Compensation plans for salespeople

The, four elements of compensation are combined into hundreds of different plans, each more, or less unique. But if we disregard the "fringe benefit" and "expense reimbursement" elements:-as is entirely reasonable, since they are never used alone-

There are only three basic types of compensation plans:

1) Straight wages or salary
2) Straight commission, and
3) A combination of salary and variable elements.

1) Straight-Salary Plan

The straight salary is the simplest compensation plan. Under it, salespersons receive fixed sums are regular intervals (usually each week or month but sometimes every two weeks), representing total payments for their services. The straight salary was once the most popular sales compensation plan, but it has been declining in importance. Such plans are more common among industrial-goods companies than among consumer-goods companies. Firms that formerly used the straight salary have tended to combine a basic salary with a variable element-that is, they have switched to combination plans.

In spite of the trend away from its use, sometimes the straight-salary plan is appropriate. It is the logical compensation plan when the selling job requires extensive missionary or educational work, when salespeople service the product or give technical and engineering advice to prospects or users, or when salespeople do considerable sales promotion work. If non-selling tasks bulk large in the salesperson's total time expenditure, the straight-salary plan is worthy of serious consideration.

From management's standpoint, the straight-salary plan has both advantages and disadvantages.

Advantages

- It provides strong financial control over sales personnel, and management can direct their activities along the most productive lines.
- Component tasks making up salespersons' jobs can be recast with minimum opposition from those affected, so there is flexibility in adjusting field sales work to changed selling situations.
- It facilitates team-selling
- It gives sales managers maximum flexibility in changing salesperson's priorities on short notice
- If sales personnel prepare detailed reports, follow up leads, or perform other time-consuming tasks, they cooperate more fully if paid straight salaries rather than commissions.
- It is appropriate when personnel in selling roles are required to provide design and engineering assistance.
- Straight-salary plans are commonly used for compensating salespeople heavily engaged in trade selling or mere order taking.
- Motivator/problem solver and relationship/value creator roles are appropriate for straight salary compensation.
- It creates stability of sales employees
- It does not tie financial rewards to sales results, which may attract personnel who are security oriented instead of achievement oriented.
- Straight-salary plans are economical to administer, because of their basic simplicity, and compared with straight-commission plans, accounting costs are lower.
- The main attraction of the straight-salary plan for sales personnel is that stability of income provides freedom from financial uncertainties inherent in other plans.
- Sales personnel are relieved of much of the burden of planning their own activities

- Because of its basic simplicity, sales personnel have no difficulty in understanding straight-salary plans.

Disadvantages

- It limits ability to use compensation as a tool to shape behaviour of salespeople
- It increases fixed selling costs
- It lowers salesperson's incentive of performing jobs
- It does not attract successful aggressive" stars"
- Since there are no direct monetary incentives, many salespeople do only an average rather than an outstanding job. They pass up opportunities for increased business, until management becomes aware of them and orders the required actions.
- Unless the plan is skilfully administered, there is a tendency to under compensate productive salespeople and to overcompensate poor performers.

However, many of the straight-salary plan's weaknesses are minimised through good administration.

All sales personnel need rating not only on their achievement of sales and cost goals, but also on their performance of each assigned duty. The total evaluation of an individual is a composite of the several ratings, weighted according to relative importance. Persons rated as average are paid average salaries. Salaries of below-average and above-average sales personnel are scaled to reflect the extent to which their performances vary from the average. Each individual's performance is regularly reviewed and upward adjustments made for those showing improvements, and downward adjustments made for those with deteriorating performances.

2) Straight-Commission Plan

The theory supporting the straight-commission plan is that individual sales personnel should be paid according to productivity. The assumption underlying straight-commission plans is that sales volume is the best productivity measure and can, therefore, be used as the sole measure. This is a questionable assumption.

The straight-commission plan, in its purest form is almost as simple as the straight-salary plan, but many commission systems develop into complex arrangements.

Straight commission plans fall in to one of two broad classifications:

1. Straight commission with sales personal paying their own expenses. Advantage may or may not be made against earned commissions.

2. Straight commission with the company paying expenses, with or without advances against earned commissions.

There is a general away from the straight-commission plan, and today no more than 6 or 7% of all companies use such plans. The straight commission plan is used in situations where non-selling duties are relatively unimportant and management emphasizes order getting. Straight-commission plans are common in clothing, textile and shoe industries and in drug and hardware wholesaling. Firms selling intangibles, such as insurance and investment securities, and manufacturers of furniture, office equipment, and business machines also are frequent users of straight-commission plans.

Advantages

- Most appropriate where repeat efforts are necessary to sustain customer purchases
- Rewards are linked to short-term, repeated performance
- Attracts high-performing salespeople
- Forces non-performers to leave organisation
- Compensations costs are completely variable
- Easy to understand and administer

- Encourages maximum sales efforts
- Minimises need for supervision by treating employee much like an independent contractor
- It provides maximum direct monetary incentive for the sales person to strive for high-level volume.
- The star salesperson is paid more than s/he would be under most salary plans and low-level performers are not likely to be overcompensated.
- Straight-commission plans provide a means for fast control since all direct selling expenses, except for traveling and miscellaneous expenses (which are reimbursable in some plans) fluctuate directly with sales volume changes and sales compensation becomes virtually an all variable expanse.
- The straight commission plan also is characterised by great flexibility by revising commissions' rates applying to different products, for instance it is possible to stimulate sales personnel to emphasize those with the highest gross margins

Disadvantages

- Salespeople will likely concentrate on customers that have patterns of frequent and substantial purchases
- It is inappropriate during new product introductions
- It may not work well for sophisticated products where missionary work is needed
- Due to link with sales and hence the market demand, this method is highly variable or volatile, which may create financial problems for the sellers
- It severely limits ability to direct salespeople's efforts, require non-selling activities, modify territories, etc.
- It encourages short-term orientation
- Salespeople can obtain a high level of income from mature territories
- It fosters salesperson's pursuit of the greatest payoff for the least effort to maximise income

- It can create conflict between the salespeople's dependence on volume and the principal's ability or willingness to fill every order
- It generates little loyalty
- It provides little financial control over sales people's activities when they pay their own expenses.
- Salespersons on straight commission often feel that they are discharging their own expenses and full responsibilities by continuing to send in customers' orders
- They are careless to prepare and send reports, follow up leads, resist reduction in the size of sales territories, consider individual accounts private property, shade prices to make sales, and may use high-pressure tactics with consequent loss of customer goodwill.
- Unless differential commission rates are used, sales personnel push the easiest-to-sell low margin items and neglect harder-to sell high-margin items.
- Some salespersons' efficiency may decline because of income uncertainties. If a sales force has many financially worried salespeople, management may have to invest considerable time, effort, and money to kindle their spirits.

Determining commission base

One important aspect of designing a straight commission system is to select the base on which to pay commission. Company selling policies and problems strongly influence selection of the base. If obtaining volume is the main concern, and then a total sale is the base. If sales personnel make collections on sales, commissions are based on collections. Commissions can be based upon shipments, billings, or payments. To control price-cutting by sales personnel, some companies base commissions on gross margins. Other companies use net profits as the base, seeking simultaneously to control price-cutting, selling expense, and net profit.

3) Combination Salary-and-Incentive Plan

Most sales compensation plans are combinations of salary and commission plans. Most developed as attempts to capture the advantages and offset the, disadvantages of both the salary and commission systems.

Where the straight-salary method is used, the sales executive lacks a financial means for stimulating the sales force to greater effort. Where the straight commission system is used, the executive has weak financial control over non-selling activities. By a judicious blending of the two basic plans, management seeks both control and motivation. Actual results depend upon management's skills in designing and administering the plan. Unless there is skillful adjustment of salary and commission, weaknesses of both basic systems reappear.

Advantages

- A well-designed and administered combination plan provides both the security of stable incomes and the stimulus of direct financial incentive.
- Management has both financial control over sales activities and the apparatus to motivate sales efforts.
- Selling costs are composed of fixed and variable elements; thus, greater flexibility for adjustment to changing conditions exists than under the commission method.
- Selling costs fluctuate some with the volume of business.
- There are beneficial effects upon sales force morale.
- Disagreements on pay increases and territorial changes are less violent than under a straight-commission plan.
- Cooperative spirit develops between salespeople and the company since salespeople may perceive that the company shares their financial risks.
- It attracts salespeople with skills beyond pure selling abilities
- It enables company to compete with employers offering alternative careers
- It helps retain employees during tough times Permits inclusion of non-sales activities

- Salary portion of compensation corresponds to management's needs for the sales staff to perform administrative duties, while the commission portion encourages increased selling effort

Disadvantages:

- It can be very complex to understand and administer
- It can dilute emphasis on key results because of a tendency to try to control too many specific activities of salespeople
- Clerical costs are higher than for either a salary or a commission system since more records are maintained and in greater detail.

Sometimes a company seeking both to provide adequate salaries and to keep selling costs down uses commission rates so low that the incentive feature is insufficient to elicit needed sales effort. But, if the incentive portion is increased, salespeople may neglect activities for which they are not directly paid. Therefore, the ratio that the base salary and the incentive portion bears to the total compensation is critical. As mentioned earlier, most companies split the fixed and variable elements on a 60:40 to an 80:20 basis.

Use of bonuses

Bonuses are different from commissions. A bonus is an amount paid for accomplishing a specific sales task whereas a commission varies in amount with sales volume or other commission base. Bonuses are paid for reaching a sales quota, performing promotional activities, obtaining new accounts, following up leads, setting up displays, or carrying out other assigned tasks. The bonus, in other words, is an additional financial reward to the salesperson for achieving results beyond a predetermined minimum.

Bonuses are never used alone; they always appear with one of the three main sales compensation methods. If used with the straight salary, the plan resembles the combination plan. If used with the straight commission, the result is a commission plan to which an element of managerial control and direction has been added. If used with the combination salary and commission plan, the bonus becomes a portion of the incentive income that is calculated differently from the commission.

Certain administrative actions are crucial when a bonus is included in the compensation plan. At the outset, the bonus conditions require thorough explanation, as all sales personnel must understand them. The necessary records must be set up and maintained. Procedures for keeping sales personnel abreast of their current standings relative to the goals are needed. In addition, any bonus misunderstandings or grievances arising should be dealt with fairly and tactfully.

<u>Deriving Compensation Plans from Marketing Strategies</u>

Marketing Strategy	***Objectives***	***Sales Tasks***	***Recommended Compensation Plan***
Build	- Build sales volume	- Call on prospective and new accounts - Provide high service levels, particularly presale service - Product / market feedback	Salary plus incentive
Hold	- Maintain sales volume - Consolidate market position through concentration on targeted segments - Secure additional outlets	- Call on targeted current accounts - Increase service levels to current accounts Call on new accounts	Salary plus commission or bonus
Harvest	- Reduce selling costs - Target profitable accounts	- Call on profitable accounts only eliminate unprofitable accounts - Reduce service levels - Reduce inventories	Salary plus bonus
Divest/ Liquidate	- Minimise selling costs and clear out inventory	Inventory dumping Eliminate service	Salary

Fringe Benefits

Fringe benefits, which do not bear direct relationships to job performance, range from 25 to 40 percent of the total sales compensation package. Some are required by federal and state law for example, payments for social security premiums, unemployment compensation, and worker's compensation. Most, however, the company provides for other reasons: to be competitive with other companies in the industry or community, to furnish reasons for employees to remain in the company's service, and to comply with what employees expect as fringe benefits.

Figure below shows fringe benefits currently offered by U.S. companies. As the variety of fringes has expanded, individual fringes have been added that appeal more to some groups than others-people with bad teeth are the ones most interested in dental insurance, while those with children are the ones most interested in plans for paying educational tuition fees for dependents. Similarly, given a choice between supplemental life insurance and increased retirement benefits from the savings plan, a fifty-nine-year-old probably would pick the latter, ' but a thirty-two-year-old father of five might opt for the life insurance.

An increasing number of companies offer a "cafeteria" approach to fringe benefits. In this approach, the company offers a core of basic benefits-the benefits required by law plus other traditional benefits, including paid vacations, medical, disability, and death benefits and a retirement program. Employees then use credits (based on age, pay, family status, and years of company service) to obtain optional benefits not included in the core; this lets employees select those benefits that best fit their needs. The different fringe benefits available to sales personnel as part of compensation plan include the following:

- **Time**
  - Holidays
  - Vacations
  - Sick leave
  - Personal leave
  - Sabbaticals
  - Pregnancy leave

- **Organisation dues**
    - Trade association
    - Civic clubs
    - Country clubs
    - Professional association

- **Retirement Problems**
    - Social security (mandatory)
    - Pension plan
    - Profit sharing
    - Salary reduction plans

- **Miscellaneous**
    - Automobile
    - Use of vacation spot
    - Parking
    - Dry cleaning and laundry
    - Lunches (all or part)
    - Secretarial services
    - Employee stock purchase plan Company-provided housing
    - Legal services
    - Financial counselling
    - Tuition for continuing education programmes,
    - Financial support for dependents'

- Education Credit unions Discounts for purchases of company products
- Childcare payments
- Matching funds to charities and schools Company, social events
- Company sports tournaments Retirement counselling
- Career counselling
- Payment of moving expenses

Employees are given opportunities to change their selection of those benefits that best fit their needs. Because needs for benefits change, employees are given opportunities to change their selections. Companies using the cafeteria approach also have "awareness programs" aimed at making employees aware of the benefits available.