How long do I pay commission?
  - Sales people can win business that has multi-year revenue income for the organisation, the question regularly arises should the Sales person receive commission for the life of the customer, contract

and/or project. The answer again is “it depends”. There are several considerations:-

- Does the sales person make an active and on-going contribution to ensuring the customer revenues and satisfaction is realised? If their role is such that they do then there is merit in considering the period.
- What is their Sales Role and objectives, are they hunters good a surfacing out new customers and new sales, or are they farmers (EG account managers), where they are good at generating more business from current customers. This of course opens up the discussion on how you organise Sales and Sales roles which is another day’s discussion.
- The other question that comes up is Hand-over of customers/accounts, this could be the handover from a hunter to a farmer (new business acquisition to account management), or handover to a new Sales person because of some form of re organisation. It’s very difficult to set hard and fast rules but I always base line it to who assured and collected the cash during the commission period.
- Whatever approach you use it’s essential that the team understand the rules and the roles and when they earn and lose commission.
- Some techniques that can be used include:-
  - Declining commission rates over a period to a stop point.
  - Having a team commission target as part of the overall commission plan where it is recognised that there are circumstances where compromises have to be made, or team members need to help each other.

- Guaranteed commission
  - There are sometimes circumstances where commission is guaranteed for a period, thought my recommendation is to avoid these scenarios, it may be prudent to consider in certain circumstances such as:-
    - A new start sales person, may need some adjustment to allow for training and ramp to productivity.
    - A Sales person may be asked to take on a specific project or assignment that could impact their ability to achieve their target and/or commission.
- Commission accelerators, bonuses & caps
  - Accelerators are often used to increase the commission reward for sales people once they have achieved the target performance, they act as an incentive to exceed the targets and reward exceptional performance. For example if their revenues and/or gross margin

performance for the period exceeds a stretch target their percentage commission increases. Again I stress there should be a financial analysis before setting accelerators so that the incremental cost/payment to a sales person represents a fair reward for the incremental bottom line performance for the business.

- Bonus payments are often used to additionally incentivise specific behaviours and performance. These are often in addition to the standard commission plan. For example a new customer bonus can be common , where the overall goal of the business is to secure new customers. Renewal or new project bonus where the incentive is to increase business from current customers.
- Competitive bonus is often used to motivate the individuals and the team to achieve or excel in general sales performance or specifically in an area that is a focus for short to medium term in the business. For example the launch of a new product may have a competition that the first sales person to secure 10 customers with a value of over $100k wins a prize.
- A cap is a maximum that can be earned in a period regardless of performance. Caps can be emotive and cause incongruous behaviours. That said no caps can also cause financial issues and disappointment if future performance is lower than an exceptional year and the sales person feels their income has dropped. Personally I favour caps, with the discretionary option for senior management to make an exception or alternative type of reward/recognition.

Target setting process

Manager's side

Remember the manager/leader will have to go through the process themselves as part of an overall management process, and the challenges and opportunities are similar for the manager as they are for the sale person. Human nature will be to under commit and over achieve, however the process needs to be designed and executed in a way that the objectives and desired behaviours are aligned. Assuming the product/service is addressing an available market with some advantage and the information and supports are available to be successful then yes we can say "it's a numbers game".

The Sales manager will/should be part of the team that sets the business units strategy and goals, he or she then takes responsibility for the Sales function and Sales KPI performance. The Sales manager will seek alignment between his personal and functional targets and those of the board or governance structure.

The agreement of the overall sales targets will be a negotiation, where there will be trade-offs on both sides until an ambitious but achievable set of performance targets are agreed that are a stretch but also that motivate the Sales manager to exceed expectations.

Because it's a numbers game for the manager, he or she will want to prepare the data/evidence that supports the targets they will commit to. Some considerations will be:-

- Marketing activities and KPI's, as marketing will be driving traffic-potential leads or actual leads to the sales process whether it's an on-line or human process.
- Market dynamics and competitive advantage over the target period
- New products/services to be launched in the period
- Current customer opportunity versus new customer acquisition
- Structure, capability and performance of all sales resources, direct, indirect ebusiness and traditional selling.
- Sales partner and channel dynamics and drivers
- The current backlog and pipeline profile

So having considered the above the manager will have a starting point which he/she then can apply the maths. Resources, Activities, Formula, Likely results.

The manager then analyses any gaps between what they can commit to and what they are being asked then tweak the strategy and plan to find alignment through the negotiation process.

On completion the manager will not only have agreement in principal on the overall target but also have a starting point to formally agree targets for each Sales resource, backed up by data

Generally it's not a serial process and if it is a serial process it has potential to create a squeeze point where targets are agreed at the top but they do not add up from the bottom, this can lead to enforced targets which are demotivators or re negotiation and inefficient management process

For the Sales Manager I recommend that the process kicks off initially with an initial headline process, where the manager reviews all the numbers and likely expectations and in parallel secures an input from the Sales resources on their initial thoughts around targets for the next period. It helps that sales resources feel they can influence the overall goals for the business also. The manager may have informally tested with the board or CEO what the early thinking is about targets for the next period and use this to set a framework for his team to produce their inputs.

The Sales Person.

Ideally you want your sales person to carry out a similar process of engineering up their targets from activity drivers.

Kick-off meeting

It's important that you communicate to the person the purpose of the meeting in advance and request them to bring along their KPI's and initial thoughts for the next target period.

During this meeting you should cover the following.

- Review of performance against targets for the previous period , broken down by the agreed time periods, segments, products, clients etc.
- Review of the current pipeline and discussion of likely pipeline starting the next period.
- Discussion on successes and losses , what worked well and what did not.

- The persons view on what the likely targets should be for the next period, why? And how they would plan to achieve these.
- You present a high level view of the organisations goals and KPI's for the next period along with the likely contribution from the Sales function.
- Discuss any changes in approach and/or priorities, new products, new supports, new focus for KPI's
- Set out in broad terms your expectations and target KPI's for the next period for the individual and ask them to review and consider all the information and develop the first formal proposal for the individual's targets for the next period and the data to support those proposals.

Remember for every individual sales person there is potential to have a different target, but this must be justified so that any external stakeholder to the target setting process would accept the differences. That said where there are very similar roles with very similar dynamics and markets a minimum general performance standard is likely to be needed.

Target review meeting 2

During this meeting you are trying to achieve consensus and alignment, so there is a gap. It's likely that you as the manager will want to achieve a target that is above your basis target for each sales person in-order to have some passing power , should there be a poor performance in some parts of your sales resource structure, this incremental increase combined with all resource increments is your passing power, or risk mitigation strategy, it's also what potentially allows you to exceed your commitment for the whole group.

What you are seeking in this meeting is that there is a mutual understanding of the basis for the numbers presented by your sales person and adjust activities and approach so there can be a consensus.

You may for one individual agree a target that is below what you planned because of their segment context e.g. a significant change to the customer segment spending powers they service as an example. However you will be making up their shortfall with some other sales resource who will have a target greater than planned or expected.

Watch out for "The low ballers & the over confident/optimistic". Remember you may not always be negotiating up.

At the end of this meeting there should be agreement that the Sales person will now prepare a final set of target KPI's that meets an agreed set of numbers, and both parties are satisfied.

Penultimate meeting

This meeting closes out the actual targets and starts to drill down into the commission aspects

KPI's

Commissions

Bonuses

Thresholds

Sliding scales

Caps

The measurement process

Payment terms

Reconciliation process

The final meeting

As the process may be iterative and parallel with the total business target setting, until the board – governance structure has agreed, approved and signed off the overall targets and rewards, you cannot finalise with each Sales person.

Finalising is about signing off the annual performance and commission plan and issuing a formal letter.