

Implementing an effective sales compensation plan

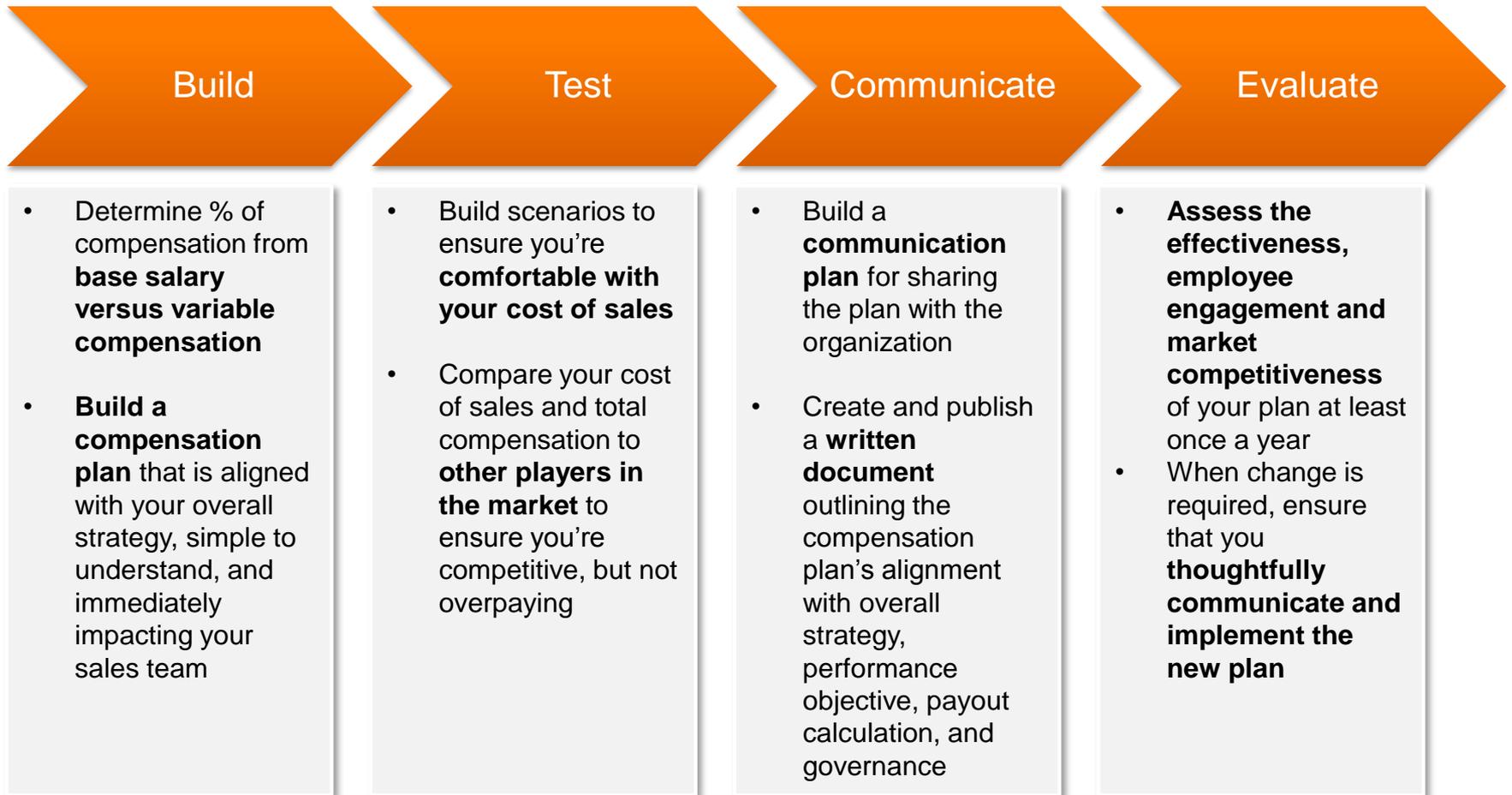
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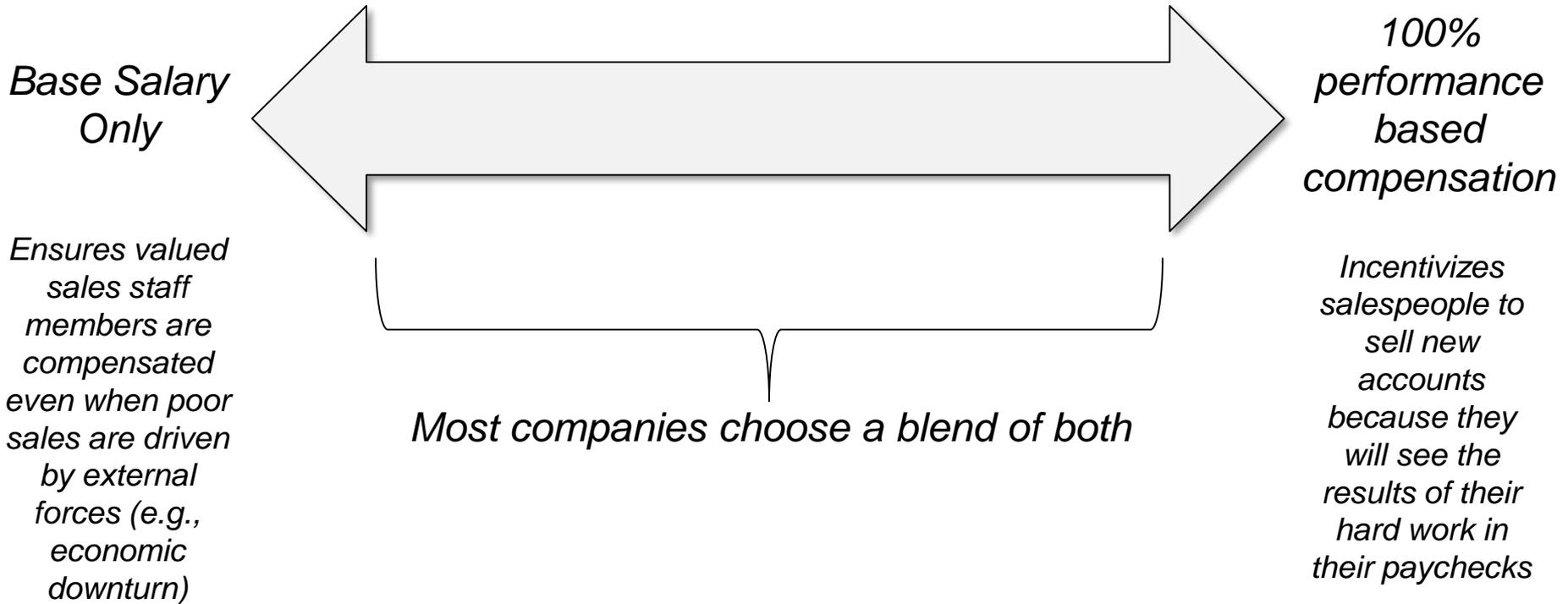
Your sales compensation plan is a critical component of effectively growing your business

- Your sales staff will **drive the growth of your business**
- Your compensation plan has the **ability to motivate the behaviors you desire**
 - Top performing firms offer 40% more of a sales rep's total compensation as variable compensation than less successful firms
- Compensation plans **provide an opportunity to define what success looks like**

Crafting and implementing an effective sales compensation strategy is an iterative process



You must determine what degree of variable compensation is appropriate for your business



There are a number of considerations in determining the right amount of base versus variable compensation

Role of the salesperson

- **To what degree does a sales person influence a customer's decision to buy a product or service?**
 - If a sales person plays a critical role, a heavy commission percentage likely makes sense to drive them to optimize sales
 - Alternatively, if many team members contribute to the sale (e.g., sales, business development and engineers), then you likely want to lower the commission ratios

Type of selling

- **What is your strategic priority?**
 - If selling new accounts is your top priority, then you likely want to offer a heavy commission ratio to encourage salespeople to quickly generate leads and follow up
 - If growing existing accounts is your top priority, a greater weight on base pay may make sense for your business

Sales cycle of business

- **How long is your sales cycle? How volatile is your market? How complicated is your product / service?**
 - If your sales cycle is short and product simple, then you likely want to offer a heavy ratio of commission based pay because salespeople will quickly see the impact of sales on their paycheck
 - However, companies operating in volatile markets or with long sales cycle or complicated products require a greater focus on base pay to provide continuity of income

The type of sales jobs on your team will drive the appropriate amount of commission

Base
Salary
Only

100%
performance
based
compensation

High base salary job components:

- The sales rep is primarily managing existing accounts
- Growing existing accounts and/or low customer churn are the top priority for the business
- Near- automatic commissions (e.g., subscription customers)
 - Typically in a later stage startup with an established customer base
- Product / service has a long sales cycle
 - E.g., airplanes take many years to sell making variable compensation challenging

Moderate base salary job components:

- The sales rep splits time between both account management and new account sales
- Growing existing accounts **and** selling new accounts are high priorities for the business
- Inherits / manages some accounts
 - Typically in a later stage startup with an established customer base

Low base salary job components:

- The sales rep is mostly / entirely focused on selling new accounts
- Selling new accounts is the top priority for the business
- A high growth and high risk sales job
- The product / service has a short sales cycle
 - Allows the sales rep to see the financial impact of their efforts quickly enough

Calculate a range of sales outcomes to ensure the business's profitability is positive and growing with sales

Evaluating the profitability of your sales compensation plan

Sales realized (in different scenarios) by a sales rep

-

Cost of goods sold
(for units sold by rep)

+

Overhead
(allocated on a unit basis)

+

Base salary of rep

+

Implied commissions

+

Implied commissions

=

Profit

Calculate a range of sales outcomes to ensure the business's profitability is positive and growing with sales

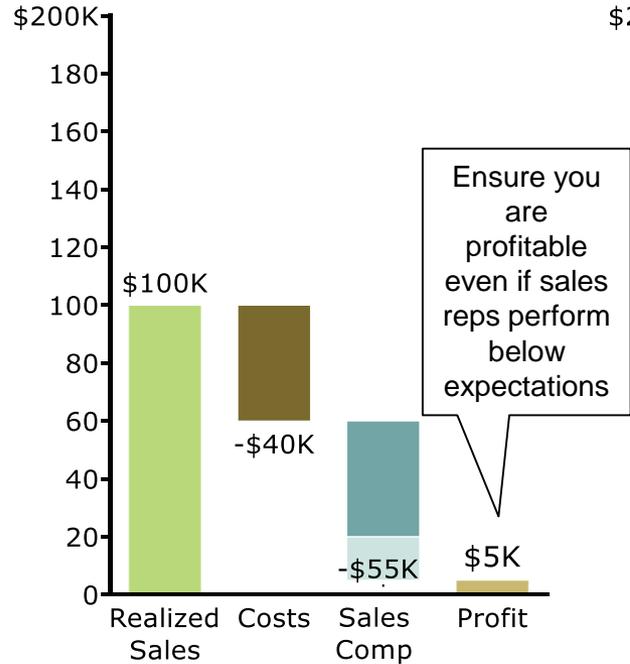
Example compensation plan: \$40K base salary plus variable compensation of 15% of sales and a \$5K bonus for reaching a \$200K sales goal

\$100K in annual sales

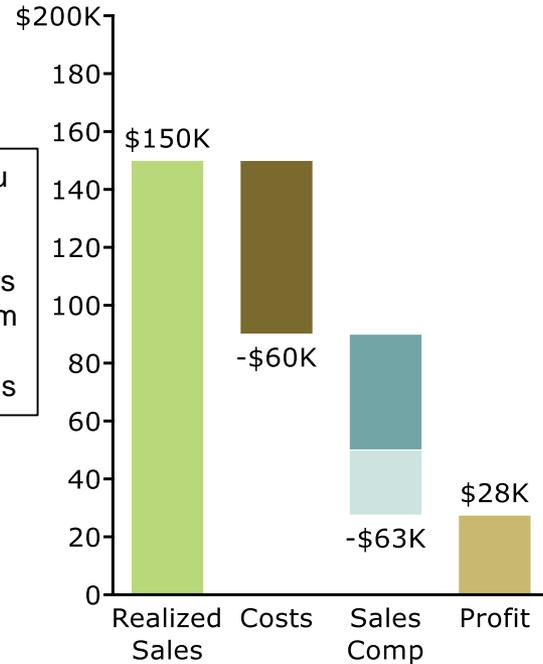
\$150K in annual sales

\$200K in annual sales

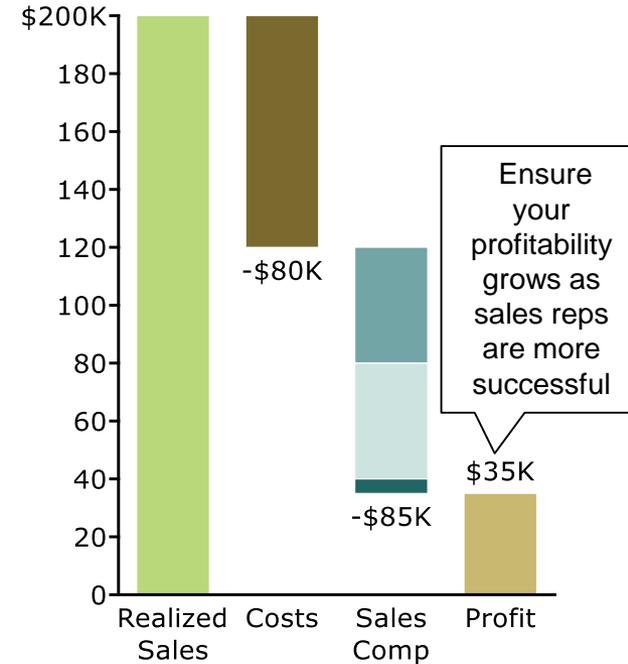
Annual compensation and sales (\$K)



Annual compensation and sales (\$K)



Annual compensation and sales (\$K)



Legend

- Sales
- Costs of goods/services sold & overhead
- Base salary
- Commissions
- Bonus
- Profit

A good sales compensation plan should result in a win-win for the business performance, company leadership, and sales reps

- It is common for early stage startups to pay effective sales team members considerable amounts, often more than the founders, CEO and other senior team members
- Evaluating potential sales outcomes' impact on sales team compensation and business performance will ensure that the plan is effective
- Many CEOs initially balk at the size of payouts, but ultimately conclude that a well designed sales plan can result in a win-win for all

“The first time I had a sales rep making a \$1M W2, I remember the rep’s name, face, body language, and of course, the deals closed. We were all so excited. And because we did the compensation plan right, the board and CFO were equally excited. It was very profitable for us all.”

Lars Dalgaard, Founder of SuccessFactors and General Partner at Andreessen Horowitz

Improved sales force performance increases sales payout, while growing the business- a win-win

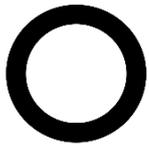
Effective sales compensation plans set metrics that are aligned with the business strategy, simple to understand, and with immediate impact on reps

Attributes of compensation plan metrics



Alignment

- Determine what the most important goal the company needs to achieve in the next year
 - Customer count? Profitability? Customer success? Market share?
- Then determine how the sales compensation plan be aligned with this objective



Simplicity

- A plan with too many variables will confuse salespeople on what behaviors to focus on
- Create a plan that clearly incentivizes the behaviors you are rewarding

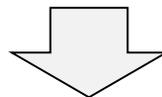


Immediacy

- Salespeople success or failure should be felt immediately in their through communications or their paycheck
- Immediacy will quickly encourage positive behaviors and discourage negative ones

Aligning your sales compensation plan with your strategy requires prioritizing the most critical objectives of the business

Why you must choose	Which single outcome (2 at most) is most critical to your strategy?
<ul style="list-style-type: none"> For many startups, the compensation plan will have a greater impact on the business than any other lever It is critical that the plan is aligned with your vision for the business and incentivizes the needed behaviors Incentivizing many outcomes will result in diluting the achievement of all of your goals 	New Net Sales
	Bigger Deal Size
	Deals with New Products
	Renewals of Current Products
	Higher Customer Satisfaction
	Lower customer churn
	Greater profitability

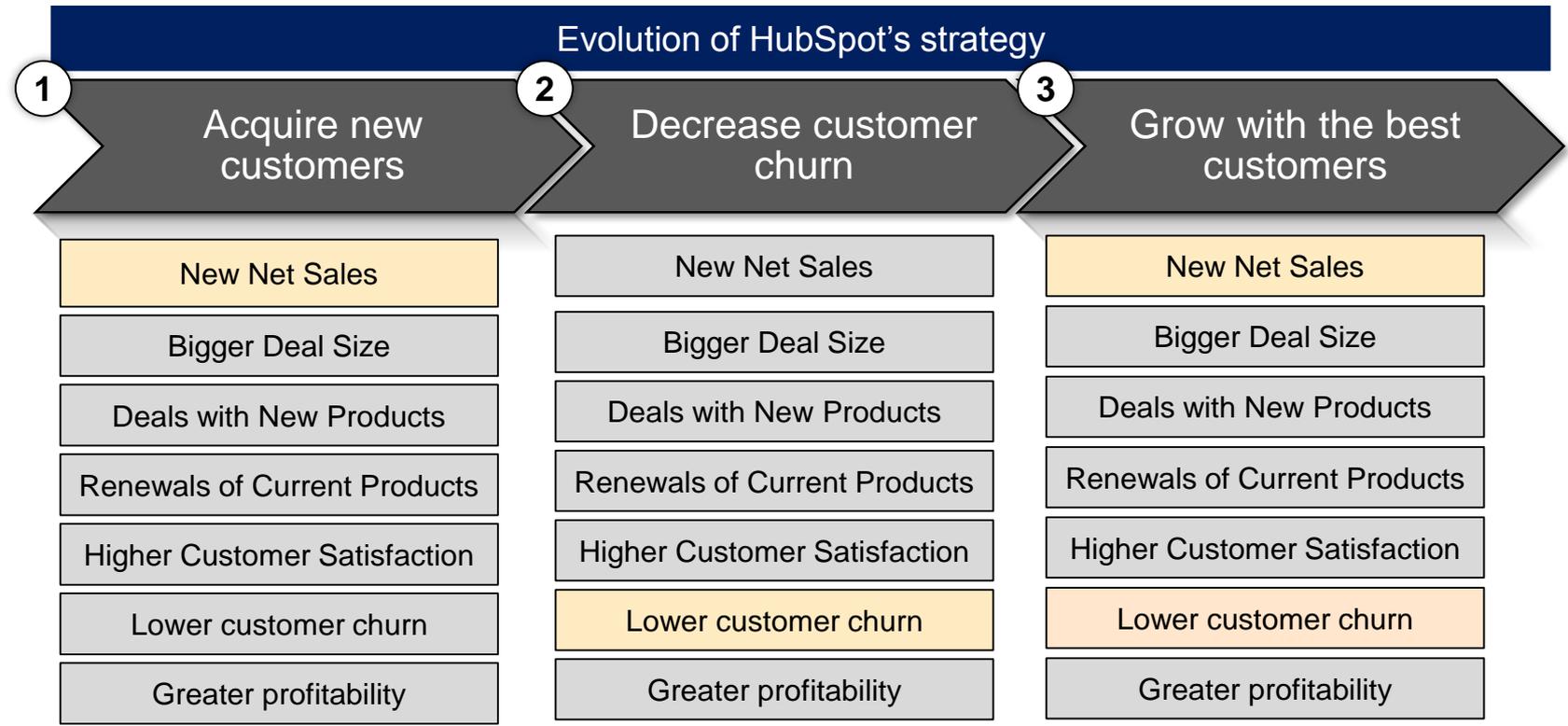


Successful sales compensation plans make tradeoffs- you cannot achieve every desired business outcome immediately

HubSpot case study: HubSpot adapted their sales compensation plan to align with their evolving strategy



HubSpot is an inbound marketing and sales platform that helps companies attract visitors, convert leads, and close customers. Founded in 2006, the company has evolved from an early stage startup to a business with over \$100M in revenue



Source: HBR: "The Right Way to Use Compensation"

Priority sales comp objective
 Deprioritized sales comp objective

1

Acquire new customers

Impetus: Early in HubSpot's history they needed to acquire customers quickly so they could see how valuable the offering actually was to them.

Compensation plan: Salespeople were paid a base salary and \$2 for every \$1 in recurring revenue with a four month clawback period on commissions.

Result: In six months, the customer base grew from 100 to 1,000, and revenue from \$300K to \$3M.



2

Decrease customer churn

Impetus: After acquiring customers, HubSpot discovered customers were churning at an unsustainable rate. After finding a 10 fold difference in customer churn rate by sales person, the CEO shared churn data by salesperson and educated the team on the importance of low churn. He announced that the compensation plan would be adjusted in the next quarter to align commissions with customer retention.

Compensation plan: The salespeople were divided into four quartiles based on their customer retention and compensated by quartile:

- Top quartile (best performers): \$4 for every \$1 in recurring revenue
- 2nd quartile: \$3 for every \$1 in recurring revenue
- 3rd quartile: \$2 for every \$1 in recurring revenue
- 4th (bottom) quartile: \$1 for every \$1 in recurring revenue, and received training on customer expectation setting

Result: In six months, churn had dropped by 70%



3

Grow with the best customers

Impetus: Having addressed the immediate churn issue, the company now needed to achieve faster, profitable growth. This would require the sales team prioritizing both signing new customers, and achieving high retention rates.

Through analyzing the data, the CEO realized that customers committed to putting in the required time and investment to make HubSpot work were less likely to defect. Additionally, more committed customers were more likely to prepay annually versus paying month-to-month.

Compensation plan: Salespeople earned \$2 per \$1 of monthly recurring revenue. The commission was paid out as follows: 50% on the customer's first month's payment, 25% on the sixth month's payment, and 25% on the 12th month's payment.

Result: The average prepayment commitment was 2.5 months prior to the plan. After the plan was rolled out, that average jumped to 7 months.

Example comp structures based on your business strategy

Example strategy	Example compensation structures to consider
New Net Sales	<ul style="list-style-type: none"> • Provide flat payout per new sale
Bigger Deal Size	<ul style="list-style-type: none"> • Provide commissions by total sales volume • Provide higher commissions on larger ticket sales
Deals with New Products	<ul style="list-style-type: none"> • Provide higher commission payout on new products
Renewals of Current Products	<ul style="list-style-type: none"> • Provide recurring commission payment with renewals
Higher Customer Satisfaction	<ul style="list-style-type: none"> • Provide portion of commission based on customer satisfaction survey
Lower customer churn	<ul style="list-style-type: none"> • Institute a retraction of commissions (a clawback) on customers that churn in the short term • Scale commissions based on sales rep's past retention
Greater profitability	<ul style="list-style-type: none"> • Pay higher commissions on more profitable products
Teamwork and collaboration	<ul style="list-style-type: none"> • Base portion of commission payments on overall business performance

In addition to standard compensation metrics, you can consider innovative ways to incentivize key enablers of the business strategy

Innovative compensation approaches

Build a culture of collaboration

- Base portion of commission payments on overall business performance

Create teamwork within sales team

- Provide 50% of compensation directly to sales rep and allow the rep to distribute the other 50% to other team member(s) that contributed to the successful sale

Utilize your payout policies to further incent desired behavior

- Utilize clawbacks- the retraction of commission payments- for customers who do not pay or who churn very early on
- Payout immediately the full compensation on customers that pay upfront for many months of the good or service

Building a simple, easy to understand plan will be critical to your sales team adopting the desired behaviors

Complex sales compensation plans promote negative behaviors from sales teams

- Sales reps can focus on the wrong objectives
- Sales reps can spend considerable time analyzing and thinking about how to reach sales targets
- Sales reps can become demotivated by lack of clarity in goals

Considerations during sales compensation planning

*“If it takes **more than two minutes for your salesperson to explain the plan to his or her spouse, it’s probably too complicated.**”*

HBR: “The Right Way to Use Compensation”

*“Salespeople **should not need a spreadsheet to calculate their earnings. If too many variables are included, they may become confused about which behaviors will lead to the largest commission check.**”*

McPhillips, Roberts, & Deans, “Should You Revamp Your Sales Compensation Model?”

*“If you get that sinking feeling during the compensation planning process that this is too complicated, then it was already way too complicated...**you have a much higher threshold for things that are complicated and unusable than the people who sell for you.**”*

Forbes, “Sales Compensation Beware You Get What You Ask For

Positive and negative behaviors should quickly be communicated to sales reps, and easily trackable by your sales leader

Rationale for crafting an immediate sales compensation plan

“Establishing a systematic link between a sale and reward/recognition is **more likely to build a positive feedback loop in sellers who are hitting their numbers** and institute a sense of urgency in reps who are consistently missing monthly targets.”

BAI Banking Strategies, “Compensating Sales for Improved Performance”

“Having a **clear dashboard boosts motivation**...it can also alert managers to who needs help and coaching.”

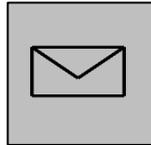
OpenView Partners, “Show Me the Money! A Guide to Creating a Scalable Sales Compensation Plan”

Tactical tools to consider for creating immediacy in your sales compensation plan



Compensation schedules that quickly incorporate sales performance into sales rep’s payout

- Must balance immediate incentives with achieving objectives with longer time horizons (e.g., minimizing churn)



Team communication tools that readout on sales performance

- E.g., a weekly email with the sales rep’s expected comp and performance relative to other reps



Sales leader dashboards that enable quick identification of underperforming sales reps and broader sales challenges, so that leadership can provide coaching and support



Regular sales team meetings where sales performance is shared, and best practices and coaching are provided

Prior to implementing your plan, ensure that you are comfortable with the maximum payout and cost of sales

Testing your sales plan will ensure you are comfortable with the end result

- You cannot retroactively change your compensation plan without risking lawsuits, considerable sales team churn, and decreased company morale
- Build scenarios of sales compensation to ensure you are comfortable with the payout
- When possible compare your sales team's total compensation to others in your market to ensure that you are paying competitively, but not overpaying

Cost of sales can be used to compare how much you're paying per dollar of revenue



Building a thoughtful communication plan is critical to effectively educating and motivating your sales team

Key consideration in building your plan

- Plan **adequate time for the Board and other mentors to provide feedback** and to iterate the plan prior to the 'go live' date
- **Leverage the sales leader's relationship with the team** to further clarify and champion the plan after the kickoff
- Provide an **easy, accessible way for sales team members to provide feedback**

Example communication plan for the first sales compensation plan

Action	Owner	Date
Share draft plan with Board for input	CEO	3-4 weeks before 'go live'
Finalize plan	CEO / Sales leader	2-3 weeks before 'go live'
<i>Plan 'go live'</i>		
Plan announcement / kickoff	CEO and Sales leader	Week of 'go live'
Share written plan document	CEO or Sales leader	Week of 'go live'
Sales leader / Reps 1-on-1s	Sales leader	Week of 'go live'
First payment	HR	2-6 weeks after
Sales rep survey follow-up	Sales leader	3-6 months after

Think through the value proposition for each sales position and communicate the proposition in written and in person communications

Base
Salary
Only

100%
performance
based
compensation

Example value proposition for **high base salary / low variable compensation** sales position:

- Show that their base salary greatly exceeds peers with more variable compensation
- Explain the stability base salary provides during uncertain economic conditions or market changes

Example value proposition for **medium base salary / medium variable compensation** sales position:

- Show their opportunity to make more money than peers through the combination of base salary and commissions
- Explain the stability base salary provides during uncertain economic conditions or market changes

Example value proposition for **low base salary / high variable compensation** sales position:

- Describe that the sales rep's effort will directly correlate with higher compensation
- Show that the sky is the limit in terms of compensation
- Emphasize the product's attractiveness and it's ability to be sold easily

A written and readily available plan document should be made available for all affected team members

A published plan document ensures the sales team can reference and understand the plan

- Your sales **compensation plan should be written, documented and made available** to the sales team
 - In some cases it makes sense to also provide an incentive calculator
- It is recommended that **the front line manager of the sales team meet with** their teams to explain:
 - How sales performance translates to compensation
 - The mechanics of the compensation calculation
 - Examples of payouts

Components of an effective written sales compensation plan

- 1 **Strategy:** Explain the overall business strategy and how the sales strategy fits into it
- 2 **Performance measures:** Detail the overall performance measures that you are targeting for the salesforce (e.g., decrease overall churn by X%, increase revenue by \$Y) to guide the sales team's focus
- 3 **Payout formula:** Outline how the sales team compensation will be calculated and when it will be paid out
- 4 **Governance:** Describe how questions or conflicts over compensation that are not detailed in the plan will be resolved

At least once a year evaluate the effectiveness of your compensation plan, and adjust as needed

There are three key elements on which to evaluate your plan

- **Strategic effectiveness**
 - How did you perform on your 1-2 strategic goals?
- **Market competitiveness**
 - How does your compensation compare to similar players in market?
 - Have you lost employees to competitors providing a more attractive offer?
- **Employee engagement**
 - What does your salesforce say about the plan?
 - Has the plan motivated them to adopt the desired behaviors?

If you decide to overhaul or adjust your compensation plan, a thoughtful approach is required

- Provide **at least 1 month of notice** prior to changing the plan
 - Providing time for the sales team to understand the new plan and adjust to the change will ensure the plan motivates the salesforce
- **Never retroactively change the plan** and respective compensation offer
 - This will erode the trust of your employees, demotivate your team, and potentially open you up to lawsuits
- **Build and execute on a communication plan** for all changes to the plan

Further reading on sales compensation plan

- HBR's, "Incentivizing you salespeople by their relative performance"
 - <https://hbr.org/2012/07/motivating-salespeople-what-really-works>
- Andreesen Horowitz's a16z Podcasts, "The Why, How and When of Sales"
 - <http://a16z.com/2016/04/08/sales-why-how-when/>

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