Sales Compensation: Money Talks!

Sales compensation seems to be a mystery to most of the printing/graphics industry. I get calls and e-mails frequently asking about compensation standards, and the truth of the matter is that there aren't any. For every 100 printing/graphics companies, there are probably 120 compensation plans in place, with many individual salespeople operating on different plans within the same company. (That's not necessarily a bad thing, but let me come back to that later on.)

The fundamental problem is that most sales compensation plans don't work very well. In other words, they don't motivate the performance and behavior that employers are looking for. That's why I'm getting all the calls and e-mails. *My salespeople aren't performing. What are other people doing to that I'm not? Somebody must be doing this right, right?*

Some are certainly doing it better than others, but industry-wide, I think there's a lot of opportunity to improve sales performance by improving sales compensation strategy. So let's start with the basics. The fundamental concept behind effective sales compensation is that *money talks*. In developing your compensation strategy, you need to ask yourself what you want it to say! Here are some possibilities:

- I want you to generate lots of sales dollars.
- I want you to generate lots of profit dollars.
- I want you to develop new customers.
- I want you to sell more of our product line to established customers.
- I want you to increase sales every year.
- I want you to work a full day every day.
- I want you to do a good job with administrative tasks, such as call reports, expense reports, and CRM maintenance.
- I want you to work well with the rest of the team.

You may not care about all of these things. There may be other things that you do care about. The bottom line here is that sales compensation—*money!*—can be used to buy/motivate specific behavior. The more explicit you make a compensation plan, the more likely it is that your salespeople will hear what you're trying to tell them.

Salary Plus Commission

I think it's pretty well accepted that a straight salary is the wrong way to compensate a printing/graphics salesperson. Look back at the "*I wants*" above. A straight salary really only addresses the last three, and provides very little incentive to work hard at the first five. Having said that, though, a straight commission plan addresses the first five, but doesn't provide much incentive to work hard at the last three. By combining salary and commission, money's "voice" is directing two specific behaviors.

Please don't think it's enough, though, to let money's voice be the only one a salesperson is hearing. To put that another way, please don't think compensation is a substitute for management. Think of it this way. *Compensation works best as a reinforcement for management.* As an example of that, one of my clients and I recently had this conversation with one of his salespeople, who could rightly be called lazy and sloppy: "Remember that you get paid a salary *and* commission. You could say that you earn the commission by working hard at convincing people to buy from you, but we pay you the salary to work hard at everything else!"

Salary Plus Commission Plus Bonus

To take *money talks* one step further, I like to add bonus opportunities to sales compensation plans. Again, take a look at the "*I wants*" above. It would be pretty to think that developing new customers, selling more of the product line to established customers, and increasing sales year to year would all be sufficiently motivated by the opportunity to earn more through commissions, Unfortunately, it doesn't usually work that way. Most salespeople need an extra *push* or *pull* to make those things happen, and again, this is a situation where management (the *push*) and compensation (the *pull*) work best together.

To address the issue of developing new customers, I might institute a short-term bonus program; for example, 30-60 days of intense prospecting activity. That might mean identifying 100 "suspects" and running each of them through a defined series of contact activities.

I would be happy to pay a bonus to stimulate that activity—and here's a key point, the bonus is intended to reward the *activity*, in the expectation that the *activity* will lead to the *objective*. What I'm really talking about here is managing on the front end of the sales cycle, rather than on the back end. Let's face it, most printers "manage" by looking at sales figures and then either congratulating or criticizing their salespeople. It's a far better strategy to manage on the front end of the curve.

To address the issue of increasing sales year to year, I might suggest a full-year, quota-based bonus opportunity. I would be willing to pay a significant bonus in order to provide a full year's worth of motivational *pull*, and many of my clients have been successful by making the reward something other than cash. "Tell me what you want," one of them told her salesperson at the beginning of this year, "and I'll tell you what your quota is." (Key point: The performance has to pay for the reward!) In this particular case, the salesperson wanted a motorcycle, and cost-justifying that required a quota that reflected a 15% sales increase. Through the first four months of the year, the salesperson is tracking toward an 18% sales increase. I think it's fair to say that he's highly motivated!

Sizing The Components

So how do you put all of this together to create a highly effective compensation plan? Let's start with a set of assumptions:

1. You are hiring a new salesperson.
2. You can reasonably expect $350,000 in sales volume from your new salesperson in his/her first full year on the job.
3. Your average gross profit on that volume will be 40%
4. You are willing to share 30% of that gross profit with your salesperson.

Let's do some quick arithmetic to see how much this job is worth. 40% of $350,000 equals $140,000 of gross profit, and 30% of that equals $42,000 in compensation. (Please note that I'm not saying that $350,000 is reasonable for every salesperson, or that you should be operating at 40% gross profit, or willing to share 30% of it, or that $42,000 is the right amount to pay a salesperson. At this point, I'm just trying to show you how to work the arithmetic. Please also note that this analysis is where you start this process. The two most important questions in compensation planning are (1) how much volume/profit can I reasonably expect and (2), how much am I willing to pay for it?)

OK, so far we have established that you're willing to pay $42,000 in return for $350,000 in sales. Obviously, that could be paid as a straight salary of $42,000, or straight commission at the rate of 12%. A better approach, though, would be a salary of $1000 per month, 7% commission, two short-term bonus opportunities paying $1000 each and a $3500 quota-based full year bonus opportunity. That all adds up to the same $42,000, and it provides motivation to address all but possibly one of the "*I wants*" above—and I'll get to that one in just a moment. For now, I hope you'll see the wisdom in a three-part approach to compensation. Money talks, and compensation works best as a reinforcement to management. *These are the things I want you to do, and this is how you'll make money by doing them!*

Revenue Sharing vs. Profit Sharing

The "missing piece" in my example so far is the "*I want*" relating to profit dollars. You can address that by basing the commission component on gross profit as opposed to gross sales volume. Let's say that your salesperson is competing for an order for window clings. Your full-markup price is $1000. Your production cost—time and materials—is $600. At 7% straight commission based on gross sales, if your salesperson sells the order at full price, he/she earns $70 and you net $330. If the salesperson discounts to $900, though, the commission only drops by 10% to $63 while your share drops by almost 30% to $237. Discounting further only increases this disparity.

Now let's change the commission rate to 17.5% of the gross margin. The revenue distribution of the full-price sale is exactly the same. The $900 sales pays the salesperson $52.50 and you net $247.50. Discounting further provides the same 17.5%-82.5% split of every gross profit dollar.

I think the point is pretty clear. You're better off sharing *profit* with your salespeople than sharing *revenue*. Again, don't read anything into the percentages I used, they were just for illustration. If we changed the straight commission rate to 4% in this example, that would equalize at 10% of gross margin. Converting a revenue sharing commission rate to a profit sharing commission rate is really pretty simple arithmetic.

Salary vs. Draw

There is one more missing piece in my example, the issue of meeting a salesperson's earnings *needs*. Look back at the compensation plan I'm suggesting for the new salesperson and the $350,000 sales expectation. I think you'll find plenty of takers for a job that is likely to be worth $42,000 in the first year, but very few for a job that only guarantees $1000 per month!

One solution to this problem is to allow a draw against future commissions. I have a situation going on right now where we're allowing the salesperson to draw the difference between what she actually earns in salary plus commission and $3000 per month. We have shown her the pace at which we expect her to build her earnings to more than $3000 per month and to pay back the draw—which is essentially a no-interest loan, with future earnings serving as collateral—and everyone is comfortable with the arrangement. In the past, the same client used to start with a higher salary and reduce it over time, but that never created the motivation he was hoping for. "They'd be complacent for the first 6 months at the high salary," he told me, "and then they'd get panicked and start looking for another job. This way, she'll be aware of the draw balance she's building up, but she'll also be able to see her progress against the timeline we've shown her."

Don't forget, by the way, that established salespeople also have earnings *needs,* and that the selling cycle and seasonality can make actual earnings somewhat irregular and unpredictable. Many printing/graphics companies allow their established salespeople to draw up to 80% or even 90% of their previous year's earnings on an annualized basis, and I think that's a reasonable practice.

As an example, if a salesperson earned $80,000 in commission last year, the monthly draw might be set at $5333 ($80,000 x 80% ÷ 12) or even $6000 (80,000 x 90% ÷ 12). For payroll purposes, a draw is typically paid on the same schedule as a salary, the total amount divided by the number of pay periods in the year. Commissions are typically paid after the middle of the month, allowing for normal month-end bookkeeping and accounting to be completed. In a draw situation, if a salesperson fails to cover the draw for the previous month, there is no additional payment, and that continues until any draw shortfall is corrected

Setting the draw at 80% or 90% of the previous year's earnings is pretty safe from the company's perspective, but it doesn't protect you against a major catastrophe, like the loss of a major customer. For that reason, I recommend setting a cap on the draw, usually 5% of the previous year's earnings. In other words, if the salesperson in this example got to a draw status of -$4000, the draw would stop and only commissions actually earned would be paid.

Multiple Plans

As I mentioned earlier, I've seen many situations where individual salespeople are operating on different compensation plans within the same company. That's sometimes the result of simple tweaking, or minor adjustments to make an old plan fit a new person, or to try to improve on an established plan. Unfortunately, it's often the result of a new salesperson coming aboard from another company and bringing his/her compensation plan along for the ride.

It is a *very* bad idea to let a salesperson dictate compensation, and that's not even considering the fact that many "job-hoppers" have been known to exaggerate both their sales volume and their earnings when negotiating with owners, who often seem more interested in hiring sales volume than sales talent. Please remember that the two most important questions in compensation planning are (1) how much volume/profit can I reasonably expect and (2), how much am I willing to pay for it? Please also remember that your *raison d'être* is profit, not just volume. The most frequent complaint I hear from printers is that "I'm paying my salesperson too much (in return for the performance I'm getting)."

Having said all of that, I have no problem with individual salespeople working on different compensation plans within the same company. After all, different people will have different motivational triggers, and different compensation wants and needs. As long as each plan speaks clearly and effectively—and as long as you remember that compensation works best as a reinforcement to management—you should be able to use compensation to achieve better performance from your salespeople.