Implementing a Performance-Based Sales Incentive System

Northeast Gas Association Sales & Marketing Conference

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What we will cover today

1. What makes for effective sales compensation plans?
2. Unintended consequences – what can go wrong?
3. Keeping on track – ensuring you maximize the returns on your plans
Willis Towers Watson: Who We Are

We have 40,000 employees serving 140+ countries.

We’ve been putting clients first since 1828.

We work with 90% Fortune Global 500, 92% FTSE 100, 89% Fortune 1000, and 1000s of non-Fortune-listed companies.

And 1000s of non-Fortune-listed companies.
Willis Towers Watson: What We Do

Integrated offering around people and risk

- Investment, Risk and Reinsurance
- Corporate Risk and Broking
- Human Capital and Benefits
- Benefits Delivery and Administration

Broad Appeal to Clients Worldwide
Top performing sales forces consider the entire spectrum of how talent is managed.

Sales compensation is an important driver of sales success – but it is not the only one.
Why do we have sales incentive plans?

**Incentive Compensation Objectives**

*Attract and retain*
- In turn, positive impacts on customer experience – more continuity
- Higher employee retention
- Better employee engagement
- Higher recurring revenue, better business results

*Focus effort*

*Motivate performance*
- More positive customer experience, higher satisfaction levels
- Higher customer retention
- Higher product utilization
- Deeper relationships/more cross-sell activity

**But there are two fundamental requirements**

- The job must directly interface with customers and influence buying
- Must be able to measure this impact
What makes for an effective sales compensation plan?

<table>
<thead>
<tr>
<th>Outcomes of Effective Sales Compensation Plans</th>
<th>Means of Achieving</th>
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<tbody>
<tr>
<td>I. Reinforce strategy and desired behaviors</td>
<td>Performance measures</td>
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<tr>
<td>II. Reflect the nature of the sales role in compensation</td>
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<tr>
<td>▪ Eligibility</td>
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<tr>
<td>▪ Pay mix</td>
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<td>▪ Incentive form</td>
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<td>III. Maximize motivational impact of incentive earnings</td>
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<tr>
<td>▪ Pay distribution</td>
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<td>▪ Pay differentiation</td>
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<td>▪ Pay and performance correlation</td>
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<td>IV. Support top talent attraction and retention</td>
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<tr>
<td>▪ Competitiveness of total compensation</td>
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<tr>
<td>▪ Internal pay equity</td>
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<td>V. Govern plan design and administration</td>
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<tr>
<td>▪ Track and manage compensation cost of sales (CCOS)</td>
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<tr>
<td>▪ Identify potential risks</td>
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<tr>
<td>▪ Create a formal governance process</td>
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</table>
What to pay for? – Performance Metrics

<table>
<thead>
<tr>
<th>Why it matters</th>
<th>Best practice</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Links the SIP and strategic priorities</td>
<td></td>
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<tr>
<td>▪ Communicates what you want your salespeople to do</td>
<td></td>
</tr>
<tr>
<td>▪ It’s how salespeople drive their individual earnings</td>
<td></td>
</tr>
<tr>
<td>▪ Maximum of 3–4 measures</td>
<td></td>
</tr>
<tr>
<td>▪ Minimum 20% weight</td>
<td></td>
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<tr>
<td>▪ Results-based rather than activity-based</td>
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</table>

**Considerations when selecting measures**

- Must be able to set credible goals
- Should either be tied to individual performance, or to a carefully defined group with ‘shared dependency’
- They must align with business objectives and the desired behaviour of the individual
The three dimensions of metrics

**Core metrics**
- Units/volume, i.e.,
  - Therms
  - Mcf
  - MW
  - MWh
- Revenue
- Gross Margin
- Milestones

**Level**
- Organisational level (individual, team, BU)
- Product
- Segment
- New, renewal, total

**Timing**
- Pre-sale
- Contract
- Implementation/delivery
- One-time or recurring
Defining Pay Mix

- The proportion of target total cash (TTC) compensation attributable to base salary, vs. the portion attributable to the target incentive
  - Expressed as a ratio that always adds up to 100%

Pay Mix

20% of TTC
= 25% of salary (20 divided by 80)

If pay mix was 70/30
= 43% of salary (30 divided by 70)

And so on . . .
Defining Incentive Form

- **Bonus**
  - Works well for new business ‘hunter’ roles and where setting individual sales goals is not viable
  - Low goal-setting confidence
  - Immature business/industry
  - Moderate to high prominence
  - Equal territory sizes

- **Commission**
  - Bonus generally fits best for jobs with recurring revenue and for which you can set credible sales goals
  - High goal-setting confidence
  - Mature business/industry
  - Low or high prominence
  - Unequal territory sizes

\[
\text{Revenue} \times \text{Commission Rate} = \text{Incentive Payout}
\]
Sales role clarification is the foundation of the sales compensation design process

**New Customer Acquisition**
- New customer acquisition
- Cold calling or prospecting
- Little post-sale effort

**Territory Manager**
- Grow territory revenue based on good relationships with many customers/prospects
- Growth comes from building a reputation in the territory
- Some post-sale effort

**Account Manager**
- Retain and grow accounts
- Identifying and addressing customer needs
- Significant post-sale effort
- Penetrating customers with new services/products

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**How Customers Buy**

<table>
<thead>
<tr>
<th>Transactional</th>
<th>Consultative</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Purchase decision is simple</td>
<td></td>
</tr>
<tr>
<td>- Sales cycle is short</td>
<td></td>
</tr>
<tr>
<td>- Price is key</td>
<td></td>
</tr>
<tr>
<td>- Focus on efficiency</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Small Game Hunter</th>
<th>Big Game Hunter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Territory Rep</td>
<td>Territory Consultant</td>
</tr>
</tbody>
</table>

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**How Sales People Sell**

**Small Game Hunter**
- Identify and address customer needs
- Significant post-sale effort
- Penetrate customers with new services/products

**Big Game Hunter**
- Identify and address customer needs
- Significant post-sale effort
- Penetrate customers with new services/products
Typically there are important differences in sales compensation design for different platform roles.

**Framework Drives:**
- Pay mix
- Upside earnings potential
- Performance area
- Incentive form

**Position Drives:**
- Pay levels
- Performance measures
- Incentive plan mechanics

**How Customers Buy**

- **Transactional**
  - Highest variable pay
  - Fewest performance areas (1 – 2)
  - Commission oriented

- **Consultative**
  - High variable pay
  - Few performance areas (2 – 3)
  - Commission/bonus oriented

- **New Customer Acquisition**
  - Territory Manager
  - Account Manager

- **How Sales People Sell**
  - Mapping roles to the matrix helps narrow the choice of optimal plan designs

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The most effective sales compensation plans move the middle and celebrate the stars

1. The very low performers should be managed out, and will be more concerned about keeping their base pay.

2. You definitely need to keep the stars happy, but there are only a few of them and they may be more motivated by recognition and personal achievement.

3. You get the biggest ‘bang for the buck’ in the middle of the pack. Most of your sales people are here and this is where the sales incentive plan is likely to be most effective. These people must participate and this is where the steep part of the payout curve should be.
Best practice sales incentive design has 85% to 90% of the population earning at least some incentive.

**Threshold** is the point below which no incentive is paid. It represents 'unacceptable' performance, usually defined as the 10th or 15th percentile.

**Excellence** is the point at which target leverage is paid. It represents 'outstanding' performance, usually defined as the 85th or 90th percentile.

<table>
<thead>
<tr>
<th>Rules of Thumb</th>
<th>Performance</th>
<th>Below Threshold</th>
<th>Threshold</th>
<th>Target (100% of goal)</th>
<th>Excellence</th>
<th>Above Excellence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent of Population</td>
<td>10-15% below threshold</td>
<td>55% above, 45% below</td>
<td>10-15% above excellence</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount to Pay*</td>
<td>0%</td>
<td>0% to 50%</td>
<td>100%</td>
<td>200% to 300%</td>
<td>(avoid caps)</td>
<td></td>
</tr>
</tbody>
</table>

*Percent of target incentive earned*
If you expect different distributions of performance, you should have different payout curves

**Situation**

- Typical B to B sales  
  - or  
  - Growth products

- Strategic account sales  
  - or  
  - Modest growth products

- Recurring revenue sales  
  - or  
  - Mature products
There are countless examples of unintended consequences

Pay for performance analysis

Vastly different payouts for relatively similar performance relative to target

FY16 Sales Volume Performance (% of quota)

Primary Measure Performance

Above cap area

Below threshold area

FY16 % Sales Volume Target Incentive Earned

R² = 0.6196

FY16 Sales Volume Performance (Weighted Average)

Weighted Average Performance

R² = 0.3982

FY16 % Total Target Incentive Earned

0% 50% 100% 150% 200% 250%

0% 50% 100% 150% 200% 250%
What's wrong with this picture?

**FY16 Sales Volume Performance Distribution**

- <65%: 2%
- 65% - 74%: 5%
- 75% - 84%: 12%
- 85% - 94%: 23%
- 95% - 104%: 28%
- 105% - 114%: 18%
- 115% - 124%: 7%
- 125% - 134%: 2%
- >135%: 2%

**FY16 Total Incentive Earnings Distribution**

- <50%: 17%
- 50% - 74%: 12%
- 75% - 94%: 12%
- 95% - 114%: 5%
- 115% - 124%: 4%
- 125% - 150%: 11%
- >150%: 39%
Our sales plans are driving unexpected or poor behavior.

Our sales people are talked about in the press for the wrong reasons.
### What might this plan drive?

**Case study – utility industry consumer sales role**

<table>
<thead>
<tr>
<th>Wins/week</th>
<th>Commission per win*</th>
</tr>
</thead>
<tbody>
<tr>
<td>43 and over</td>
<td>$55.00</td>
</tr>
<tr>
<td>37 to 42</td>
<td>$40.75</td>
</tr>
<tr>
<td>31 to 36</td>
<td>$35.00</td>
</tr>
<tr>
<td>25 to 30</td>
<td>$27.50</td>
</tr>
<tr>
<td>24 or less</td>
<td>$0.00</td>
</tr>
</tbody>
</table>

* Commission level is applied to all wins retroactively
Case study: Plan driving undesirable behaviors

“Not cancelling customers due to negative credit”

“Highly accelerated commission”

“Mis-selling”

“Faked customer agreements”

“Focus on customer size led to burning through lower value sales”

“Complex sales incentive plans”
What drives behavioral risk in incentive plans?

**Pay mix**

- [Pay mix chart]

**Payment cliffs**

- [Stepped pay-out curve graph]

**Product bias**

- [Cart icon]
  - VS.
- [Bucket icon]
  - [SOAP icon]
  - [Broom icon]
Creating a plan governance framework

- Sales incentive plan governance is all about managing the life cycle of a sales incentive plan

Alignment & Design
- Compensation philosophy
- Incentive plan design
- Scenario modelling and costing

Goal Setting and Budgeting
- Goal setting
- Budgeting, forecasting and accruals

Administration
- Collecting and validating performance data
- Calculating award amounts
- Communicating, motivating and reporting
- Managing exceptions, disputes and adjustments
Why the cost at target is typically greater than the sum of targets

Which is OK as long as you properly model and budget the plans in the first place.
In closing . .

- Role clarity is key to developing the right incentive plan
- Choosing the right performance measures drives strategic alignment
- Sales incentives are more than just ‘commissions’
- Mechanics need to be calibrated to maximize motivation
- Be careful of unintended consequences
- Ensure you have proper governance and oversight

And most importantly, remember that you can’t pay for everything you need your sales people to do!