



Sales Compensation Plan Components

Pay your sales reps what's fair and what they earn

A sales compensation plan cannot be developed carelessly if sales reps are to be properly motivated and compensated. We find that many companies have ill-defined, confusing and generally inappropriate sales compensation structures.

It is important to create a sales compensation structure that motivates sales reps to higher levels of performance. It is also important to allow sales reps to earn compensation as a direct result of their efforts without crippling their ability to meet their monthly obligations. In other words, pay sales reps well by creating incentives to achieve higher levels of sales, but provide a safety net that is not too high or too low. This can be a challenging task.

There are essentially four possible components from among which to choose in developing your sales compensation plan; salary, commission, bonus and sales incentives. I believe that a well constructed sales compensation plan can include all four components.

If you opt to pay your sales reps a base salary, try to keep it low enough to allow room to create sufficient incentive and motivation, but high enough to give your reps some breathing room in meeting financial obligations. Generally a base salary will fall somewhere between 15 and 40 percent of total compensation. Obviously as a sales rep becomes more successful, the percentage of total compensation will fall. Therefore, a rep whose base salary represents 40 percent, for example, of total compensation in the early months of employment might end up with 15 percent of total compensation made up by salary after a period of time. Some organizations provide a training or "greenhorn" salary that is initially higher and is reduced over time to allow sales reps to get their customer base established and sales volume up. The thinking here is logical and acceptable since the sales reps won't be worried about paying bills in the early going and can focus on selling and building relationships.

Some organizations prefer to base sales compensation on straight commission. The thinking here is that a straight commission structure allows reps the opportunity to get out of selling exactly what they put into it and the reps can directly correlate their activity with their compensation. And to some extent this line of thinking has some merit. However, a straight commission structure can be a disincentive for some potentially outstanding sales reps to join an organization. In most cases, it takes some time to get to a level of sales that provides an acceptable level of income. Therefore, in the early months or years of a rep's tenure with the company the income level is often not sufficient to meet the reps' monthly obligations. This can be a distraction and an incentive to give up. Some will argue that if the rep gives up they didn't have what it took to make it anyway. Some industries such as the insurance and brokerage industries have made it virtually standard practice to offer a straight commission structure. And they have been successful in doing so. But, there are a number of industries where this type of structure simply won't work.

I believe that, for most industries, commissions that make up a part of a broader sales compensation plan tend to work better. Commissions can be based on sales or gross profit. However, be careful not to provide commissions based on sales whenever the sales rep has any control over pricing. Sales reps are human and commissions based on sales only invites price reductions to make the sale. In some cases, the price reductions can be too deep leaving the sales rep with commission, but the company with little gross profit on the sale.

In a plan that involves several components, commissions should make up the biggest part of total compensation. Generally, this will range up to 80 or 85 percent of total compensation. A well balanced plan will have commissions making up in the neighborhood of 65 percent of total comp.

Adding a bonus structure to a sales compensation plan can add incentive to reach new levels. Generally speaking bonuses should be paid at quarter or year end for meeting or exceeding sales goals, for reaching certain target incentive levels or for some other specific, measurable reason. As an example a bonus structure could be set up to pay \$5,000 for reaching a certain level of total sales, \$7,500 for reaching yet another level, \$10,000 for reaching yet another, and so on. Be careful not to add too many levels. It will simply complicate the plan. Also, make the bonus big enough to incent reps to want to hit each level. One interesting approach is to create a wider gap between bonus levels and make the bonuses cumulative.

The final component that can be included in a sales compensation plan is sales incentives. These are generally non-monetary incentives such as trips or gifts. These are often associated with sales contests, but can also become a part of a sales compensation plan. Incentives are best used for achieving short-term results. The incentives selected should be significant enough to get sales reps' attention. Incentives that aren't attractive are not worth offering. The offer will fall on deaf ears and won't provide sufficient motivation to stretch to higher levels.

Putting a sales compensation plan together needs careful study. Run a sensitivity analysis to assess the impact on sales rep compensation and company profitability at various levels of sales. It is important to build a plan that is simple, straightforward and easily administered. Avoid complicated, confusing plans at all costs.

Good luck and good selling!

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