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Best Ways to Pay Your Sales Staff

If your sales reps aren't producing enough, it may be because your compensation plan is askew. Some tips on tailoring it to your business

Matt Wilson needed a top-notch sales staff—and he was no longer sure he had one. His 70-person masonry company, Holland (Ohio) Wilson Tile & Stone, had prospered during the real estate boom, posting \$8.1 million in 2007 sales. But as conditions soured, his four reps, no longer enjoying the ease of a quick sale, didn't seem particularly hungry to close deals. "Too many times, I'd see customers in my showroom, and there was no eagerness either to upsell them or even to push the sale," says Wilson.

It turned out the reps' compensation plan was partly to blame. Salespeople received 80% of their compensation in base salary, which gave them little incentive to hustle. When they did make sales, commission payouts were low—and complicated: 3% of gross profit, but only after they hit a monthly quota. "I have no problem with my salespeople making money," says Wilson, a vice-president at the company his father founded in 1985. "But we wanted them to get rich off selling, as opposed to just getting rich off being here."

Figuring out how to compensate your sales staff fairly is no easy task. Many business owners only learn that their plans are curbing reps' motivation or encouraging them to sell the wrong products when sales fall, they lose market share, or reps defect to competitors. Only 41% of business leaders say they're satisfied with their sales compensation plans, and fewer than half say the plans do enough to encourage the right selling behavior, according to a September 2008 survey by Deloitte.

The most common mistake entrepreneurs make is simply to copy a competitor's plan, tweaking it slightly to fit his or her own budget. But compensation plans should be unique to your products or services, to individual reps' experience, and to your sales goals or profit margins. If you're looking for a one-size-fits-all plan, "The answer is no, it doesn't exist," says Liz Cobb, chief executive of Makana Solutions, a Lexington (Mass.) company that makes sales compensation software.

As the economic landscape changes, plans that were once perfectly serviceable may need a redesign. If sales have slipped, either base salary or commission may now be too high, cutting into profits. If you're trying to build brand recognition, increase market share, or energize your sales staff, you might consider boosting payouts. "You can't 'cut' your way out of recession—you have to grow revenues," says John Bremen, global practice director in the sales compensation group at Watson Wyatt in Chicago. "Sales compensation plans are very useful tools in the current environment."

CALCULATING BASE SALARY

Getting your plan up to snuff is as much art as science. Once you have a general idea of how much each rep will be paid in total, you need to find the right mix of base salary and commission. A 30% base/70% commission mix is fairly typical, but make sure to adjust from there. An established sales rep with years of experience might demand a higher percentage in base salary, while a greener rep fresh out of school might be willing to work almost exclusively on commission.

If your company is well-known and has few competitors, you might set a higher base, perhaps using a 50/50 mix. In those cases, "It almost feels like the salespeople are taking orders," says Randy Ramirez, a compensation consultant at BDO Seidman in New York. "There's still a very defined skill set . . . but the salespeople offer a more consultative service." On the other hand, if you have multiple rivals and need an aggressive sales push, you could do with a 20/80 mix or even make reps' pay commission-only.

A base salary should cover reps' basic living expenses (rent and food, not lease payments on a fancy car), or a minimum of \$1,500 to \$2,000 a month. "The reason you offer base pay is not to make people hungry," Bremen says. "It's to help them manage cash flow." If you can't pay that much, don't bother paying a base.

Then consider additional incentives. Startups often recruit talent with the promise of stock options. It's common to designate options worth, say, 5% to 10% of the company's value, to be divvied among top performers. Many companies use bonuses, calculated based on profitability and paid in cash or vacations, gift cards, luxury items, or other swag, to get employees to hit sales targets. That way, you pay for your staff's achievements after your company has been fueled by them.

RAMPED OR FLAT RATE?

The next step is defining how commission will be paid. Ideally, a rep's commission is a percentage of either revenue or profit generated over a month or quarter. Unless you're trying to dump excess inventory, it rarely makes sense to tie commission payments to the number of units sold. But Matt Haselhoff, sales and marketing director at Installation & Service Technologies in Prairie Village, Kan., a provider of point-of-sale hardware and software, once worked for a company that did just that. "I still can't believe they did this," he says. Reps would practically give away units rather than risk losing a deal.

Haselhoff kept that example in mind when designing the compensation plan for his team. Each rep should be able to earn \$85,000, he figured. Of that, 35% is base salary, while 65% is commission that's paid in full if the rep generates \$100,000 in profit for the company. (Reps can earn more if they beat that goal.)

To translate the general commission percentage into an amount to be paid on each sale, you'll need a good understanding of your company's financials. Say you own a home appliance store and sell refrigerators at \$3,000 a pop. You'll need to know the profit on each fridge after taking into account everything from overhead to how much you paid the manufacturer. "If I have one salesperson, maybe I can give that person 10% to 15% of the profits," Bremen says. "If I have 100 salespeople, I can probably give them 5% to 6%. It all goes into the calculus."

You'll also want to consider flat vs. "ramped" commissions, where the percentage paid out rises as reps sell more. A flat payout rate is often applied to less profitable products or services. Ramped commission rates are commonly used for best-selling items or a company's primary product. A ramped rate "definitely motivates them to achieve more," says Cobb.

It's working for Haselhoff. His reps get paid 17% commission on the first \$50,000 in profit and 24% on the second. For anything beyond the annual goal, reps earn 30%. For each plateau a rep reaches, he or she gets an additional \$1,000. "You can incentivize by the stick, and you can incentivize by the carrot," says Haselhoff. He projects that sales will climb as much as 20% this year as a result of the new plan.

The last step is to iron out such details as who gets the commission if a national rep and a territory rep oversee a single sale. It's also a good idea to have an attorney review the plan.

At his masonry company, Wilson started revamping reps' pay plans in March 2008. He wanted to give them the chance to make \$70,000 a year, about twice what most were bringing in. After reviewing his company's sales history and goals, he settled on a ratio of 35% base salary to 65% commission. He used software from Makana to set different, ramped commission rates for popular items, such as granite countertops or porcelain tiles. As further incentive, reps can make up to an extra 8% when they sell the company's installation service along with its custom cabinets.

Selling the plan to his staff wasn't easy at first, because the base pay was lower. But, Wilson says, "Once they saw the benefit to it, they were all very excited." Every rep made more than he had the year before, including one whose pay jumped \$12,000. Says Wilson: "They went from almost hiding at their desks to—when someone comes in the door—almost fighting over them." Sales for 2008 shot up 22%, to \$9.9 million. Wilson is pushing for 12% growth in 2009 and considering hiring more salespeople. Because now he knows they'll earn their keep.

[Return to the BWSmallBiz June/July 2009 Table of Contents](#)

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