

# Compensating Media Salespeople

By  
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In recent years many companies have incorporated rewards into their compensation systems for achieving company goals rather than individual goals, for teamwork and cooperation, and for customer service. This trend was confirmed a sales-compensation survey that showed that less than one percent of US salespeople were paid on a straight-commission basis, a pay system used in many media companies.<sup>i</sup>

- In a major reorganization of the Digital Equipment Corporation's (DEC) sales force in 1993, the compensation system was changed radically to reflect new corporate strategy. The new sales incentives were based in part on measuring customer satisfaction more accurately via surveys and factoring these customer survey results into compensation plans.<sup>ii</sup> At the beginning of 1994, IBM restructured its compensation system to reward profitability and customer satisfaction. In the new system, 60 percent of sales commissions (about 35 percent of a salesperson's total remuneration) are based on the profitability of an order, not on overall revenue, and 40 percent are based on customer satisfaction, based on customer surveys.<sup>iii</sup> DEC is gone, but its greatest legacy might well be its innovative compensation system that started a revolution. Customer satisfaction surveys are growing in popularity as a management tool, and according to a survey by Bain & Co. they are the second most widely used management tool in business.

Schuster and Zingheim compare the sales compensation plans of the best performing companies with those of the worst performing companies in their sample across several industries. The best performing companies always integrated their sales compensation plan with corporate goals and did not follow industry practices in designing and implementing their sales compensation plans. Also, the best performing companies gave rewards that were based primarily on performance on desired sales activities rather than just on volume or total revenues.<sup>iv</sup>

Cespedes reports that approximately two-thirds of U.S. companies use a combination of salary and incentive compensation. The reasons companies give for using salary-plus-incentive systems is that it helps them keep compensation costs flexible, it is helpful in setting performance standards that achieve desired company goals and objectives, and it allows management to maintain greater supervision and control over selling efforts.<sup>v</sup>

**Goals of a compensation system.** A well-designed compensation system in should accomplish as many of the following objectives as possible, as suggested by three compensation experts, Edward Lawler,<sup>vi</sup> Richard Henderson,<sup>vii</sup> and Allan Nash:<sup>viii</sup>

1. Aid in meeting an organization's strategic goals.
2. Aid in communicating corporate goals, performance standards, and expectations.
3. Tie compensation directly to current sales performance.
4. Attract and hold good people.

5. Keep salespeople's motivation high.
6. Help in analyzing sales potential, planning account coverage, and allocating selling time.
7. Be understood by salespeople.
8. Be fair to employees.
9. Be fair to the organization.
10. Provide management control.
11. Enhance teamwork and cooperative effort.

**Guidelines for a sound compensation system.** Some of the guidelines for designing a sound plan are:

1. The variable portion (bonus or incentive) must be large enough to justify a salesperson's extra effort. An incentive that is over and above a salary should be at least 15 percent of the total compensation (in the period the incentive or bonus covers) to be effective. Incentives under 15 percent of total compensation are not effective and provide very little additional motivation or incentive.
2. There should be a good balance between security and incentive.
3. Rewards should be based primarily on an individual's performance and effort, and directly commensurate with desired sales behaviors, activities, and results.
4. The plan should be competitive in the industry and in the area (market or region).
5. The plan should reflect the strategy and objectives of the organization.
6. The difference between the compensation of high and low performers must be significant—the highest paid salesperson should earn a minimum of 40 percent more than the lowest-paid salesperson.
7. There should be rewards for both hard (quantitative) and soft (qualitative, behavior-based) performance criteria.
8. There should be no perceived ceiling on earnings.
9. Opportunity for reward must be equal among all salespeople.
10. There is management control over what is sold.
11. There are some rewards for non-selling duties.
12. Incentive payments should generally be prompt and frequent, while remaining large enough to be sufficiently motivating.

**Major problems with compensation systems.** The biggest problem with most sales compensation systems is that they violate objectives number one and two: Aiding an organization in achieving its strategic objectives, and communicating corporate goals, performance standards, and expectations. These problems occur for two reasons. First, sales management has not thought of linking sales compensation directly to strategic objectives and, second, most sales departments have no clear idea of what their long-term goals, standards, and expectations are, other than “go out and get an order” or “bring in enough billing to make budget.”

**Definition of sales performance.** The **objectives of a sales force** are:

1. To get results for customers (another way of saying “create a customer” that is specific to the media business)
2. To develop new business
3. To retain and increase current business
4. To increase customer loyalty

These are the objectives that should be rewarded, not merely getting orders, or making budget. In order to meet these objectives, media salespeople have these overall **sales strategies**:

1. Sell solutions to advertising problems
2. Reinforce the value of advertising and of your medium
3. Create value for your product
4. Become the preferred supplier
5. Innovate

To carry out these strategies, salespeople have **three primary functions**:

1. To create a differential competitive advantage in a buyer’s mind
2. To manage relationships
3. To solve problems

Keeping these objectives, strategies, and functions in mind, following is a comparison of the positive and negative features of the three basic compensation methods commonly used by American businesses, reprinted from Wyatt Data Services' *Manual of Sales Incentive Plans, Volume II*.

## FEATURES OF SALES COMPENSATION METHODS <sup>ix</sup>

FEATURE	SALARY ONLY	SALARY PLUS INCENTIVE	COMMISSION ONLY
Sales Representative Income	Highest income security with lowest degree of income at risk.	Balances income security and income at risk.	Lowest income security, with highest degree of income at risk.
Sales Behavior	Easily used to encourage customer service and non-sales work.	Flexibility to tailor compensation mix to varied sales situations.	Tends to encourage aggressive sales at the expense of customer service and non-sales work.
Reward Flexibility	Lowest degree of flexibility to reward high producers.	Flexible reward mechanism through variable incentive component.	Highest degree of flexibility to reward high producers.
Design Flexibility	Relatively easy to change goals, territories and accounts.	May be difficult to change goals, territories and, accounts.	Difficult to change goals, territories and accounts.
Administration/Communication	Easy to administer, understand, and communicate.	May be costly to administer, complex, and not easily understood by the sales force.	Easy to administer, understand and communicate.
Cost of Sales	Predictable selling costs with tendency to high fixed selling costs during business downturns.	Decrease in sales expenses during business downturns depends on variable portion of salary/incentive mix.	Tends to increase cost of sales by automatically raising commissions paid without extra effort.

Following are the types of commission systems commonly used in many media industries.

**Straight commission or commission only.** A commission-only system typically pays a percentage commission on sales. In smaller market radio and television stations, the commission could be as high as 15 percent, in large-market broadcast stations such as New York or Los Angeles, it could be as low as .50 percent.

**Billing vs. collection.** Commissions can be paid on the basis of billing or collections. If commissions are paid on collections, the company is taking the precaution that salespeople do not sell schedules to advertisers who cannot or will not pay their bills. Many companies, particularly those in smaller markets where

cash flow is often critical, use the paying-on-collections approach because few accounts pay their bills on a current basis. Many small accounts stay 60 or 90 days behind, and many smaller advertising agencies do not pay the media until their clients pay them, which usually means that local media outlets wait a minimum of 45 days for payment. Many larger agencies do not pay their bills for 60 or 90 days in order to use the float to their advantage.

Even though it may help cash flow and keep salespeople from selling to too many deadbeat accounts, paying on collections is hard on salespeople and is not recommended by experts.<sup>x</sup> Salespeople often do not see commissions on a sale for months after they have made it. Even worse, many companies make salespeople collect from past-due accounts, which is a further demoralizing element (the business office should be primarily responsible for collecting past-due accounts, in a nice, gracious manner, and in consultation with salespeople). If salespeople are responsible for collections, they can “get carried away, push too hard, and lose all sense of ethics.”<sup>xi</sup>

It is usually better to pay on billings than on collections. If companies pay on billing, there must be an accounting system in place that keeps track of collections so that salespeople can be charged back for billing on which they have been paid commissions, but which is not subsequently collected in 90 or 120 days. This charge-back system must be rigidly enforced in order to discourage salespeople from selling to accounts that are not creditworthy, or, worse, from placing phantom orders. Phantom orders are placed by unscrupulous salespeople for accounts that they know have no intention of paying their bills or who were not even solicited, just to gain unearned commissions.

Many organizations add commissions back to a salesperson’s paycheck if an account subsequently pays after the 120 days; however, most of these stations deduct from these repaid commissions any costs that they might have incurred in collecting the past-due money. This deduction of collection expenses is a good idea because it reinforces to salespeople the importance of selling to accounts that can and will pay their bills on a timely basis.

**Draw vs. guarantee.** Salespeople on commission usually receive a *draw* or *guarantee* at the beginning of each month against anticipated commissions. This draw or guarantee is meant to tide them over until they get paid their commission on advertising schedules that are run.

One major problem with a draw is that it is very difficult for beginning salespeople to get started and see commissions begin to come in. It is not unusual for starting salespeople to have to live on a relatively small draw for several months and then see their first commission check disappear as the draws are subtracted from it. It is not a particularly good idea to have a compensation system that discourages new salespeople.

In order to overcome this problem, many companies give new salespeople a guarantee instead of a draw. A guarantee is a payment given at the beginning of a month that the organization promises will be the minimum compensation that salespeople will be paid.

Some companies give beginning salespeople a guarantee for three or six months and then change them over to a draw. This system might be workable in a situation where there is absolutely no chance of money being taken back, even in a slack month. However, in smaller markets where there is a possibility the salespeople might not earn enough commissions to cover a draw, this system is not a good idea. People are apt to take the guarantee for the protected period while they desperately seek another job that gives them a more secure feeling of a steady income. Some companies offer new salespeople a reasonable guarantee (say \$1500 per month) and then reduce it by one-twelfth each month for a year in the hopes that a salesperson will have established a viable account list by the end of a year.

If compensation is based on commissions only, then the guarantee system is better. The draw system does not build trust or a feeling of loyalty or security. If salespeople cannot bring in enough billing after a few months to cover a reasonable guarantee, then sales managers have probably hired the wrong salespeople, trained them poorly, or have too many salespeople on the staff.

**Commission-only is not the most effective system.** A commission-only compensation system is not the most effective way to pay salespeople, according to Walter Kiechel, writing in *Fortune*:

Yes, you can pay...on a commission-only basis, particularly if you just want them to ring as many doorbells as possible. But don't expect much managerial leverage that way. The sales staff will simply sell the products they have always had the most success with. What they probably won't do: push new offerings that, while important to the company, are hard to sell; spend a lot of time providing follow-up service to customers; spend time to cultivate new prospects. If you hope to have some say in what your salespeople do, you will have to treat them, in this one respect, like other employees: You may have to pay them a salary, which you then can supplement with commissions or a bonus.<sup>xii</sup>

One of the reasons commission-only systems are used is that the system meets several management administrative (as opposed to strategic) goals: It is easy to administer and its costs are in direct proportion to revenue. However, in other industries that sell services, sales compensation systems are typically more complicated because of the complex role of the salesperson.<sup>xiii</sup>

Some media companies are following the trend in other industries and using salary-plus-incentive arrangements. There are several reasons why the commission-only system is being discarded:

1. A commission-only system does not aid in meeting strategic objectives. In fact, it often impedes objective setting. Since commission-only systems place emphasis solely on short-term billing, other vital sales objectives such as developing new business, effective use of inventory, selling for high rates, selling specials, and maximizing revenue are often given short shrift by salespeople.
2. It does not aid in communicating corporate goals or performance standards, because remuneration is based strictly on billing, or revenue, which is measured quantitatively. There is no weight given to qualitative factors such as work habits, effort, cooperation, top-level-client prospecting, or ethical selling, for example.
3. A commission-only system often creates intradepartmental competitiveness and conflict because billing is based, to a large degree, on two variables: The quality of a salesperson's account list and the amount of inventory available to sell. Under a commission-only system, destructive internal warfare often develops over who gets the best account list, with no thought given to who can best sell a particular account. Secrecy and selfishness are often the result.
4. Maximizing revenue is forgotten as salespeople try to maximize their own billing, often by selling as much inventory as possible for whatever price they can get so they can sell it before someone else does.
5. It does not give management much control over inventory, and it makes account-change decisions difficult. Salespeople get extremely possessive about accounts, thus limiting management flexibility.
6. It creates short-term thinking to the detriment of developing long-term relationships.
7. The assumption underlying the commission-only system is that people are motivated only by money. This assumption was probably never valid, and is even less so in the more quality-of-life-conscious current generation of young people. People are turned on by friendly, cooperative co-workers, by challenges, by interesting work, by security, by caring and supportive management, or by growth-oriented situations, not just by money. People in the media today have a number of interesting and exciting alternatives for making money, and what they are looking for is satisfying, interesting work.<sup>xiv</sup>

Super sports agent Mark McCormack wrote an article in *Sales & Marketing Management* magazine titled "The Case Against Commissions." He writes:

...I made up my mind a long time ago that the best way to keep our company going was to encourage teamwork, communication, and cooperation. That's why I choose to compensate my salespeople on a salary plus a bonus plan. When the company gains, so do the salespeople. A commission structure, which tends to pit a salesperson's self-interest against the company's best interests, doesn't seem to fit this scenario.<sup>xv</sup>

Arthur Leavitt, the ex-head of the SEC, believed that straight commissions were the cause of much of what was wrong in the brokerage business, such as unscrupulous salespeople churning accounts just to get commissions.

However, many knowledgeable people agree that salary (about 40-60 percent of total) and incentive pool (60-40 percent of total) is the best system. Although, straight commissions can work well if the compensation level is high enough to attract the best salespeople available. Also, if agency and account lists are distributed fairly (perceived to be fair by the salespeople) and adjusted often to reflect performance and account shifts, straight commissions can function reasonably well, but it requires constant adjustment by sales management. Salespeople typically see commission-only systems as unfair and favoring the people who have been with the company the longest—the survivors.

Furthermore, it is possible to pay salespeople too much with a straight commission system. It was reported in a *Fortune* magazine article that a salesperson at WFAN-AM in New York made \$400,000 in one year.<sup>xvi</sup> That salesperson was probably great—he must have been to bill enough to make \$400,000 on a station that does not consistently appear in the top ten in the ratings. But is any salesperson at a New York radio station worth \$400,000? Would he have sold as just as much if he made \$200,000? On the other hand, could a radio station be able to attract a top-flight salesperson for \$200,000 in New York? Obviously, there has to be a balance and tradeoff between paying enough to get top salespeople and not paying more than necessary to attract good salespeople.

One of the many criteria for a sound compensation system is that it be fair to both employees and the company. Managers must balance their desire to pay their salespeople well with the need to keep costs in line.

**Commission-only variations.** There are two variations on the commission-only method that are occasionally used: graduated commissions and variable commissions.

Graduated commission plans go two ways: up or down. The systems either pay progressively higher commission rates as billing goes up, or pay progressively lower commission rates as billing goes up. Progressive and retrogressive commission systems do not to work in practice. The progressive system can quickly get out of hand and cost a company too much. The system also fosters internecine warfare among the salespeople for accounts. The retrogressive scale punishes people for selling more, which is totally counterproductive. It is simply a way for a company to save money and reduce a salesperson's level of opportunity—a condition that salespeople recognize immediately and hate.

Most variable commission systems don't work because they don't empower people to make the best decisions for the company. A typical variable system might pay a different commission rate for new business, another rate for selling special inventory, or another rate for special packages or promotions.

If a higher commission percentage is given for new-business, it must be for *developed* new business, or business that salespeople can prove that they made an effort to develop by showing presentations, letters, and so forth. It is counterproductive to give a higher commission merely for “new” business that has not been active for 12 or 13 months that salespeople cannot prove they have made a *tangible* effort to develop.

Also, for a higher new business commission to provide extra motivation and empowerment, it must be substantially higher than the regular commission percentage. A new business commission must be at least 100 percent greater than regular commissions to have any hope of succeeding (otherwise the majority of salespeople will not bother).

The basic problem with most variable commission systems are the underlying assumptions that a relatively small differential amount of money will influence salespeople's behavior and that salespeople will have a significant degree of control over what clients buy and pay for.

For example, if a company paid a 10 percent commission on regular business and a 15 percent commission on new business (a 50 percent premium), then the assumption would be that the higher commission would motivate salespeople to concentrate on developing new business. Under this system, if a salesperson could expect monthly billing of \$30,000 from regular business, he or she could earn \$3,000. In assessing billing potential, the salesperson would estimate how much new business could be developed. Next, the salesperson would estimate how much effort would have to be expended to develop new business. Then, the salesperson would make a comparison between how much new business could be developed with the extra effort versus how much additional regular business could be developed with the same effort.

Continuing the example, assume that a salesperson estimated that the extra effort could bring in 25 percent more business in the average month (or an additional \$7,500 new business on an average monthly billing of \$30,000), or \$1,125 in additional commissions at the 15 percent new business rate. However, the same amount of additional effort might bring in the same 25 percent increase in regular business, or an additional \$750 in commissions at 10 percent. The difference is only \$375 in income for going after the more difficult to sell, long-term new business. Salespeople will usually stay within their comfort zone and settle for the lesser amount, assuming they decide that any extra effort is worth the additional money, which, of course, they may not.

A network-owned television station in Los Angeles tried a system of paying approximately one percent commission on regular business and 6 percent on new business—a whopping 500 percent bonus for developed new business. After several years, the station abandoned the system because it did not motivate any of its entrenched agency salespeople to bring in new business (they were probably farmers or comfort-seekers), while some of the retail-oriented salespeople (those who preferred to call on direct business—they were hunters) were compensated at such high levels that corporate headquarters questioned management's sanity. The motivation to develop new accounts is more a function of a salesperson's basic personality and selling preferences than it is of the amount of new-business commission premium.

Salespeople who view themselves as primarily agency service people (farmers) often cannot change their personalities and overnight become missionary salespeople (hunters). If a company wants to emphasize new business development, it should change

its commission structure and see if it motivates people to get on board with the sales department's sales strategy, and then replace people who cannot adjust.

Many companies are dividing their sales staffs into two separate teams—a developmental or marketing team and an agency or transactional team—and paying them differently. The agency team is often on a lower salary and a higher incentive and the developmental team on a higher salary and lower incentive to encourage long-term thinking and reduce the pressure of closing business.

Of course, the basic assumption error management makes is that all salespeople are only motivated by money. Numerous studies have shown that money is not the prime motivator with the majority of people – even with salespeople. Some people are only motivated by money and some people are not motivated at all by money. Be careful of both types.

**Salary-Plus-Bonus Based on Quota or Budget Achievement.** Some companies use a system of paying salespeople a salary plus a bonus based on achieving individual monthly or quarterly sales revenue quotas or budgets. For example, a company might pay a salesperson a \$5,000 monthly salary plus a quarterly bonus (often a stated dollar amount) of \$10,000, for example, for achieving a predetermined quota.

The problem with salary-plus-bonus systems is that they take a great deal of time to administer, since a manager must have monthly discussions with all salespeople to set quotas. These discussions are often prolonged and heated because sales managers usually try to set quotas that have stretch in them, and salespeople want low quotas to assure that they get their bonuses. In these situations, the highest rewards often go to salespeople who are best at negotiating quotas and who have the best account lists, not necessarily best at selling. Also, it is extremely difficult to set quotas that are perceived to be fair by all salespeople.<sup>xvii</sup> And if the quotas are set in a top-down fashion you can be assured that salespeople will feel they are unfair, and, thus have absolutely no motivating effect. To the contrary, unachievable, perceived-to-be-unfair quotas are demotivating and discouraging.

Furthermore, quotas are often based on the previous year's revenue level, which tends to focus on past performance success rather than on a realistic assessment of future opportunities and current performance in turning prospects into customers. Also, accurately forecasting or projecting future revenue is quite difficult in the volatile media marketplace today. Making an estimate of future business for planning purposes is one thing, but it becomes more difficult when compensation is based on quota setting. Lowballing by salespeople becomes common practice. Rewarding salespeople based on reaching a predetermined budget or goal works much better when revenues are rising from year to year than when revenues are declining due a variety of factors not under a salesperson's control. When business is bad, as in a recession, salespeople often have to work harder than ever and are still not able to meet the previous year's numbers (on which quotas are typically based) and thus have virtually no chance of reaching the quotas or getting a bonus.

By far the worst outcome when tying compensation to quota achievement is that the system virtually guarantees that salespeople will stop working as soon as they make the quota. They know that going over quota or budget means that their quotas will subsequently be raised the next year and in subsequent years, making it impossible to make a budget in the long term.

Also, paying based on making quota or budget emphasizes revenue, which means that whoever has the best list has the best chance of making quota. Therefore, compensating based on hitting a budget number causes salespeople to behave the same way they do under a commission-only system.

Thus, the purpose of setting demanding but achievable individual sales budgets or goals to help a company achieve its overall objectives is usually defeated under a salary-plus-bonus system. Additionally, under a salary-plus-bonus system, maximizing revenue is not a goal, making budget is. A sales department can make or miss a budget in any month or quarter depending on luck (ratings or circulation declines, decline in the economy, and so forth), but luck plays no part in maximizing revenue, a concept based on demonstrating an intelligent effort regardless of ratings, forecasts, budgets, economic conditions, or account movement in or out of the market or medium. Jack Welsh, ex-CEO of General Electric, said about budgets, “Making a budget is an exercise in minimalization. You’re always trying to get the lowest out of people, because everyone is negotiating to get a lower number.”<sup>xviii</sup>

**Salary-plus-commission.** Some companies use a salary-plus-commission arrangement. The advantage of this type of commission system is that it provides some security for salespeople, tends to even out income over a year, and gives companies a method of rewarding non-selling activities such as involvement in company promotions and presentations. The salary-plus-commission system, depending on the size of the salary, tends to put a higher floor and a lower ceiling on salespeople’s earnings.

The disadvantage of this system is that salespeople continue to behave as though they were being paid under a commission-only system. It has all of the disadvantages of a commission-only system and none of the advantages of cooperation and teamwork of other systems, especially a pool system.

**Salary-plus-incentive pool.** Many media companies are using a salary-plus-incentive pool compensation system of one type or another. The typical salary-plus-pool system pays salespeople a base salary and also gives them a percentage of a commission pool, which is similar to profit-sharing arrangements many advertising agencies utilize.

Salaries can vary among salespeople based on a variety of variables such as seniority, ability, or past performance, for example.

**Designing a Pool System.** A pool or profit-sharing system can be extremely effective. The amount of money that goes into a pool can be based on several factors, such as a percentage of a company’s local or total revenue. If a percentage of total revenue (local

and national) goes into the commission pool, then it tends to encourage local salespeople to work on national accounts. Some broadcast stations also give their national sales representative companies a commission (five percent, for example) on total billing in order to reduce the bickering over local versus national business.

Many companies that use a pool system base a salesperson's share of the commission pool on factors other than billing—sales effort and selling behavior are the key factors. Sales managers describe the behaviors that carry out company strategies and then award pool shares based on performance on the listed behaviors, effort, and activities. For example, a sales manager may want to reward salespeople for developing new business, getting high rates, and using qualitative research in sales presentations. At the end of the month or quarter, the sales manager evaluates each salesperson's performance on the desired behaviors and gives the salesperson an appropriate share of the pool. The behaviors and activities are determined in advance for all salespeople, not for individual salespeople, so that everyone can be evaluated on a fair basis.

Thus, a salesperson who did 29 percent of the company's revenue the previous year might have done so because of a good list of accounts and might not have developed new business or done well on other performance criteria in the current year. The sales manager might reduce that salesperson's share to, say, 15 percent of the pool, while raising another lower billing salesperson's share to reward that salesperson for making an extra effort on the desired, predetermined behaviors and activities, such as getting high rates or developing new business.

This type of pool system is better than a commission-only system or a pool system that rewards people based on their current or past billing, because it rewards salespeople for selling the way the company wants them to sell and for helping the company reach its strategic sales objectives. This type of pool system allows sales managers to reward people according to effort and cooperative, team-oriented behavior, not according to revenue, which is determined in large part by a salesperson's acquired (usually through attrition of other salespeople) account list. A flexible management-discretion pool system also helps salespeople focus on how well the entire sales department and their fellow salespeople are doing.

The biggest benefit of a salary-plus-pool system is that it aids in building teamwork and cooperation. It can help companies get their salespeople to think of what is best for the company, not just for themselves. For example, salespeople are much more willing to trade accounts in a pool system. They want the salesperson with the best relationship and personality fit with a customer to call on that customer regardless of previous account assignments. The goal in a pool system is for the company's total revenue to increase. The notion is that a rising tide lifts all boats.

Also, money from the pool can be used for special recognition awards, such as a \$5,000 surprise award for landing a large new account, or money can be used to reward a salesperson for getting a major renewal or for stressing the importance of relationships and long-term business. Furthermore, a small percentage of the pool can be given to

sales support personnel. A small percentage of the pool given to the usually underpaid support staff is invariably supported enthusiastically by salespeople.

The drawbacks of a salary-plus-pool system are that pool systems are often erroneously perceived as group rewards and not as individual rewards and salespeople can consider the system to be unfair and inequitable if they perceive that there is a great deal of disparity in ability and expended effort among the staff, especially if a few strong salespeople feel they are carrying several weaker ones. Also, if shares of the pool are based on past performance, such as previous year's billing, it tends to unfairly favor people with seniority and larger account lists regardless of current performance and effort.

Pool shares must be based on current performance and effort, with higher pool shares going to salespeople who make an extra selling effort and demonstrate the desired sales behaviors.

**Implementing a Pool System.** *Fairness* is the critical element in a pool system (in fact, in *any* compensation system). Before implementing a new compensation system, it is imperative that management get salespeople's input. In an article titled "Fair Process: Managing in the Knowledge Economy" in the *Harvard Business Review*, Kim and Mauborgne report:

...the central idea that emerges from our fair-process research is this: individuals are most likely to trust and cooperate freely with systems—whether they themselves win or lose by those systems—when fair process is observed...Fair process responds to basic human needs. All of us, whatever our role in a company, want to be valued as human beings...we want to be treated with respect for our intelligence...we want our ideas to be taken seriously...we want to understand the rationale behind specific decisions..” Fair process involves seeking people's input—letting them have their say. Fair process is not decision by consensus—it does not set out to achieve harmony or win people's support through compromise. Fair process gives every idea a chance and every one the opportunity to be heard.<sup>xix</sup>

For example, in every sales department, salespeople know who the best salesperson is. The salespeople see who works the hardest, who makes the most calls, who develops the most new business, who has the best relationships with clients, and who gets the highest prices. As long as the salesperson who others perceive to be the best earns the most money, and the second best earns the second most money, and so forth, the majority of the salespeople will perceive the compensation system to be fair. Poor performers won't think such a system is fair and will whine, which is like .150 hitters in baseball blaming the umpires for their lousy batting average.

A good rule of thumb is that salary should not be more than approximately 66 percent of a salesperson's total compensation. If salary exceeds 66 percent of the average salesperson's compensation, then complacency could develop. On the other hand, one of

the best performing sales staffs in broadcasting (according to an agency survey) is paid a salary that is 75 percent of their total compensation. Relatively high salary levels tend to have the same effect that pool systems do. They give management more control, they foster cooperation and account switching among a staff, they give salespeople a sense of security (especially in difficult rating or economic downturns), and they tend to reduce staff turnover.

### **A Combination of Systems is Best**

The most effective type of compensation system for today's media salespeople is a combination of systems.

Using the monthly revenue levels in the above examples, below is how a combination system might look if an organization compensated six salespeople by giving them a monthly salary of \$5,000, plus a share of a pool that is based on 12 percent of revenue. Shares of the pool are paid quarterly (or monthly, if preferred) based on sales management's evaluation of performance on several important, predetermined, specific, and communicated behaviors and activities. If pool shares are paid quarterly, salespeople can be given a monthly draw against expected pool shares. Pool share percentages in the example below vary substantially depending on the sales manager's evaluation of a salesperson's performance.

<u>Sales-person</u>	<u>Monthly Billing</u>	<u>% of Monthly Billing</u>	<u>Monthly Salary</u>	<u>Quarterly Pool Award</u>	<u>% of Pool</u>	<u>Total Quarterly Compensation</u>
#1	\$50,000	3.33%	\$5,000.00	\$2,500.00	4.13%	\$17,500.00
#2	\$150,000	10.00%	\$5,000.00	\$5,500.00	9.09%	\$20,500.00
#3	\$250,000	16.67%	\$5,000.00	\$7,500.00	12.40%	\$22,500.00
#4	\$250,000	16.67%	\$5,000.00	\$9,500.00	15.70%	\$24,500.00
#5	\$300,000	20.00%	\$5,000.00	\$20,500.00	33.88%	\$35,500.00
#6	\$500,000	33.33%	\$5,000.00	\$15,000.00	24.79%	\$30,000.00
<b>Total</b>	<b>\$1,500,000</b>	<b>100.00%</b>	<b>\$30,000.00</b>	<b>\$60,500.00</b>	<b>100.00%</b>	<b>\$150,500.00</b>
					Pool %	4.03%
					Total %	10.03%

In the example above, each salesperson has been given a share of the commission pool based on sales management's evaluation of the salesperson's performance based on several criteria that sales management communicated to everyone beforehand (you'll find a list of performance criteria later in this article). Sales management has given salesperson #1 a slightly higher percent of the pool than the person's billing might indicate, perhaps because that salesperson ranked higher on desired performance criteria than others did. Salesperson #3 has had her pool percentage increased significantly compared to the percentage of billing, indicating a superior effort in achieving pre-stated performance criteria. Salesperson #6 billed 33 percent of the total, but was given only 24.79 percent of the pool, because the salesperson ranked relatively low on the desired performance criteria for the period (month or quarter), the effort was below what was

expected, and the effort (and subsequent pool shares) were not as good as the efforts of salesperson #5.

As discussed previously, salaries do not all have to be equal for all salespeople, although they are in the above example. Salaries can be based on years with the company or experience and can be negotiated individually, but they must be perceived as being fair.

The salary-plus-pool system is a powerful one that allows management to reward salespeople for activity- and effort-based performance (a quantitative element) and for qualitative, behavior-oriented elements. The salary-plus-pool system also allows compensation to be tied to sales performance on desired sales dimensions and for carrying out a department's sales strategy.

### **Implementing a Combination of Systems**

The combination of systems described above comes close to satisfying more of the objectives and guidelines for a sound compensation system given at the beginning of this section than any other compensation system does. When designing a system using the above model, managers generally should keep the total incentive portion above 33 percent of a salesperson's total annual remuneration.

Also, when a system is used that includes a percentage of a pool based on qualitative, behavior and activity elements, it is imperative that the elements be clearly communicated to the sales staff before each evaluation period, and that each salesperson be given candid, specific feedback immediately at the end of an evaluation period (monthly or quarterly, but no longer than quarterly). When salespeople are told why they were awarded their pool percentage, desired behavior and activities are being reinforced and salespeople are being given specific feedback on what is expected of them to fit in with the unit's selling strategy.

None of the evaluative elements should be billing or achieving an individual sales budget. If billing or making a budget are included as factors that are evaluated, then salespeople will behave as though they were working under a commission-only system — account lists become of utmost importance, they will not trade accounts, and they will work for themselves, not the company.

Furthermore, there should be a significant difference between the lowest pool payment and the highest one. If salespeople perceive that the payments are relatively equal, the payments lose all of their reinforcing power, and salespeople come to expect an average payment as part of their overall compensation system—they do not view pool payments as rewards for good sales behavior or consequences for poor sales behavior.

When salespeople are informed about their pool share, they should also be told the range of all the of the other salespeople's pool shares in dollars and in percentages (top amount and share and bottom amount and share) and told what their rank position of pool shares is compared to the other salespeople so they clearly know where they stand in relation to the others. It is also a good idea to post a list of the ranks of the top half of the sales

department where everyone can see it (“Mary #1 pool share for first quarter, Mike #2 pool share, and Jane #3 pool share,” for example). The concept of publishing just the top half of the ranks is to reward those who do well and avoid embarrassing those who are at or near the bottom.

Listed below are some of the behaviors and activities on which pool-share payments might be made. According to David Cichelli, who runs the sales compensation design program for the American Compensation Association, “you have relatively few measures to reward the sales strategy that you want and not overload the compensation program... We generally suggest no more than three measures in a compensation system.”<sup>xx</sup> So, choose three, or at most four, elements below (or make up your own) to use as a basis for periodic evaluations and change these elements from time to time based on a sales department’s strategic selling needs.

### **List of Possible Evaluation Elements**

1. Performance on core competencies (positive attitude, emotional intelligence, listening, creating value, closing, negotiating, e.g.)
2. Customer satisfaction
3. Developing new business
4. Individual goal achievement (not billing)
5. High rates
6. Selling special programs or promotions
7. Closing key target accounts
8. Creating added value
9. Cooperative attitude
10. Use of qualitative research and case studies
11. Depth of account knowledge
12. Selling ideas
13. Vertical agency selling (buyer, planner, creative, executives)
14. Renewal percentage
15. Knowledge of competition
16. Knowledge of market
17. Knowledge of competitive rates
18. Seeking management help
19. Meeting deadlines
20. Support of other salespeople
21. Accurate and timely use of systems such as Salesforce
22. Observing company policies and procedures
23. Effective time management
24. Active participation in sales training
25. Effective prospecting

### **The Floating Salary-Plus-Pool System**

Some companies allow both their salary levels and pool levels to go up or down in proportion to revenue. In other words, as revenue goes up, the amount of money in the pool goes up, as in previously described systems, and, also, as revenue goes up, salaries go up. This system is based on the principle that a fixed percentage of revenue is put into the salary pool rather than a fixed amount of money. Management can distribute salary increases (or decreases) in the salary pool evenly among salespeople or according to performance. This system makes salespeople very happy when revenue goes up, because they share in the increases both with higher salaries and with more in the pool to distribute. The system provides less of a safety net for salespeople when revenue falls, but it does provide management with a lower potential floor on salaries. I recommend that the salary pool increases but never decreases with changes in revenue, it's too demoralizing when the pool decreases and you are apt to lose good salespeople.

### **A Warning About Implementing a New System**

Many sales departments have implemented a salary-plus-incentive pool system and found them highly successful. However, when switching from a commission-only system, one or two of the salespeople with the best account lists often quit. These salespeople are typically list jockeys whose account lists have grown because of attrition and who have top billings because of their lists, not because of their great sales ability or efforts. Companies are usually glad to see these entrenched list jockeys leave, and typically billing, new business, and, especially, rates go up after a commission-only system is dropped and the list jockeys leave. Therefore, when switching to a new system, expect to lose a few list jockeys or at least for the top-billing salespeople to be unhappy initially.

### **Confidentiality Or an Open System**

If there are different salary and compensation levels among salespeople, as is inevitably the case, sales managers have to make a decision on whether to let everyone know what everyone else is making or to keep compensation information confidential. The arguments for confidentiality are: Salespeople do not necessarily know all of the details about other salespeople's performance (degree of difficulty of account list, amount of new business, creativity, initiative, average rates, and so forth), and, thus, it is sometimes difficult for them to evaluate each other objectively.

In an open compensation system, if one employee complains about his or her remuneration level compared to someone else's, the sales manager has to give an elaborate explanation that might violate another salesperson's privacy. In an open compensation system where everyone knows what everyone else is making, some managers avoid the potential for conflict and give everyone close to the same amount. A general rule of thumb is that openness about compensation often causes the difference in pay between top performers and average performers to drop in half.<sup>xxi</sup>

On the other hand, in open systems where sales compensation is regularly posted (monthly, for example), salespeople do not have to guess who is making the most money, they can see it. An open system tells salespeople where they stand; it is clear, measurable feedback. If, and it is a big "if," a compensation system is fairly administered by sales

management, an open system is an excellent way of demonstrating management fairness and how management rewards activities, effort, and strategic selling. An open system can generate a high degree of trust in management.<sup>xxii</sup>

If management has something to hide—unfair account list distribution, playing favorites, rewarding seniority rather than performance—then confidentiality is probably better. If management has nothing to hide and wants to gain the trust of its salespeople, then an open system is probably best. Some companies communicate the pool shares but keep salaries confidential. This system seems to be a good compromise.

In either case, at least a 40 percent spread between top and average salespeople's compensation levels is desirable.

### **Bonus Based on Exceeding Revenue Objectives or Budgets**

To make the above salary-plus-pool system even more effective, a bonus can be added based on the sales department exceeding its overall yearly or bi-yearly local or total revenue objectives, budget, quota, or target. For example, if a company's total sales budget is \$2,000,000, all salespeople might be offered a bonus of 15 percent of their total remuneration as soon as they go 5 percent over the yearly budget. Thus, when total billing reaches \$2,100,000 (105 percent of budget) at the end of October or November, a salesperson who has made a total of \$45,000 so far that year would receive a bonus of \$6,750. Do not give bonuses for hitting revenue objectives or a budget, that should be expected, but give one for exceeding revenue objectives or budget by several percentage points (105 percent is a good number). In this manner bonus money does not have to be paid if a company goes over a budget by a small amount, just \$10, for example.

Bonus arrangements can vary a great deal. They might be based on a percent of compensation to date, or a flat amount given to all salespeople, or as a higher percent of billing going into a pool on all subsequent business (but make it high enough to make a real difference). Whichever method is selected, the bonus should be a minimum of 15 percent of a salesperson's remuneration. This 15 percent rule holds true for contests or for any incentive award. It takes at least 15 percent of their salary to get salespeople's attention. Paying salespeople a large bonus based on exceeding a budget is also an excellent way to create strong peer pressure on underperformers.

One of the big problems with paying bonuses based on making budgets is that making a company's budget is very often not a function of sales performance, but of other factors such as ratings, circulation, or market growth, or the needs of ownership to pay back loans to bankers. It is possible to reward a sales staff for a below-average sales performance in a year of unexpected revenue growth (which makes top management angry) or, even worse, fail to reward salespeople for a spectacular performance in an off year when audience or impressions drop significantly or market or industry revenue declines substantially. In the latter case, it is easy for management to make salespeople feel like losers because they did not meet an unrealistic budget. Making people feel like losers is a poor way to motivate and retain them.

### **Word of Caution**

One of the common errors sales managers make is to believe that money motivates most salespeople most of the time (the “money-motivates-me-so-it-must-motivate-everyone-else” syndrome).

Research indicates that motivating salespeople with money is like trying to fool people. It works with some people all of the time and with all of the people some of the time, but it cannot be used with all of the people all of the time.

In addition to money, other rewards such as recognition, career opportunities, security, sense of accomplishment, autonomy, client satisfaction, and friendly coworkers motivate salespeople. Different types of people give different levels of importance, or valance, to these rewards. In general, increased financial rewards are most highly valued by experienced salespeople and by those with large families, and other rewards, particularly promotion and opportunities for accomplishment and growth, are most valued by younger, less experienced salespeople, those who are unmarried, and those who have relatively high levels of formal education.

### **Flexibility Is Vital**

The fact that different people are motivated by a fairly wide range of different elements is a good argument for having a flexible compensation system that allows management to tailor compensation packages to suit the needs of individual salespeople and encourage them to be as productive as they can be. In the media business today, selling is too complex to rely on ineffective, inflexible compensation systems that were designed decades ago for a simpler age of selling. For example, a company might have a salesperson who is inexperienced in selling and negotiating but handles retail accounts well and writes effective copy. In this case the salesperson might work more productively on a straight salary with participation in a year-end bonus.

### **The New Realities**

Compensation expert Edward Lawler writes: “The world of business has changed dramatically in the last several decades, yet pay practices of most organizations have not. Fundamentally, they differ little from the practices of the 1950s when American companies dominated the world's economy.”<sup>xxiii</sup>

Lawler goes on to indicate that he believes many organizations are more concerned with doing the wrong things right than with searching for the right pay practices. “They have pay systems that are driven more by history and what other organizations do than by strategic analysis of organizational needs.”<sup>xxiv</sup> He indicates that “instead of trying to gain competitive advantage by doing different things, most companies seem happy to copy what other companies do and thereby avoid being at a competitive disadvantage.”<sup>xxv</sup>

Research over the last 20 years has made great strides in establishing the effectiveness of various new pay practices. The experience of such companies as IBM, Toyota, Honda, Herman Miller, Procter & Gamble, Lincoln Electric, Google, and Whole Foods can also serve as models of how innovative pay-for-performance systems can increase

productivity. It is time for those in the media industries to look for new compensation systems.

### **Compensation Systems: Worst to Best**

The ideal compensation system is one that rewards salespeople for achieving a company's strategic selling objectives, that is flexible and takes into account individual differences, and that, above all, is perceived to be fair by the salespeople and one in which their input—fair process—is included and their opinions respected.

Here are the compensation systems I have discussed, listed from worst to best:

- **Worst:** Salary plus bonus (typically based on making budget)
- Draw against commission
- Guarantee against commissions
- Salary plus commission
- Fixed salary plus pool
- **Best:** Relatively high flexible salary-plus-pool-plus-bonus combination (salary paid monthly, pool paid quarterly, and bonus paid on exceeding a total yearly revenue budget).

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