Optimization of the sales incentive system

R&P speaks at the CEO-Congress

Optimization of the Sales Incentive System
Annual CEO-Congress - Lausanne

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Roll & Pastuch has repeatedly been awarded as Germany's best consultancy for marketing and sales

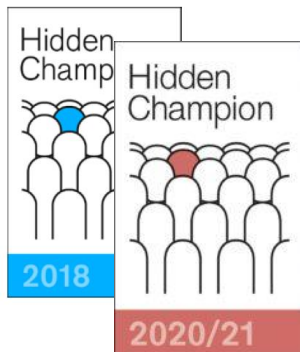## Best of Consulting "WirtschaftsWoche"

Prof. Roll & Pastuch has repeatedly been awarded by WirtschaftsWoche as "Best consulting company for Marketing and Sales"

Top Consultant

According to brandeins, Prof. Roll & Pastuch has been a top consultant for many years

Hidden Champion

Rank	Company	Rating
1	Prof. Roll & Pastuch	409
2	Batten & Company	403
3	Simon-Kucher & Partners	402
4	Boston Consulting Group	389
5	McKinsey	384

Most recently, the award as Hidden Champion was presented again for Marketing and Sales by the specialist magazine Capital

Prof. Roll & Pastuch – Management Consultants has a strong focus on revenue-driven profit growth

Consulting focus

Our focus is on revenue-driven profit growth

Price and sales optimization

PROFIT =	Price	X	Quantity	–	Costs

Industry focus

Automotive	Technology
Commodities	Machinery/engineering
Chemicals	Tools
Energy and utilities	Industrial goods
Consumer products	Medical devices & services

Key topics

Pricing	Sales	Strategy
▪ Price increases	▪ Sales audit	▪ Growth strategy
▪ Value pricing	▪ Customer segmentation	▪ Digital strategy
▪ Discount systems	▪ Sales incentive system	▪ Sales strategy
▪ Digital products	▪ Value selling	▪ Market entry strategy
▪ International pricing	▪ Sales efficiency	▪ …

Conferences and studies*

We present the latest trends in sales and price management on international and national conferences

* excerpt

During today's session I would like to talk about the strategic topic of the sales incentive system

Overview: Optimization of Sales Incentive System

1.	**Challenges**	What are current challenges / trends associated with the sales incentive system?
2.	**Structure / System**	What strategic questions should you consider, when optimizing a sales incentive system?
3.	**Optimization**	How can the system be optimized? What decisions should be made?

Optimization of Sales Incentive System

The sales incentive system poses a huge challenge for many companies – Often both management and employees are not satisfied

Typical sales incentive system challenges:

Selected issues: Corporate

How can I get more steering via the sales incentive system? Almost all salespeople get similar pay-out?

Employees do not act according to corporate targets but optimize salary!

What is the right level of variable salary? We have huge differences even inside a country?

We have huge administrative efforts in running the system – How can we improve?

We want to drive profit but sales is targeted fully on volume…. What can we do?

…

Selected issues: Employee

The incentive system is so complicated – I do not understand what to do to improve pay-out?

One of my colleagues received a windfall profit – He has secured his pay-out for the mid-term…

I spend a lot of time trying to calculate the decisions of my sales…

…

Sales Incentive System as Component of Performance Management

The incentive system does not…

…substitute sales / performance management

…substitute lacking sales training

…substitute lacking sales processes

Sales Management	Sales Controlling	Sales Planning	Sales Processes
	Sales Training	**Sales Incentive System**	Sales Skills
Customer Planning	Portfolio Strategy	Discount System	…

Overview motivational factors
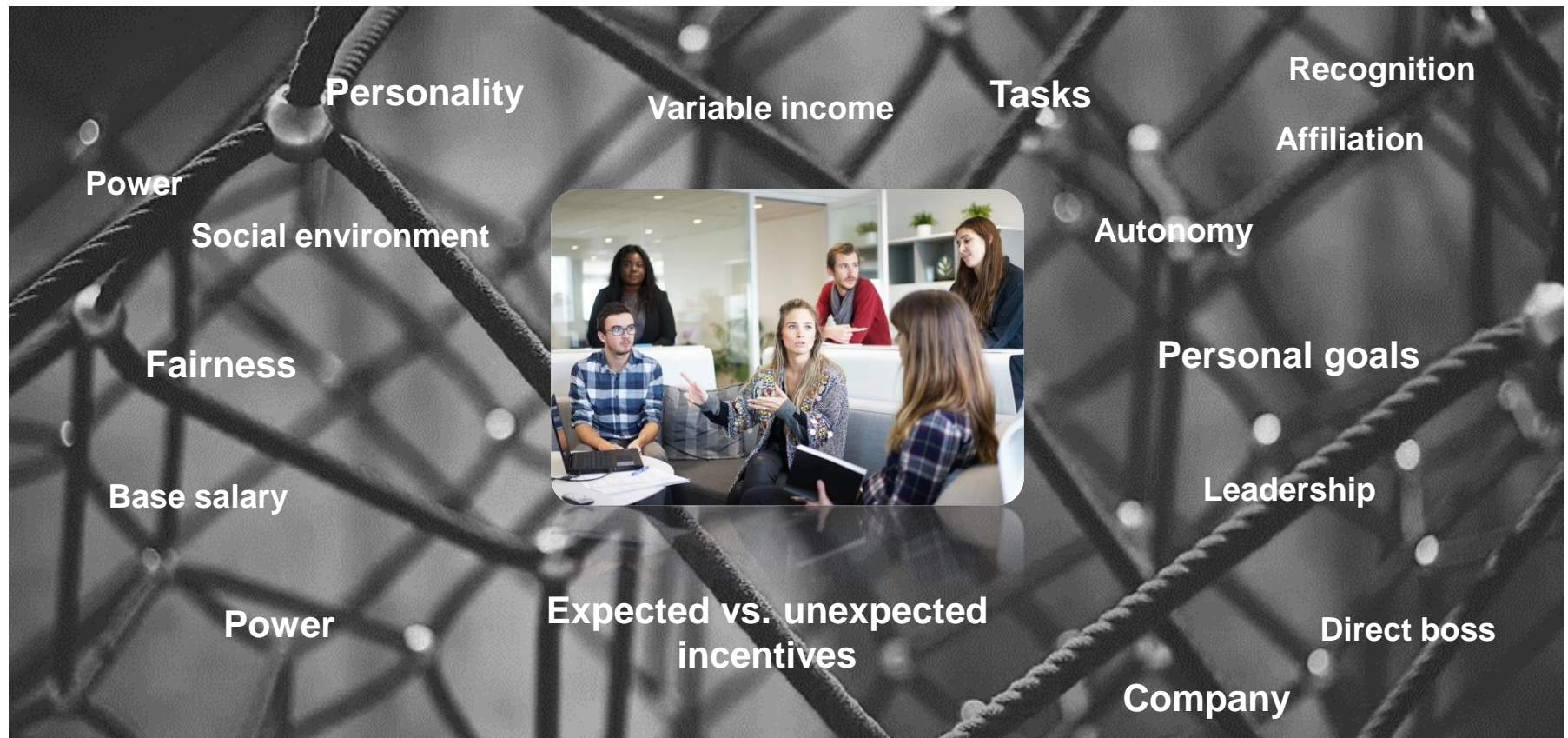
Conflict due to conflicting incentives
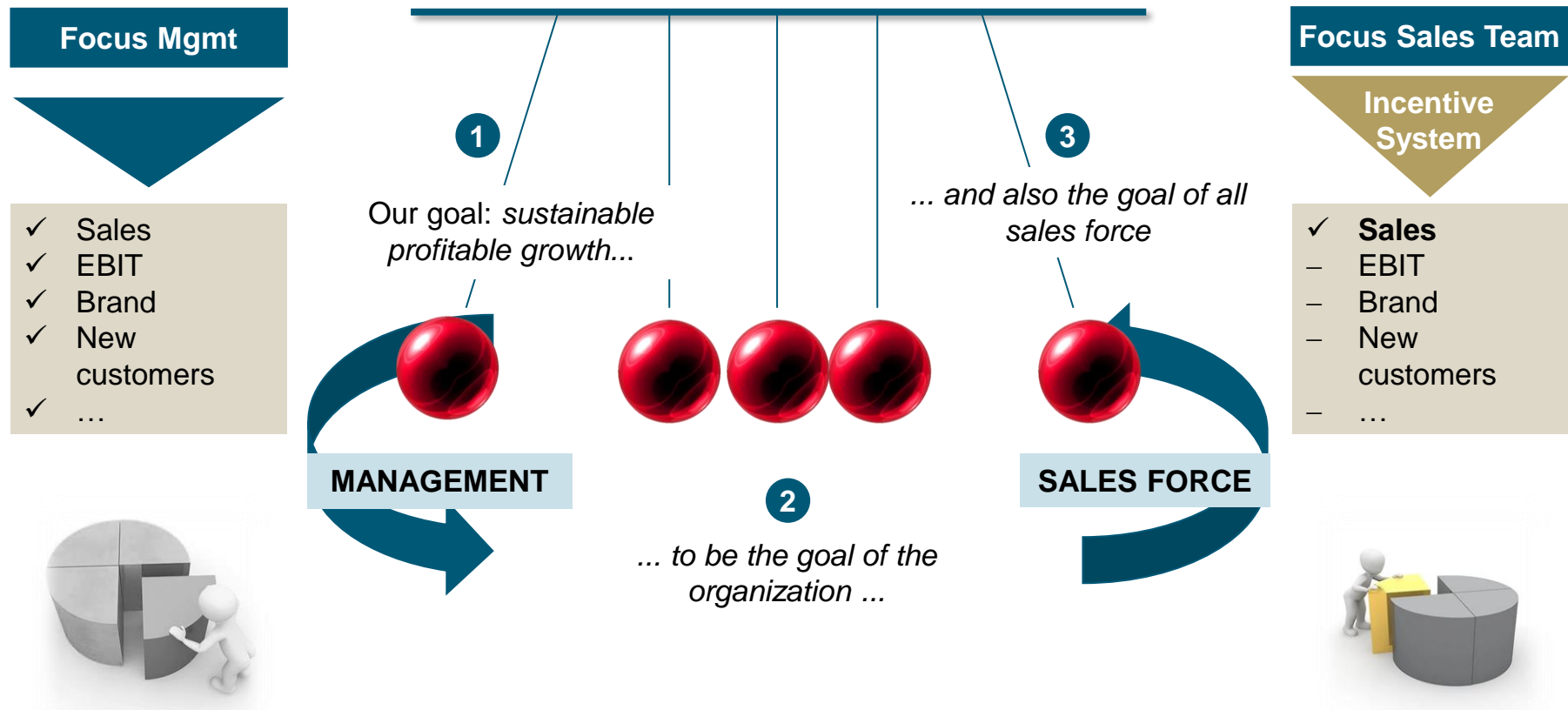
Focus Mgmt

- ✓ Sales
- ✓ EBIT
- ✓ Brand
- ✓ New customers
- ✓ …

1 Our goal: *sustainable profitable growth...*

3 *... and also the goal of all sales force*

MANAGEMENT

2 *... to be the goal of the organization ...*

SALES FORCE

Focus Sales Team

Incentive System

- ✓ **Sales**
- − EBIT
- − Brand
- − New customers
- − …

Overall view: Sales motivation systems

1 Salary system **FOCUS**	**2** Incentive system (Temporary)	**3** Culture and control
Definition of the salary components:	Definition of temporary motivational campaigns	Focus on all non-monetary elements of motivation
▪ Elements / weighting of system	▪ Individual push actions to control or promote specific points (e.g. promotion, new customers, etc.)	▪ Factors influencing the general motivation in the team
▪ Curve progression at target achievement	▪ Direct measurement of success	▪ Transparency in the sales team to optimize self-control
▪ Planning system		
▪ …		

We keep temporary incentive components in mind as a fallback option and to streamline the target system

Forms of incentives for employees

- Events (Experience)
  - Travel
  - Action Events
  - Award as Best Practice in the Sales Meeting
  - Field service of the year
- Money (Have)
  - Vouchers
  - Special premium
- Status (Being)
  - Company car
- Development (Becoming)
  - Trainings
  - Seminars
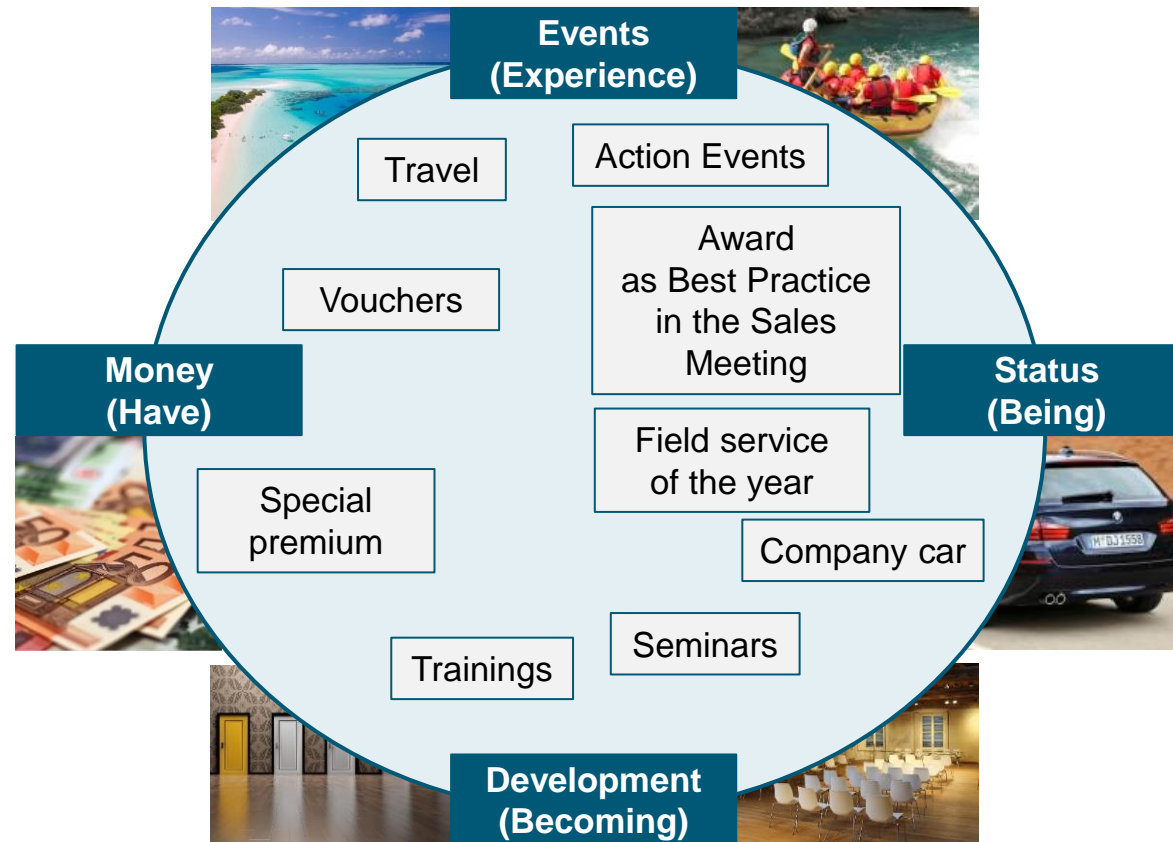
Notes

- In addition to extrinsic motivation, which is often ensured by monetary benefits, the intrinsic motivation of an employee is essential

- Monetary incentives have a very clear steering function, but can conflict with intrinsic motivation

- Company events, awards for special achievements or other forms of recognition are often more favorable

During todays session we would like to talk about the strategic topic of the sales incentive system

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Optimization of Sales Incentive System	1.	**Challenges**	What are current challenges / trends associated with the sales incentive system?
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A synchronized salary system should meet both corporate and employees needs

Requirements for the compensation system...

... from employees' perspective		... from company´s perspective

✔ **Relevance / Influence:**
Impact of personal effort, success and compensation should be recognizable.

✔ **Fairness (horizontal / vertical):**
Level of compensation should be plausible in comparison to peers / superiors

✔ **Predictability:**
Both amount of the fixed / variable salary components should be predictable in the medium term.

✔ **Comprehensibility and transparency:**
The calculation of variable compensation should be understandable

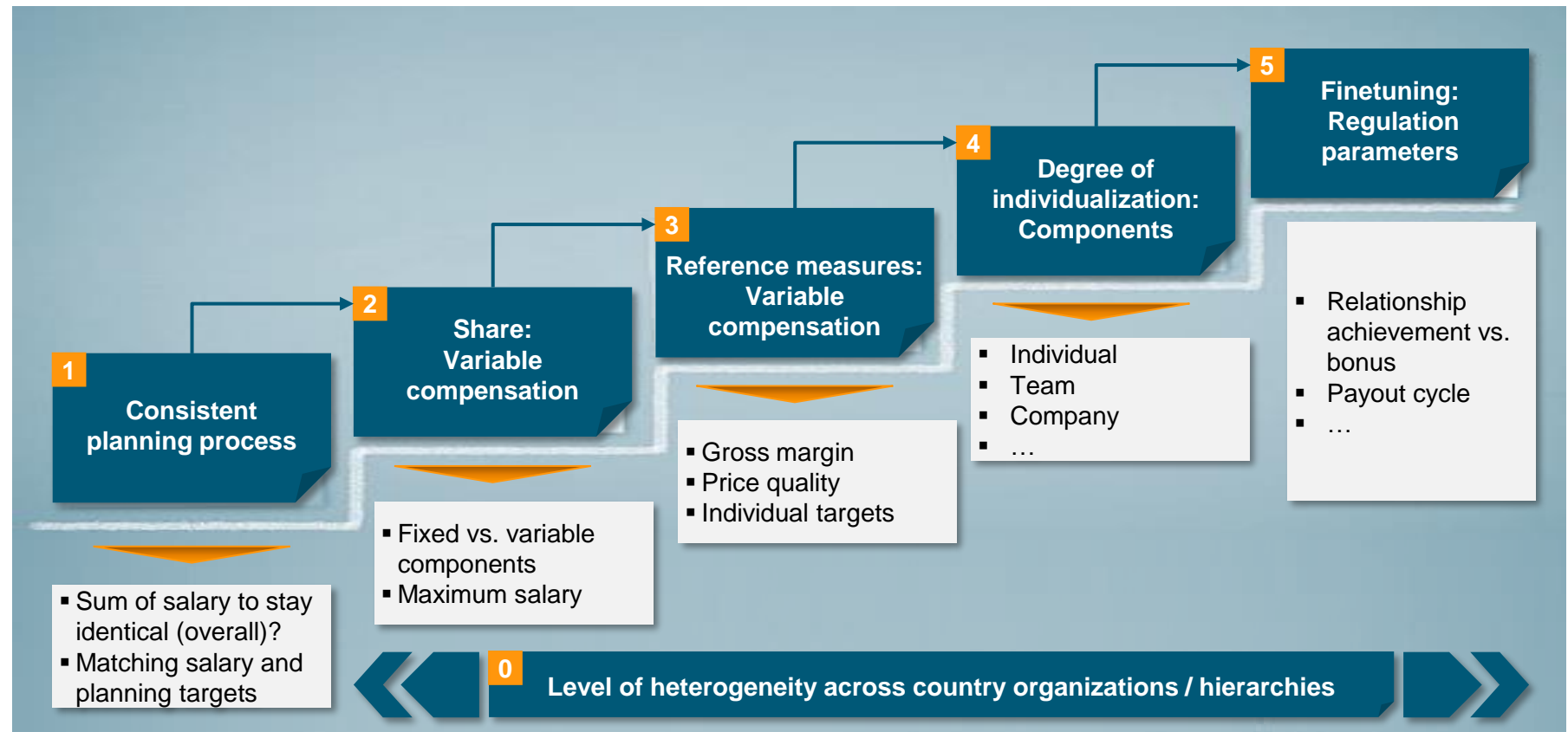**Target:
Win-win situation** between management and employees

✔ **Optimum incentive effect:**
The compensation system is designed to steer / motivate employees to act in line with corporate objectives

✔ **Team promotion:**
The system is designed to encourage employees to put selfish interests aside in favor of team interests

✔ **Employee retention:**
Capable employees should be retained

✔ **Budgetability:**
Cost of compensation should remain budgetable, flexible and limited

The components of a salary system should be optimized and adjusted in a systematic process taking all relevant parameters into account

Steps for optimization of a salary system

1 Consistent planning process

- Sum of salary to stay identical (overall)?
- Matching salary and planning targets

2 Share: Variable compensation

- Fixed vs. variable components
- Maximum salary

3 Reference measures: Variable compensation

- Gross margin
- Price quality
- Individual targets

4 Degree of individualization: Components

- Individual
- Team
- Company
- …

5 Finetuning: Regulation parameters

- Relationship achievement vs. bonus
- Payout cycle
- …

0 Level of heterogeneity across country organizations / hierarchies

20

A thorough assessment of the status quo is essential to identify potential hurdles for project success

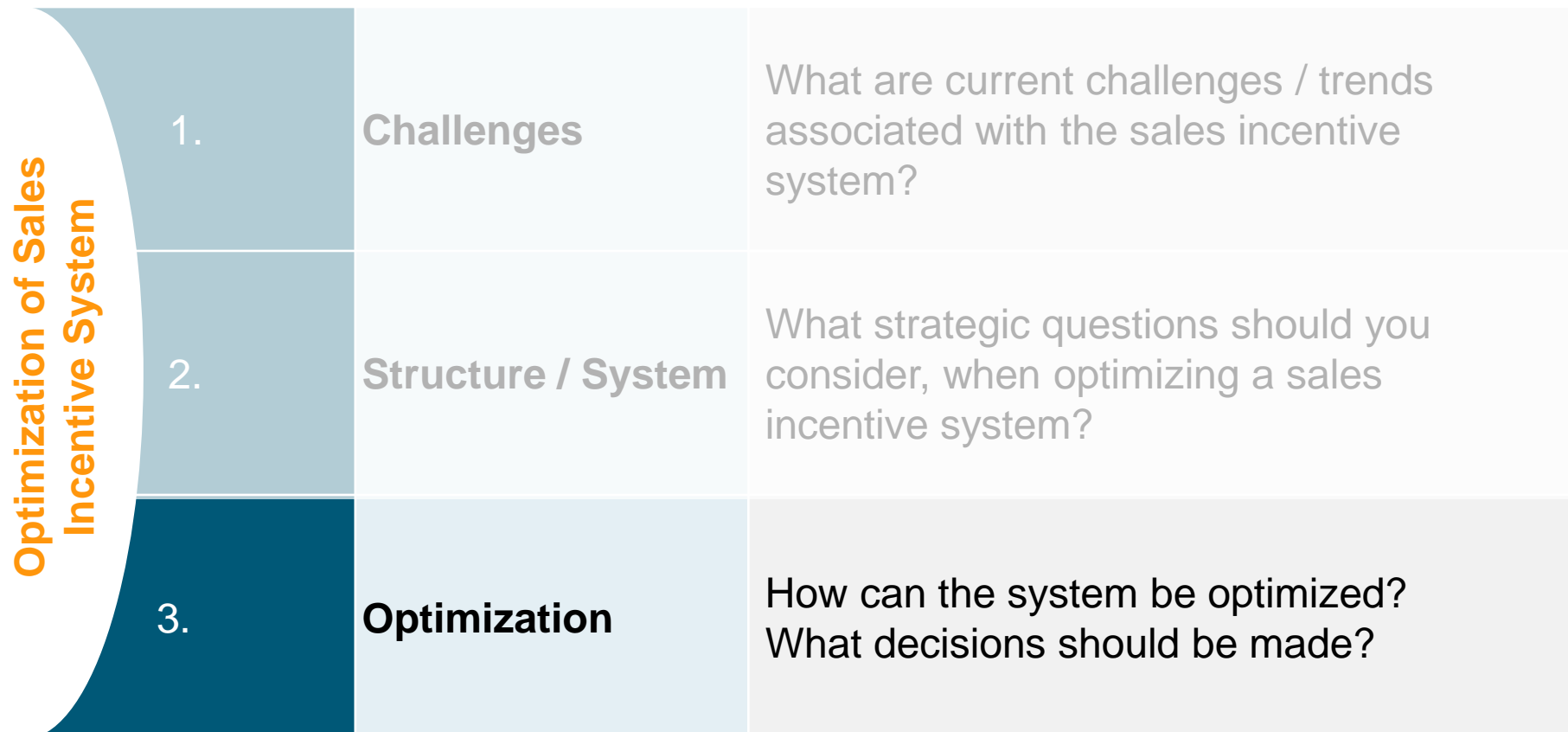**PROJECT EXAMPLE**

Salary structure: level of heterogeneity

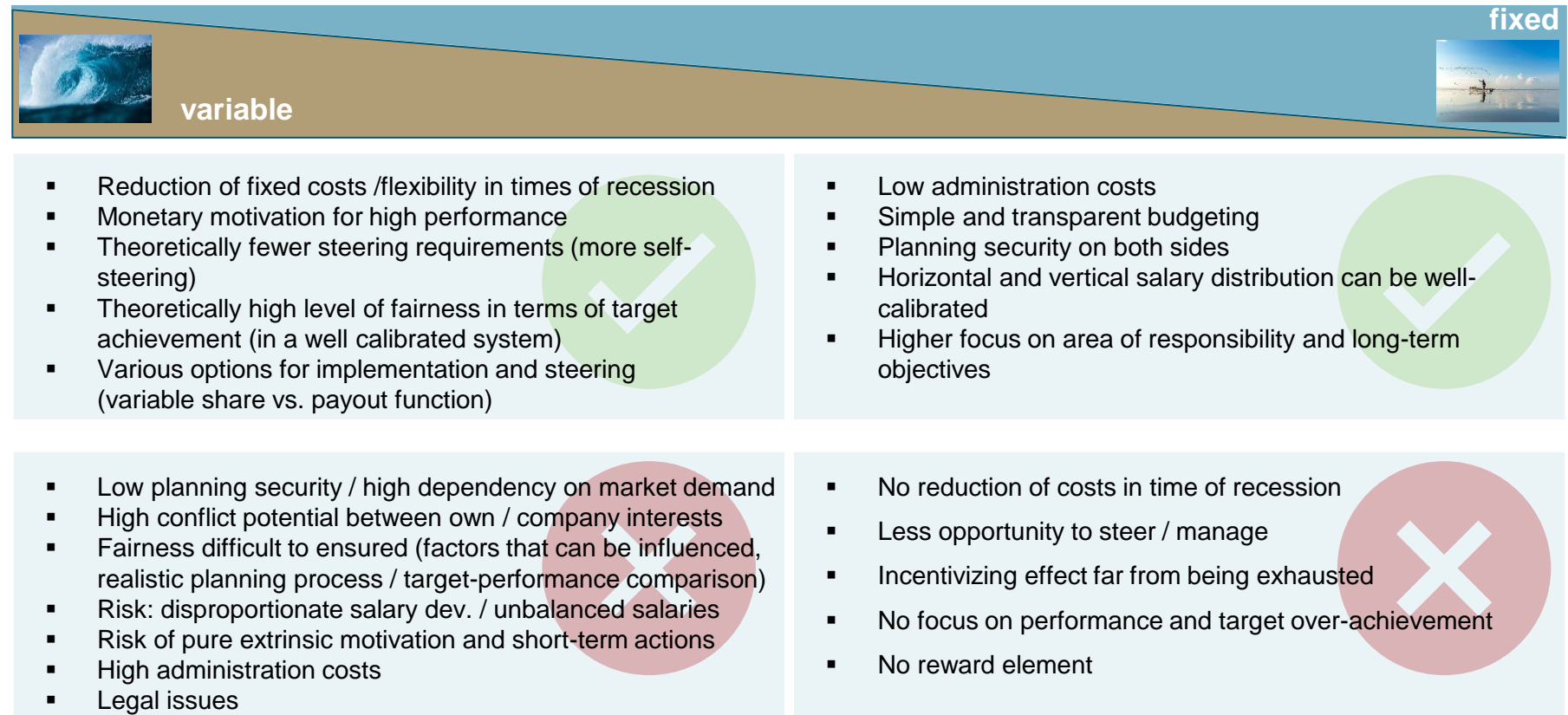| Salary structure heterogeneity between...		**high** *Level of heterogeneity* **low**		
... countries		▪ Country specific salary model ▪ Variable part of salary differs strongly (elements partly not implemented) *ASSESSMENT*	▪ General salary models to choose from ▪ Framework for share of variable compensation	▪ Basic model containing fixed salary elements / variable elements already implemented companywide
... hierarchies		▪ Highly individual salary elements that are not always related to hierarchy specific objectives / corporate planning	▪ Defined salary models linked planning processes and objectives across hierarchies	▪ Majority of salespeople have the same salary elements / proportions in line with their respective hierarchy
... individuals		▪ Highly individual salary elements and proportions for ADMs on same hierarchy level	▪ Defined salary models to choose from ▪ Framework for share of variable compensation	▪ Strictly defined salary elements and proportions model containing fixed salary elements companywide

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Overview: Optimization of Sales Incentive System

Optimization of Sales Incentive System

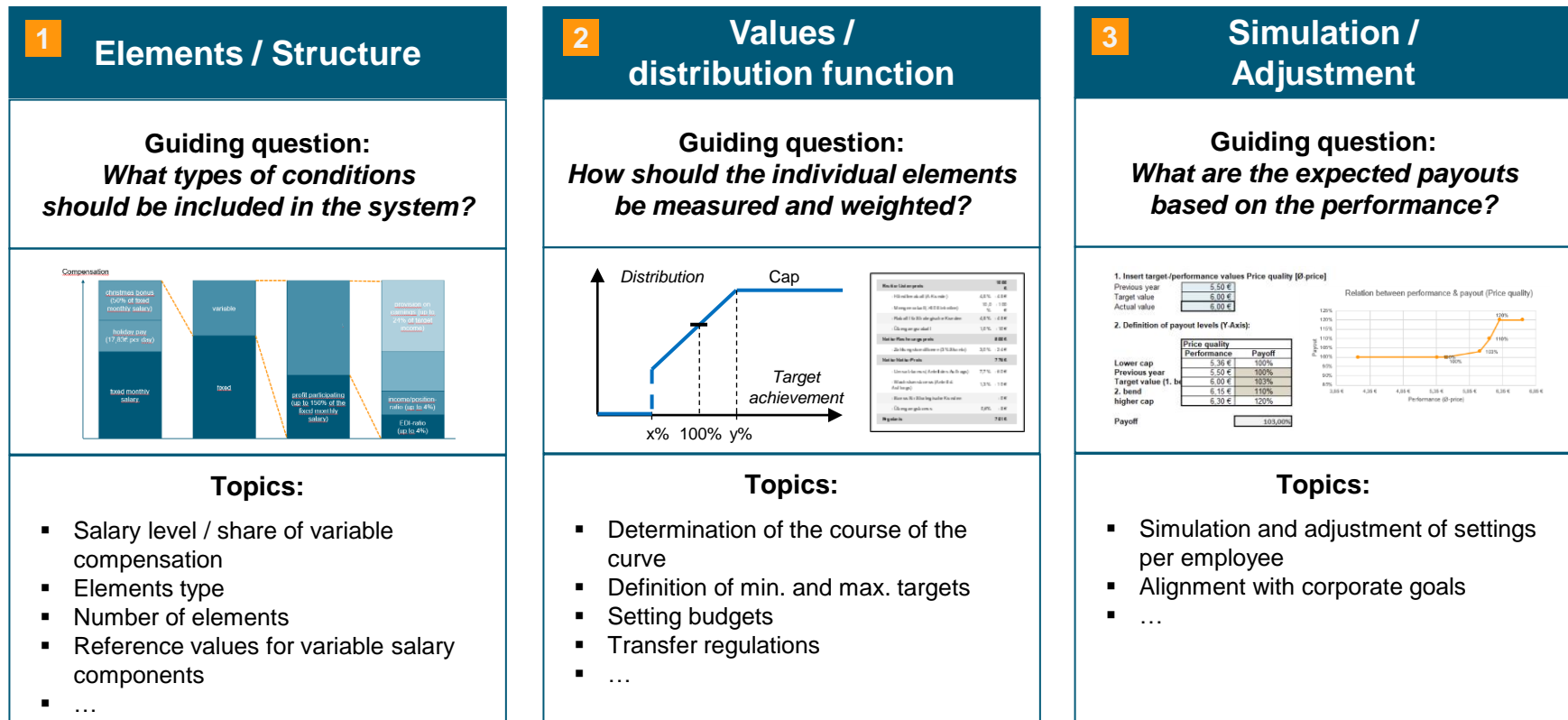|		
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A sustainable balance in-between variable and fixed salary system must be found depending on needs and corporate culture

General pros and cons of variable vs. fixed salary structures

fixed

variable

- Reduction of fixed costs /flexibility in times of recession
- Monetary motivation for high performance
- Theoretically fewer steering requirements (more self-steering)
- Theoretically high level of fairness in terms of target achievement (in a well calibrated system)
- Various options for implementation and steering (variable share vs. payout function)

- Low administration costs
- Simple and transparent budgeting
- Planning security on both sides
- Horizontal and vertical salary distribution can be well-calibrated
- Higher focus on area of responsibility and long-term objectives

- Low planning security / high dependency on market demand
- High conflict potential between own / company interests
- Fairness difficult to ensured (factors that can be influenced, realistic planning process / target-performance comparison)
- Risk: disproportionate salary dev. / unbalanced salaries
- Risk of pure extrinsic motivation and short-term actions
- High administration costs
- Legal issues

- No reduction of costs in time of recession
- Less opportunity to steer / manage
- Incentivizing effect far from being exhausted
- No focus on performance and target over-achievement
- No reward element

Put a strong focus on the sustainable selection and design of the elements of the salary system

Procedure model

1 Elements / Structure	**2** Values / distribution function	**3** Simulation / Adjustment
Guiding question: *What types of conditions should be included in the system?*	**Guiding question:** *How should the individual elements be measured and weighted?*	**Guiding question:** *What are the expected payouts based on the performance?*
Topics:	**Topics:**	**Topics:**
▪ Salary level / share of variable compensation ▪ Elements type ▪ Number of elements ▪ Reference values for variable salary components ▪ …	▪ Determination of the course of the curve ▪ Definition of min. and max. targets ▪ Setting budgets ▪ Transfer regulations ▪ …	▪ Simulation and adjustment of settings per employee ▪ Alignment with corporate goals ▪ …

The selection of reference variables is based on the existing sales targets and should be derived systematically

Sales targets / reference figures

Optimization of volume	▪ Sales ▪ Growth ▪ Market share ▪ …	**+** Easy measurement **-** Pure volume thinking is rewarded
Maximization of profit	▪ Contribution margin absolute ▪ Discount (%) ▪ EBITDA (%) ▪ …	**+** Important for sustainable profitable growth **-** Often difficult to calculate at individual level
Improvement of customer relationship	▪ Customer satisfaction ▪ Customer loyalty ▪ …	**+** Important for the timely detection of problems **-** Difficult to measure
Optimization of internal processes	▪ Response time to requests ▪ Number of offers ▪ …	**+** Increasing importance from the customer's point of view **-** Partly difficult to measure

Evaluation

One typical impact of revenue-based sales incentive system is that the make price increase enforcement difficult

Impact of sales team incentive system

Does your incentive system support the implementation of price increases?

Gain by profit increase (no personal gain)

Risk of losing revenue (lower personal bonus)

Incentive system

Price increase
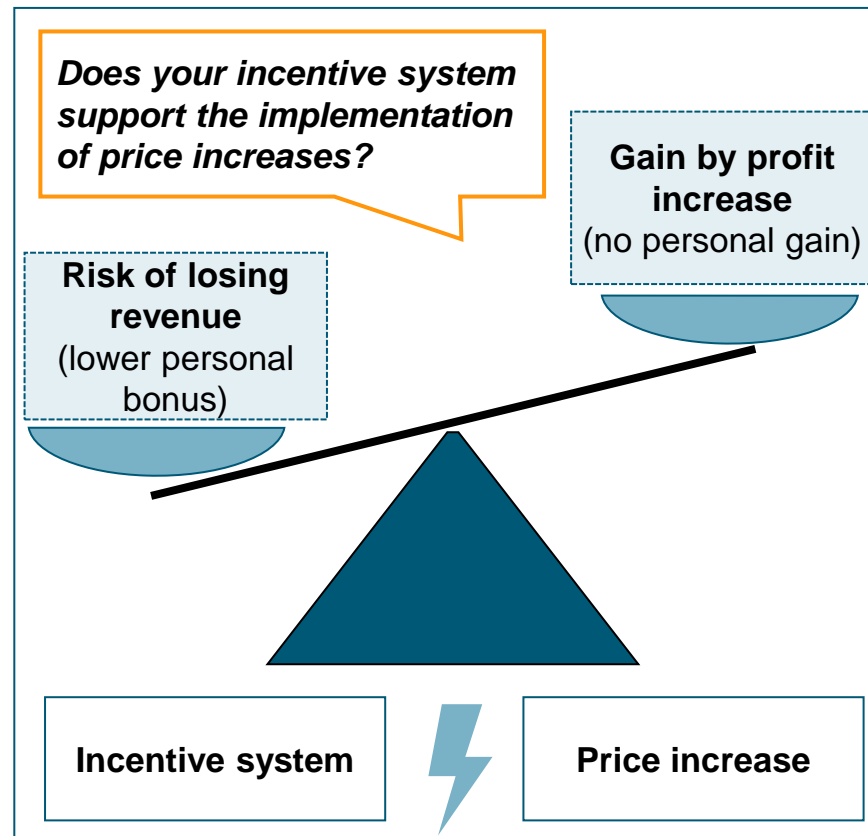
- Several companies have a sales incentive system that is based on revenue but not on price quality / profitability

- If sales is incentivized on revenue only, then during negotiations the fear of losing revenue is higher than the potential gain of profitability

- This will lead to a lack of self-confidence and motivation to follow-through with the increase and defend profitability eroding the price increase

- Introduce profitability / price quality elements to foster motivation / awareness to defend / raise profitability

Detailed design of possible profit measurement parameters

	Discount	CM Absolute	CM Percentage	Price quality
Parameter	*Pay-out determined on basis of granted discount*	*Pay-out determined on basis of generated absolute CM1*	*Pay-out determined on basis of generated CM1 in %.*	*Pay-out determined on basis of fulfillment price / discount targets*
Rating	✅ Simple calculation and handling ✅ Direct compensation of individual sales performance ❌ Difficult to consolidate ❌ Lower motivation to achieve a target range	✅ Simple calculation / handling ✅ Influence of the real earnings situation ❌ Dependence on cost dev., therefore not fully influenceable by sales ❌ Sales's insight into the revenue structures ❌ Partial overlap with sales targets ❌ Cannibalization possible regarding price quality	✅ Simple calculation / handling ✅ Influence of the real earnings situation ❌ Dependence on cost development, therefore not fully influenceable by sales ❌ Sales's insight into the revenue structures ❌ No volume consideration	✅ Add. volume cannot compensate high discounts ✅ Overachievement of goals is possible and generates high motivation ❌ High planning effort ❌ No volume consideration

The basis of incentive elements can be based on individual, group or even corporate performance with different impact

Design decision: Degree of individualization (per component)

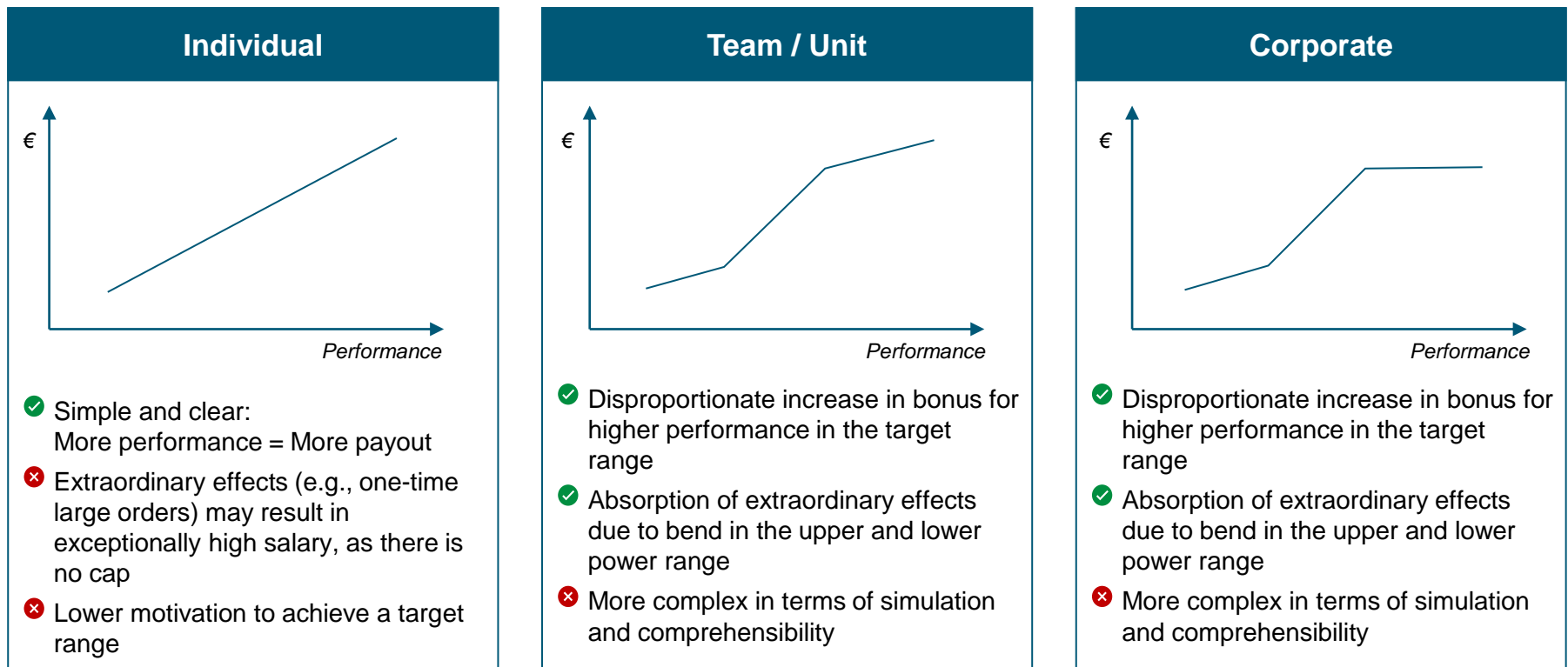| Individual	Team / Unit	Corporate
✅ Individual merit / performance not rewarded individually	✅ Team goals are reflected	✅ Strategic corporate goals are reflected
	✅ Especially key account / general activities are fostered	✅ Mitigate market dynamic / share risk
❌ Team goals are not reflected	❌ Individual merit / performance not rewarded individually	❌ Unit / team merit not rewarded invidually
❌ Company goals are not fully reflected	❌ Unit targets prioritized in front of corporate targets	❌ Individual merit / performance not rewarded individually
❌ Individual vs. company goals overweighted		

ℹ️ Especially for sales teams where collaboration / key account management is key individual components have the tendency to foster individualistic behaviour ℹ️

The basis of incentive elements can be based on individual, group or even corporate performance with different impact

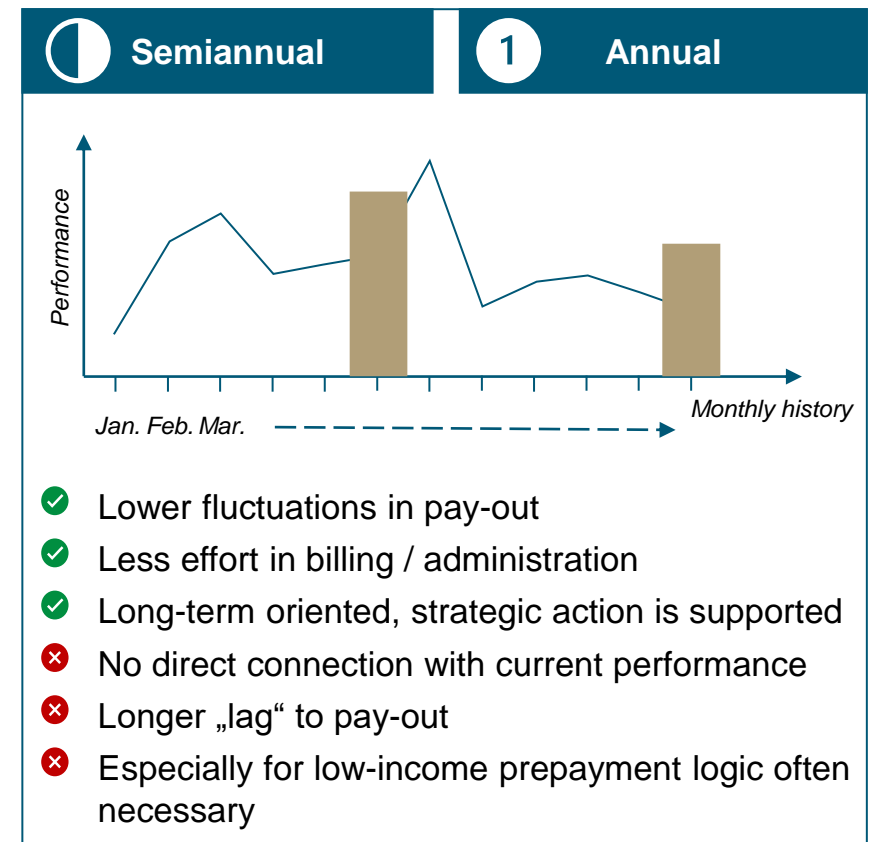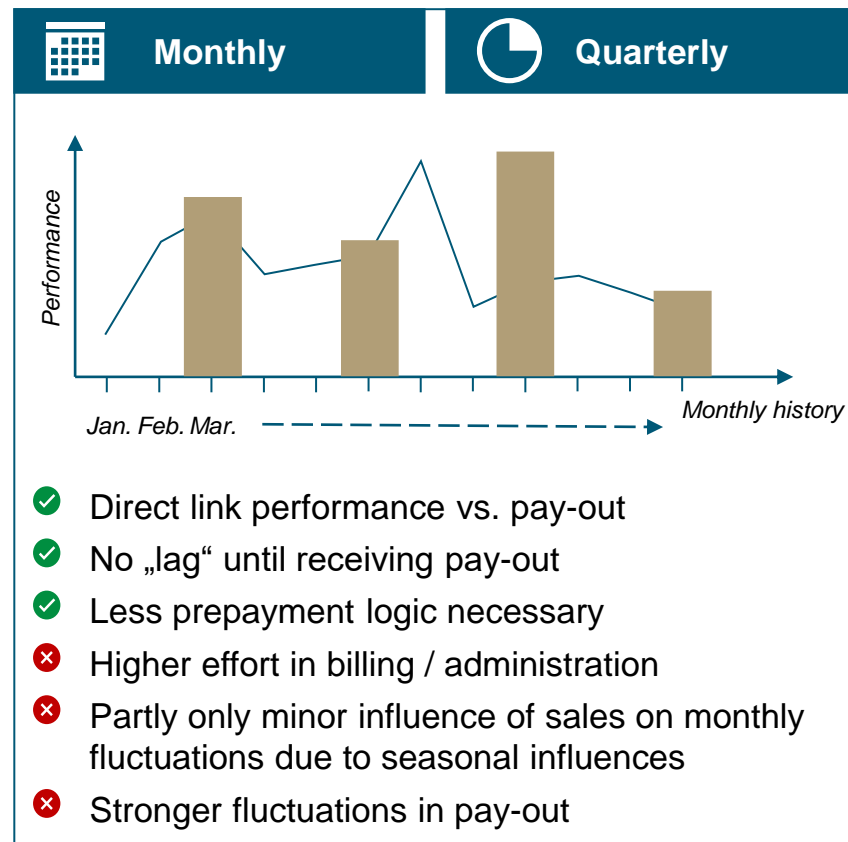## Design decision: Degree of individualization (per component)

Individual	Team / Unit	Corporate

Individual

€ ... *Performance*

- ✅ Simple and clear: More performance = More payout
- ❌ Extraordinary effects (e.g., one-time large orders) may result in exceptionally high salary, as there is no cap
- ❌ Lower motivation to achieve a target range

Team / Unit

€ ... *Performance*

- ✅ Disproportionate increase in bonus for higher performance in the target range
- ✅ Absorption of extraordinary effects due to bend in the upper and lower power range
- ❌ More complex in terms of simulation and comprehensibility

Corporate

€ ... *Performance*

- ✅ Disproportionate increase in bonus for higher performance in the target range
- ✅ Absorption of extraordinary effects due to bend in the upper and lower power range
- ❌ More complex in terms of simulation and comprehensibility

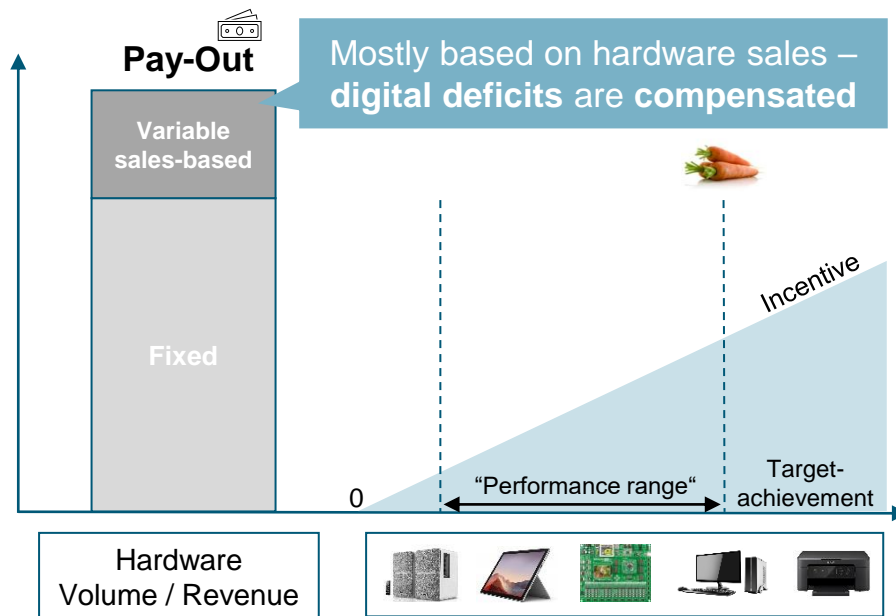ℹ️ As a rule, the curve progressions should be identical for all employees within a cluster ℹ️

The payout cycle should balance both motivational impact and administrative burden – Also the sales cycle differs by company

Design decision: Pay-out rate (per component)

Monthly	Quarterly

Performance

Jan. Feb. Mar. - - - - - - - → *Monthly history*

- ✅ Direct link performance vs. pay-out
- ✅ No „lag" until receiving pay-out
- ✅ Less prepayment logic necessary
- ❌ Higher effort in billing / administration
- ❌ Partly only minor influence of sales on monthly fluctuations due to seasonal influences
- ❌ Stronger fluctuations in pay-out

Semiannual	1 Annual

Performance

Jan. Feb. Mar. - - - - - - - → *Monthly history*

- ✅ Lower fluctuations in pay-out
- ✅ Less effort in billing / administration
- ✅ Long-term oriented, strategic action is supported
- ❌ No direct connection with current performance
- ❌ Longer „lag" to pay-out
- ❌ Especially for low-income prepayment logic often necessary

Challenge: Digital product sales vs. incentive systems (1/2)

Pay-Out

Mostly based on hardware sales – **digital deficits** are **compensated**

Variable sales-based

Incentive

Fixed

0   "Performance range"   Target-achievement

Hardware Volume / Revenue

- ✖ Via **hardware sales volume / revenue targets** are directly **fulfilled** – this is **not the case for** long-term **subscription** sales

- ✖ Most **systems lack** a **profitability** / **pricing component** thus **high profitability of digital products does not have** a significant **impact** on pay-out

- ✖ **Penetration rates are not relevant** for regular incentive systems – thus **initial motivation** to get started with digital sales in **inhibited**

Challenge: Digital product sales vs. incentive systems (2/2)

Hardware Sales	Qualitative Targets	Price Quality	**Digital Sales**
X%	X%	X%	X%

Penetration Rate

10% 20% 30%

Payout

Low Medium High

! Booster for all components

- ✓ **If digital sales are critical** and **strategic** to your companies future – **Do not enable other performance to compensate for 'digital deficit'**

- ✓ Introducing a **dedicated component** for **digital sales** pushed the goal internally

- ✓ To truly motivate utilize indicators such as **penetration rates** to understand the performance of an individual sales person

- ✓ **Set boosters** eg. **push overall pay-out** if specific **digital goals are met**

EXAMPLE

Component profile: Volume

Component:	Volume	
Measure:	Order entry	…
Measurement granularity:	Complete portfolio	…
Model:	Target	Deal-by-deal
Target level:	Rep	Team	Company
Curve: pay out	linear	…
Cap: pay out	130%	…	none
Min target achievement	70%	…	none
Settlement	…	…	…
Pay-Out	quarterly 50% pre-payment	…	…
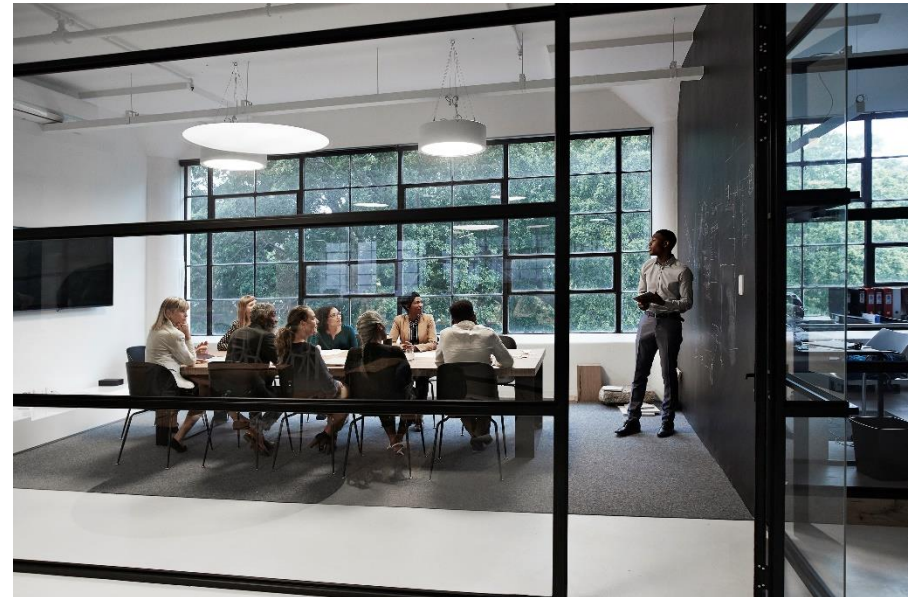
For the initial calibration of the salary system, we use proven tools to simulate the effects

Modeling of the distribution functions

PROJECT EXAMPLE

Salary system: modeling of the payout function

This tool makes it possible to model the payout function (curve progression) of the new salary system. On the basis of a few parameters, it is possible to determine the form in which the relationship between performance and payout is to be designed.
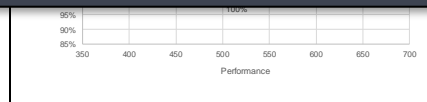
1. Input target/performance values **price quality [Ø price].**

Previous year	5,50 €
Target value	6,00 €
Actual value	6,00 €

2. Definition of payout levels (Y-axis):

	Order intake	
	Performance	Payout
Lower cap	5,36 €	100%
Previous year	5,50 €	100%
1st bend	6,00 €	103%
2nd bend	6,15 €	110%
Upper cap	6,30 €	120%

Payout	103,00%

Relationship between performance and payout

Information: Brown fields = input fields

Variable remuneration	
Max. bonus	20%
Max. malus	0%

Weighting	
Reference	Factor
Order intake	20%
Turnover	40%
Price quality	40%

Calculation of Ø-prices	
Product	Factor
XGR1	40%
BSHZ	40%
MOGU	10%
SAMP	10%

Payout (total)

	103,00%

3. Definition of the (performance) points where the curve should change (X-axis):

Order intake				Turnover				Price quality			
Slope of the payout function			Reference	Slope of the payout function			Reference	Slope of the payout function			Reference
Lower cap	10,0%	below	Target value	Lower cap	10,0%	below	Target value	Lower cap	2,5%	below	Target value
Previous year	-		-	Previous year	-		-	Previous year	-		-
1st bend	-		-	1st bend	-		-	1st bend	-		-
2nd bend	10,0%	above	Target value	2nd bend	10,0%	above	Target value	2nd bend	2,5%	above	Target value
Upper cap	15,0%	above	Target value	Upper cap	15,0%	above	Target value	Upper cap	5,0%	above	Target value

Pragmatic communication measures should be selected to support the introduction of the new salary system

## Communication - success factors and key content

Communication

Target group
Who?

Messages
What?

Measures
How?

Matching Formulation	Mediation & Explanation	Control & Control
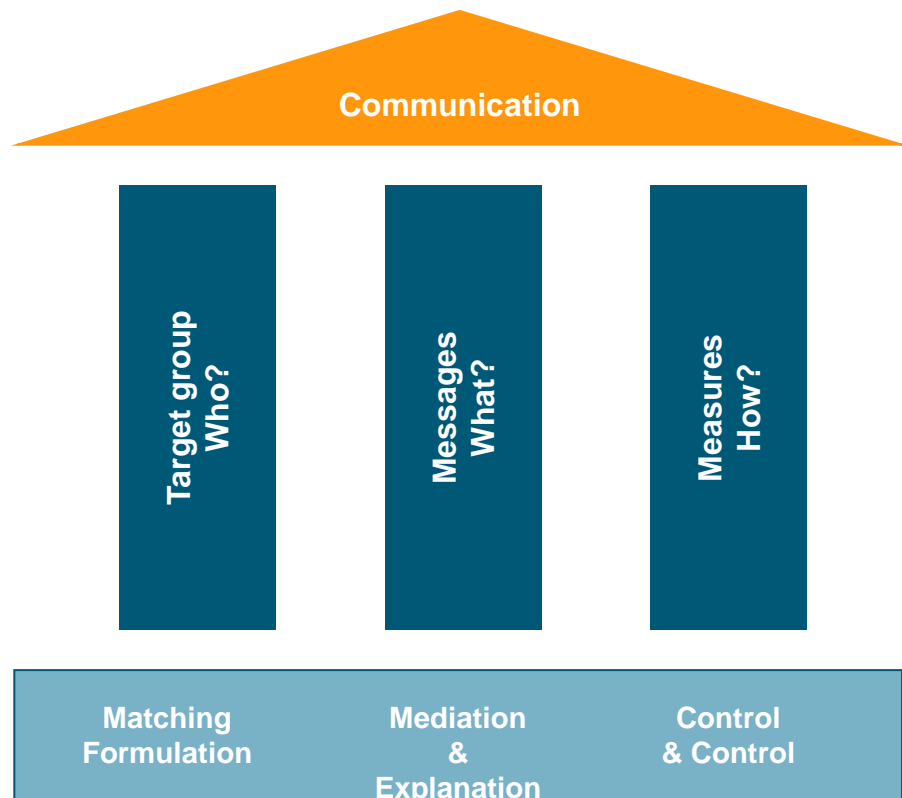
Target group:

- All stakeholders: Sales team, management, works council

Message:

- *"The new salary system is a win-win situation for everyone involved. You have a chance to earn more money and the company has an even greater opportunity to achieve its goals."*

FOCUS

Measures (potential):

- MA meetings
- Newsletters
- Info brochure
- Info tool
- …
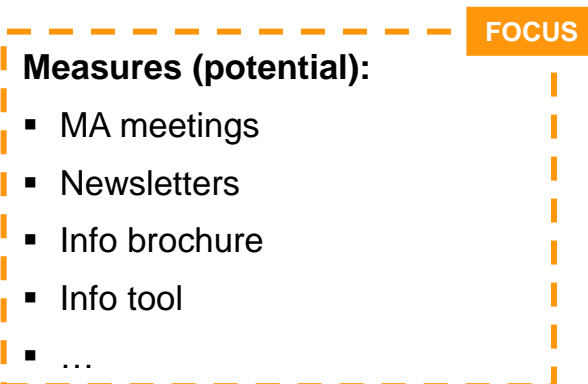
Answers to potential questions/objections from employees should be prepared - this ensures consistent communication

FAQ lists to prepare for queries

FAQ list		
Question/objection	**Possible counter question**	**Possible answer**
Why do only the sales employees and department managers get a bonus?		The company's targets are primarily expressed in terms of sales and profit. Since it is primarily the sales employees who can exert a direct influence on these key figures, performance-related compensation is introduced at this point.
…	…	…
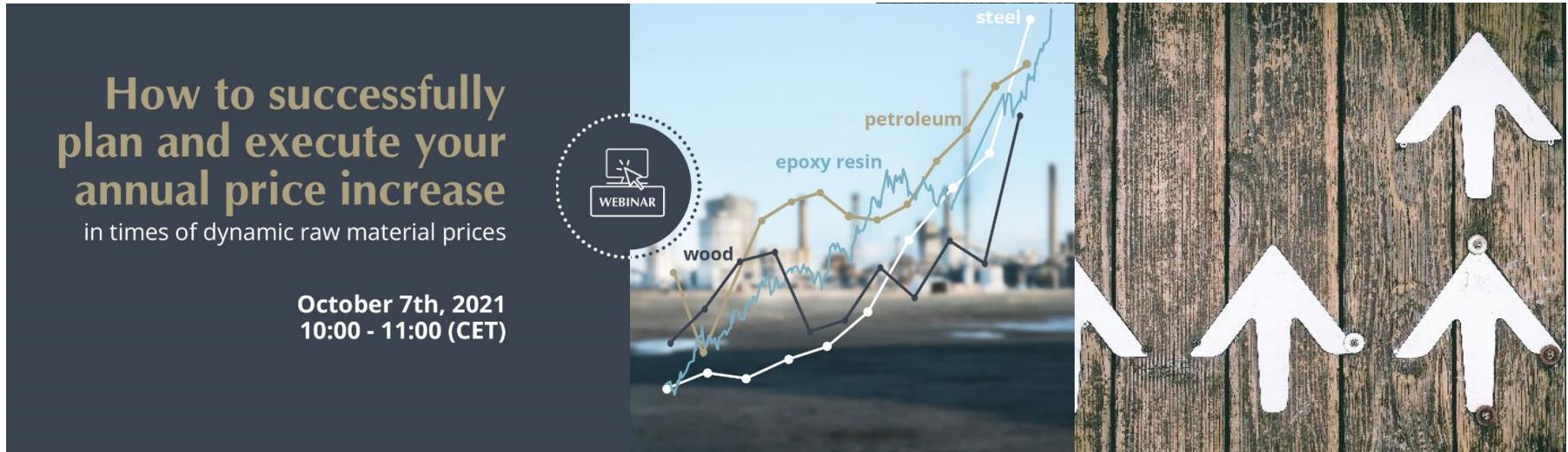
1. collection of typical questions or objections to the introduction of the salary system.

2. formulation of a counter-question in order to obtain a more differentiated question or to rebut the objection

3. formulation of a convincing response that focuses on the advantages of the new system.

I cordially invite you to joint me at my webinar on October 7th 2021 – Contact me if you are interested but can not make it

R&P Webinar: How to successfully plan and execute your price increase

Questions to be addressed in our 60-minute live webinar:

- How are price adjustments prepared systematically?
- How can price adjustments be optimally implemented
  (e.g. differentiation according to product groups, dealing with list and net prices)?
- How can the price increase be systematically enforced and what tools / preparation does sales need?

Register here

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