The purpose and effectiveness of sales compensation plans

by

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ABSTRACT

Sales compensation makes up a large portion of a company's annual cost. It is, therefore, important for the sales compensation plan to align with the company's (principal) objectives and motivate the salespeople (agent) to achieve the company goals. An additional goal of the sales compensation plan is to drive sales employee retention, as turnover rates in the sales profession are high as are the replacement costs.

The problem addressed by this research into sales compensation plans is twofold. First, to explore the types of sales compensation plans exist and what are their potential effects on employee motivation and retention, and implication on performance for the company. Second, to assess how the alternative compensation systems affect salespeople's incomes and their motivation to sell. From the foregoing, the research question becomes: To what extent do changes in compensation plans affect employee's decisions to explore alternative employment? The answer to this question is of benefit to both the employer and the employee. If changes lead to drastic reductions in compensation, even if expected effort declines, it might motivate turnover. The thesis provides a review of the extant literature on sales compensation plans across various industries and how they correlate to employee performance. It also analyzes alternative compensation methods, and explores the effect of compensation downgrading.

The analysis uses the case study approach and explores multiple scenarios of Original Auto Parts' salespeople compensation system. It specifically explores the effect of compensation downgrading on salespeople morale and effort. The study compares Original Auto Parts' salespeople effort and compensation under the old sales plan and the

new plan. The results showed that compensation downgrading was more acute when a salesperson has a larger volume territory than a small sales volume territory. They showed that the two compensations systems had different objectives by what they reward. While the old system rewarded growth, the new system focuses on profitability. While the two objectives can be structured to be congruent, it requires more attention by managers and their management and compensation of their salespeople.

The study provided some solutions to addressing these challenges identified with the case study. Original Auto Parts may enhance the base salary of its salespeople to a level that allows them to pursue a profitability pathway that does not adversely affect their original compensation. The company may also use alternative compensation mechanisms, such as bonuses and merchandise, to boost salespeople appreciation of the parity of their compensation under the old and new systems for the same level of effort. If Original Auto Parts fails to match the compensation levels in the two systems, they risk increasing the risk of salespeople turnover increasing.

It is important, however, to note that while compensation is a large motivator for salespeople's decision to stay with a company or seek alternative employment, there are other factors to consider, the importance of which will vary by employee. The salesperson's values and how they align with the company's value, or how well they like and work with their team and manager, are intangible factors which also affect a salesperson's motivation to stay or leave in addition to compensation.

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CHAPTER I: INTRODUCTION

1.1 Background

Salespeople are of critical importance to any company, as they help drive relationships and business with customers. Sales compensation is important in the loyalty and retention of salespeople. The retention power of compensation increases when employees interpret changes in compensation policies as reductions, providing them no alternative to increase their incomes (Boles et al., 2012). As employees explore their options, their decisions need to rest on good information about alternative compensation systems and how different companies implement them. They do not want to change employers only to find that they do not have the ideal compensation system. Exploring alternative compensations systems and their effectiveness in motivating salespeople is the prime reason for undertaking this study. In this sense, this research is exploratory. The research is also motivated by the search for a way employees who see changes in their compensation systems change can alter their individual strategies to enhance their incomes if they choose not to change employers.

It is important for the objectives and goals of the company to align with the implementation of their strategy. Part of this strategy should include salesforce retention, as sales compensation makes up a large part of a company's expenditures, which will be elaborated on in the literature review. A company must understand the driving forces behind why salespeople stay or leave the company and develop the appropriate strategy to drive employee retention during changing or evolving compensation systems.

The company (principal) provides a signal to the salesperson (agent) on the goal they wish to achieve. If the signal is incorrect or warped, then the delivered result by the agent will not align with the objectives of the principal. Therefore, it is of utmost importance for the sales incentive plans to align with the goals of the organization, whether it be market share gain, increased net profitability, etc. In the case of changing a salesperson's compensation plan where overall compensation is reduced, the salesperson is likely to be less motivated to put forth effort, putting in jeopardy the objectives of the company. In a business-to-business model, it is also important for the objectives and compensation of the company's salespeople to align with the other party's objectives. For example, the company and their distributor should share similar goals. Salespeople's selling efforts might decline if they believe their compensation is inferior to that of distributors. Thus, while the company might save on compensating salespeople, they might reduce overall profit because of lower sales.

1.2 Research Problem and Question

The problem this research seeks to address focuses on two sides of the same coin. First, explore the alternative compensations systems for salespeople and their assessed effects on retention, motivation, and performance of their organizations. The other is to evaluate the how alternative compensation systems affect employee incomes and their potential effect on motivation to sell.

The research question is this: To what extent do changes in compensation affect employees' decisions to explore alternative employment? Answering this question is important for both employees and organizations. For organizations, the answer should help them evaluate the outcome effects of alternative compensation strategies on employee decisions and performance prior to their implementation. For employees, the answer should help them decide if changes in compensation strategies offer them opportunities to enhance the achievement of alternative or new objectives. Organizations should be interested in this research because it will help them reduce the adverse effect of their compensation policy changes. Employees should also be interested in this research because it should help them make better decisions in response to changes in their organizations' compensation policies.

1.3 Objectives

The overall objective of this research is to explore the alternative compensation programs for salespeople and evaluate their impact on performance. The specific objectives are as follows:

1. Review the literature on employee compensation schemes, focusing on salespeople in multiple industries and explore their relationship with employee performance.
2. Analyze alternative employee responses to changes in compensation schemes with the view of discovering how income might be increased without changing employment.
3. Develop some recommendations from the results to inform both employees and organizations in how they minimize potential disruptions to their incomes and performance through careful assessment of potential organizational actions and employee reactions.

1.4 Thesis Outline

The remainder of this thesis will complete and exhaustive literature review on various compensation strategies and policies focused on salespeople. It will then examine how employees respond to these various strategies, and how it affects their livelihood. The alternative compensation models, and how they can be used to offset any negative employee responses due to policy changes, will be examined. A case study of compensation downgrading will be examined, with recommendations made for both the employee and the employer. Finally, a summary of findings from the research, and recommendations for both employees and employers regarding changing compensation systems will be addressed. Any future research objectives will also be addressed.

CHAPTER II: LITERATURE REVIEW

A salesperson, defined by Merriam-Webster, is a man or woman who sells in a given territory, in a store, or by telephone. The salesperson is one part of the group that makes up the overall salesforce of a company. While customers are the lifeblood of any company, salespeople are responsible for bringing them to the company. While marketing promotes and item the company has to sell and customer service interacts with customers after the sales, salespeople are the ones who match the product up with the consumer. They may be considered the last stitch that connects the company to its paying customers. They generate demand for their companies' products by understanding any gaps potential customers may have (Oxford College of Marketing 2014). This is accomplished by creating relationships with customers, which are generally founded on trust, which helps build loyalty, driving business growth and customer retention (Oxford College of Marketing 2014). Ultimately, salespeople generate revenue by selling products. This makes them critical to their organizations' viability, competitiveness, and performance. Therefore, recruiting and retaining the right salespeople through competitive incentives and compensation are critical to an organization's overall performance.

This chapter is organized into four subsections. Subsection 2.1 presents the purpose of compensation plans. Subsection 2.2 presents various types of sales compensation plans, and the economic benefits of them for the employer, employee, and the customer. Subsection 2.3 discusses general failures of sales compensation plans as well as the economic failures of each type of sales compensation plan discussed in Subsection 2.2. Subsection 2.4 discusses compensation downgrading, and the subsequent effects on employee effort.

Salesforce compensation is a very important topic for organizations. After all, compensation affects the quality of people that an organization attracts (Boles, et al. 2012), and changes in compensation can lead to increased turnover in organizations (Boles, et al. 2012). It has been estimated that sales force compensation cost firms about $800 billion annually in a study from 2012 (Viswanathan, et al. 2018). In this chapter, we shall review and present the purpose and alternative compensation systems organizations use for their salespeople. Next, we shall assess the relative successes of the alternative compensation systems across selected industries. As sales people and their compensation is a large expense for employers (Rouzies and Onyemah 2018), it is important for firms to ensure they get the plan right, and the compensation plan aligns with the strategic goals of the firm (Zoltners, Sinha and Lorimer 2015).

2.1 Purpose of Sales Compensation Plans

The key purpose of any sales compensation plan is to drive the strategic goal of a company. This strategic goal could be different for companies in a given industry. The goal may be profitability, market share, or blocking a competitor from entering the market (Zoltners, Sinha and Lorimer 2015). If a firm is focused solely on market share, then the salesperson should be compensated on their sales volume at the end of a given period. If a firm is focused on selling higher margin/value products, then they should compensate the salesperson for selling those higher margin/value products.

The compensation objective for many companies is focused on profitable sales growth or doing whatever it takes (in some cases losing money) to grow the business and market share (Zoltners, Sinha and Lorimer 2015). If gross profit is the goal, and the salespeople can influence the gross profit (price sold to the customer) then the firm can incentivize the employees to grow gross profit. It must be able to measure the metric (gross profit, net profit, profitability, etc.) at the territory level, (which can be more complicated than a traditional compensation system), and effectively communicate those numbers to its salespeople.

Whatever the goal of the firm, the sales incentive plan must align with the strategic goal of the firm. If the firm is in a business-to-business sales model, it is also advantageous for the other firm to share a similar strategic direction. For example, if a firm compensates its own salespeople based on gross profit, but its distributors are paid based on volume, there becomes a disconnect between the businesses and the strategic goals of each do not align, which will cause friction between the businesses. If a competing firm can realize this disconnect, it could be an opportunity to displace competitive business.

2.2 Types of Sales Compensation Plans

All compensation plans are meant to motivate and generate a certain behavior in the recipient. The behavior motivated by the compensation plan should align and drive the strategic goals of the company. This perspective is framed by the principal-agent theory, which argues that because a principal is unable to monitor an agent's efforts, a compensation model may be implemented to solicit the desired effort from the agent. However, output from the incentivized effort by the agent has to be monitored, or the agent may take advantage of the compensation plan for their own benefit (Prendergast 2008). This could be a conscious decision as an employee intentionally manipulates a sales program to maximize a bonus, or a subconscious decision as one tries to maximize their compensation. Therefore, it is important for the principal to be able to manage the end result of the agent (Prendergast 2008). As mentioned earlier, for some firms it could be increased market share, while others could be seeking increased net profit. It is up to the firm to decide what the business goals are and what metrics will be used to hold the agent responsible. It is also important for the principal to be able to measure the agent's contribution, as the principal will not want to compensate the agent more than their marginal contribution to profit. Again, the effort put forth by the agent is very difficult to measure by the principal, but the results obtained by the agent's effort must be measureable and align with the strategic goals of the principal for the sales compensation plan to work (Prendergast 2008).

This research and literature review assumes people will follow and make rational decisions based on human behavior theory. One part of this theory is that people are generally motivated to do the right thing (Prendergast 2008). Thus, they are intrinsically motivated to do a good job. This is especially true for salespeople, who typically want to do right for themselves and their customers. If a principal has an agent who is not intrinsically motivated to do a good job, they should seek removal of that agent as they will seek to take advantage of the company.

While intrinsic motivation is present in most people, extrinsic motivation is most important for the agent, as it is designed to drive the result desired by the principal. Since sales is unambiguous (it is measureable), then extrinsic motivation plays the primary role (Kreps 1997) in the agent's motivation, and therefore proves why sales compensation plans are of vital importance. Extrinsic motivation can be counterproductive and skew one's intrinsic motivation (Kreps 1997). It is again important for the extrinsic motivation for the agent (sales compensation) to align with the goals of the principal. If not, the agent will look to manipulate their own behavior (intrinsic motivation) to maximize their compensation. Other forms of extrinsic motivation, like fear of job loss (especially if the agent feels they are being compensated well), or letting down fellow team members, can also contribute to positive intrinsic motivation (Kreps 1997). These types of motivations play into the different compensation strategies that will be discussed below.

There are four types of sales compensation plans that will be discussed in the following subsections: fixed salaries, quota-based bonuses/commissions, merchandise plans, and symbolic awards. The details, as well as the advantages of each type of plan are discussed. Additionally, a figure showing the relationship between effort and compensation will be discussed. The following section will discuss the issues with each type of plan.

2.2.1 Fixed Salaries

A fixed salary compensation model is where a salesperson is paid an annual salary, of say $75,000, and is not given any more for hitting or exceeding sales goals. In this sense, fixed compensation models are independent of effort, being based on the intrinsic motivation of the individual as the primary rationale for effort. Fixed salary compensation models represent a very small percentage of sales compensation plans at 5% (Krakel and Schottner n.d.). The reasoning being the small percentage of this sales compensation plan offers no incentive for a salesperson to produce extra effort and grow the business. This type of sales compensation plan was found to only be suitable for instances where the revenue-cost ratio for the salesperson was small, meaning little sales effort is necessary to obtain the sale. An example of a fixed salary compensation plan would be a sales clerk in a convenience store selling gas, drinks, and snacks, or a sales clerk in a retail store. Little effort is required, and the only motivation would come from whatever form of intrinsic motivation the employee had to “do a good job”. A consumer could benefit from this type of system if they are looking for a no-hassle easy purchase, and know what they are buying. However, if they are looking for some advice, perhaps on different articles of clothing, they may prefer a salesperson that has a vested interest in making the sale.

2.2.2 Quota-Based Bonus/Commission

The quota-based and commission types of compensation plans were found to be the most widely used across the studied firms (Krakel and Schottner n.d.). The quota-based bonus system means a salesperson must hit a certain target, sometimes over multiple selling periods, to obtain a certain reward. This bonus system could be applied on top of a base salary for a salesperson. A commission scheme pays the salesperson a certain rate per unit sold. This could be the salesperson's sole source of income, so this would be advantageous to a firm who needs high effort exerted to drive revenue (Krakel and Schottner n.d.).

The company and employee benefit from the quota-based bonus model because the company incentivizes the salesperson to grow and shares the growth with them. The salesperson is given extrinsic motivation to go above and beyond and hit a certain goal. An advantage for the consumer is the potential for a long-term salesperson willing to partner with them for a win-win scenario, to help grow their business and develop a long-term, trusting relationship. This is driven by intrinsic motivation of the salesperson to do the right thing for themselves, the company, and the customer for the long-term.

A commission structure could be a flat rate or dynamic. A dynamic model could increase commissions over time, and can be used when future sales are increased by current sales. The company benefits from this model as the salesperson assumes all the income risk-if they don't perform, they don't get paid. The company also benefits, because a good salesperson will be highly motivated to sell and maintain long-term relationships as their income depends on it, especially with a dynamic commission system. The salesperson will be extrinsically motivated because of the pay system, but must have even more intrinsic motivation than the quota-based system, because there is no base salary to fall back on. Similarly to the quota-based bonus, assuming a quality salesperson, the consumer should benefit from a long-term business partnership, as the salesperson must be credible to maintain sales (and their salary) through multiple sales periods with new and current customers.

Additionally, quota-based bonuses could be combined with commissions to further drive sales and reward sales people if their sales exceed a certain target deemed acceptable by the employer. Both of these systems should be utilized if the revenue for the company is dependent on the effort of the salesperson, with a quota-based system being more intermediate while a pure commission strategy will drive even higher levels of employee effort (Krakel and Schottner n.d.). If structured correctly, these strategies will ensure the salesperson has the correct extrinsic motivation to follow the strategies of the company.

2.2.3 Merchandise

The above-mentioned sales compensation plans encompass payment to salespeople as cash. Another form of compensation, which has been increasing in popularity among firms, is using merchandise in lieu of a cash payment to employees. A merchandise plan is more costly for a company than giving the cash equivalent to employees, as it must incur administration fees and other upcharges to vendors in the program. A recent study in 2018 analyzed how cash and merchandise compensation programs influenced sales people (Viswanathan, et al. 2018). The company analyzed had a cash plus merchandise reward system. After changing to a cash only system, the company saw a 1% decrease in sales. The resulting 1% change, however, was small enough that other factors could have caused the decrease, not just the change in program. However, individualized trends were observed where certain people prefer cash while others prefer merchandise. Those who prefer cash incentives where those who had less disposable income, as they preferred cash to spend on their necessities and items they found of importance. Those who preferred cash also thought abstractly, as in what could they do with the cash? This study found the most productive sales people preferred merchandise to cash. The study suggested an analogy to loyalty points/programs where people prefer merchandise rewards over straight cash (Viswanathan, et al. 2018).

A benefit for the company would be using these merchandise programs flexibly throughout the year to reward good behavior, not just once a period as sales bonuses are typically paid out. This could help drive certain behavior and task completion not directly tied to selling, but of business importance to the company (i.e. correct sales product forecasting). The employee may find some of the merchandise more extrinsically motivating than cash, and enjoy the taxable benefit of not paying taxes on the merchandise, as it is not directly considered income like a typical bonus or commission.

2.2.4 Symbolic Award

A symbolic award could be a plaque, certificate, etc. given to an employee to recognize their work. Compared to other compensation plans, the cost to the firm is minuscule (minus the physical cost of a plaque). These alone may not drive sales growth and could be used as in addition to a sales incentive plan mentioned above. An example of a supplementary symbolic award would be recognizing one individual on a sales team for having the best sales numbers for a particular quarter. This program would be intrinsically motivational and rewarding for an employee, especially those looking for validation from the company, supervisor, or other team members.

2.3 Failures of Sales Compensation Plans

As mentioned above, sales compensation plans are important as they serve as the primary motivator for salespeople. When they fail and salespeople become unmotivated, business and revenue can suffer. Furthermore, salespeople may be more prone to seek employment elsewhere. If the employee is on a downward trend, and a shock, such as a failed compensation plan happens, the employee could make a rash decision and quit (Boles, et al. 2012). This could be negative for the employee, as they made a hasty decision before weighing all the options, and have remorse for leaving the job. The company may feel the negative effects if a good employee leaves and finds a job with the competition, moving business with them. Different types of shocks and employee response will be discussed in Chapter 3.

A sales plan should be as straightforward as possible and align with the strategic goals of the company. According to Mark Coleman at Compensation Analytics, there are three reasons compensation plans fail: perpetual redesign, poor communication, and weak execution (Compensation Analytics, LLC 2010). With regards to perpetual redesign, if a firm is constantly changing the plan to try and perfect it, it becomes easy for the sales force to become confused and not fully understand the plan, therefore reducing trust and engagement in the plan. The company might also change something in the plan that is actually not a problem. The design of the plan should only be changed when it does not align with the goals of the company. Additionally, plans must be communicated clearly with regular reinforcement by the manager. It is their job to ensure understanding and provide regular reminders on the plan. When poorly executed, compensation plans can leave sales people frustrated and confused. A salesperson should be able to accurately track and see their progress in real time, and not have to worry about inaccuracy of reports.

The company must ensure quality data to build employee confidence in the accuracy of the plan, which is increasingly challenging as sales plans are evolving and becoming more complex, like mentioned above with paying on net margin versus net sales. While a sales plan should remain constant, the company does need to ensure over time that it is still aligned with the goals of the company, and adapt for environmental and other market changes (Rouzies and Onyemah 2018).

The above information provides generalities for failures of sales compensation plans in general, and the importance of the need for a good sales compensation plan to drive employee retention. Below, failures of each type of compensation plan discussed in Subsection 2 of this chapter will be analyzed.

First, the downside in fixed salary plans is the employee has no extrinsic incentive to upsell, which would make the company (and employee) more money above their perceived value of the salary. As mentioned earlier, extrinsic incentives are key in a sales compensation plan for providing incentives to the salesperson, and therefore provides the reasoning why so few companies use this method, and why it won't drive any extra effort and results. Perhaps the convenience store clerk, from the example above, who is paid a fixed salary, should be incentivized to sell a higher margin candy bar, or the sales clerk in a clothing store could sell a more expensive, higher margin coat, giving them both extrinsic motivation to put forth the extra effort. Unless the employee has large intrinsic motivation for doing a good job under a fixed salary, like perhaps a long-time family owned business, the employee will only put forth the effort indicative of the salary.

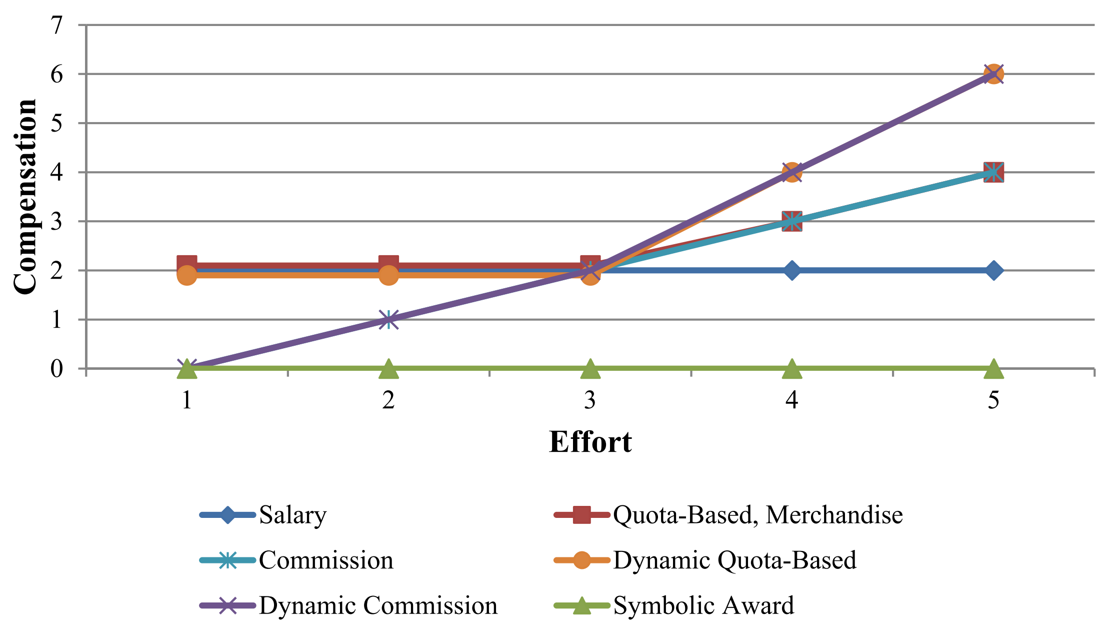
The downside of a quota-based bonus for the company is salespeople may focus on short term rather than long term goals, and sacrifice future relationships and business to gain a short term sales reward. The company implementing a multi-period incentive plan would help alleviate this issue. Another downside for the company is if a salesperson is underperforming the value of their salary, they are still stuck paying it for a loss. A downside for the salesperson, which translates to the company, is if the salesperson feels the quota to make the bonus is unattainable, they may give up and forgo the possibility of the reward. A downfall for the consumer is a salesperson could be up selling them to receive a higher reward, though a multi-period system would alleviate this issue.

The downside of a commission bonus system for the firm is the potential for higher turnover as income is not guaranteed, and salesperson must have the right amount of intrinsic motivation to go along with extrinsic. If the compensation plan does not reward the effort put in by the salesperson, the company is likely to see high turnover as the salesperson does not see high enough extrinsic motivation.

Merchandise compensation programs, similar to quota-based bonuses and commissions, can fail when the salesperson does not feel the extrinsic motivation (value of the reward) aligns with the effort put in. They can also fail if the salesperson does not see the value in the merchandise they can obtain. From the company perspective, these programs are more expensive than straight cash compensation models (vendor upcharges and administrative fees), so the firm needs to ensure they are receiving the supplemental value from salespeople to justify the increased cost.

Below, Figure 2.1 demonstrates the agent's effort versus compensation with regards to all incentive models discussed in Subsection 2.2. As mentioned above, no additional effort will result in additional compensation with a fixed salary compensation plan. A symbolic award also offers no additional compensation for effort put in. As salespeople are extrinsically motivated, these plans will do little to create business growth. However, if a salesperson is going to put in 3 units of effort or less, they would be better off on a salary system. The quota-based, commission, and merchandise systems all increase compensation as effort increases. This extrinsic motivation will push salespeople to drive business growth. Finally, the dynamic versions of quota-based and commission have the most compensation reward per effort put in. As long as a salesperson puts in more than 3 units of effort, any sales compensation plan other than salary is more lucrative. A company should be careful, though, about unintended consequences of salespeople maximizing compensation at the expense of company profit.

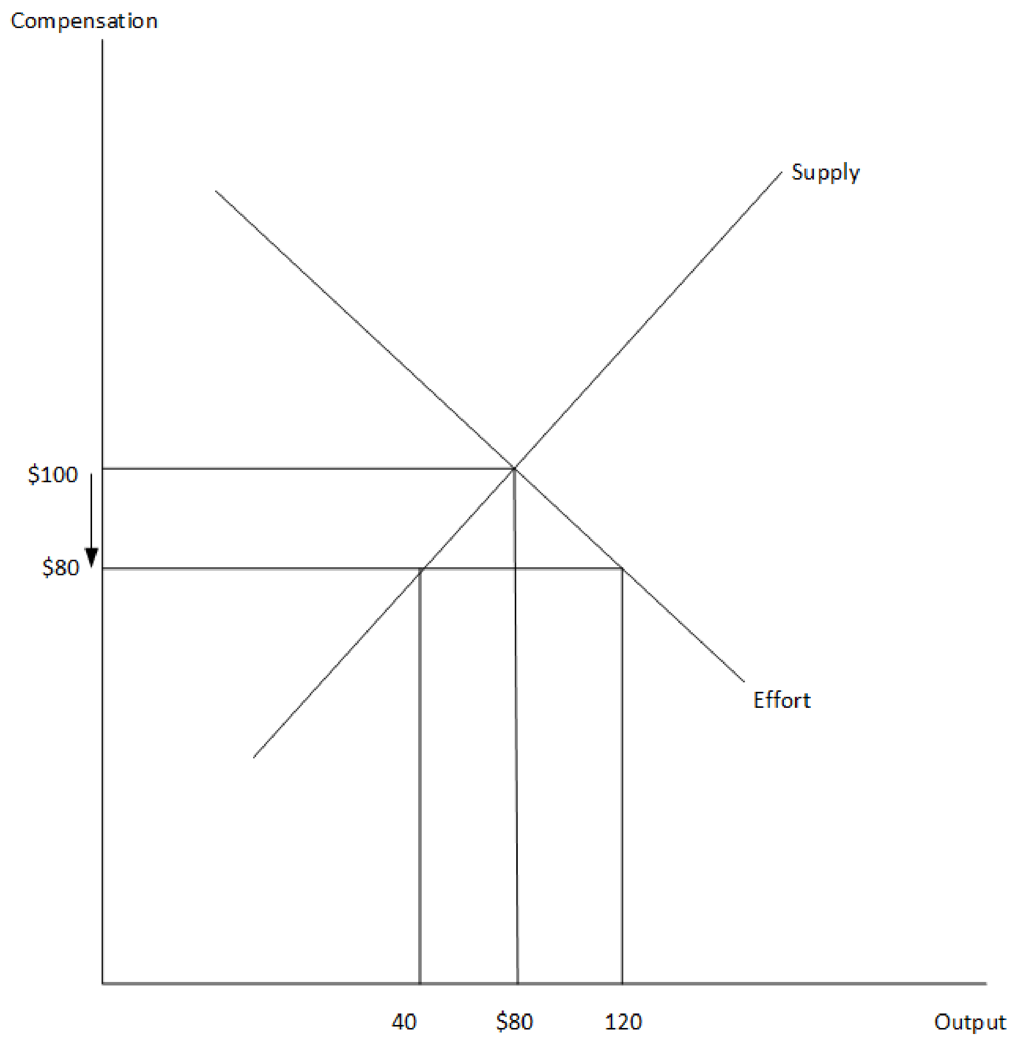
Figure 2.1: Compensation Types Related to Effort



2.4 Compensation Downgrading

A company may choose to downgrade salespeople's compensations. This could occur after a buyout or merger, or if a company believes it is compensating salespeople more than it has to, given the marketplace. While this may be a way to save money in the short term, it will typically cost the company money in the long run, as the economics for salespeople are sticky downwards, and they will find something else to do or find a way to make up the lost revenue. For example, if an employer is paid $100 for a particular effort, and the employer unilaterally cuts the "price" to $80, it must be expected that holding all things constant, effort should decline, as shown by Figure 2.2. Since salespeople are putting forth less effort, customers can suffer which will affect the revenue for the company in the long run.

Figure 2.2: Compensation Downgrade



CHAPTER III: CASE STUDY AND EMPLOYEE RESPONSE

This chapter will contain a case study of Miola Outdoors, which sells hunting equipment, specifically deer stands and blinds. Miola Outdoors recently changed their salesperson compensation plan, resulting in decreased compensation for salespeople, ceteris paribus, and this case study will analyze if and how a salesperson can maximize their effort to achieve the same total compensation under the new plan as they did with the old plan. First, the old plan, and expected compensation will be analyzed. Second, the new plan, and expected compensation will be analyzed. A model will then be utilized to help a salesperson determine the amount of effort required to maintain the same overall compensation they earned under the old plan. Finally, factors other than compensation will be discussed as employees decide to stay with the company or seek employment elsewhere.

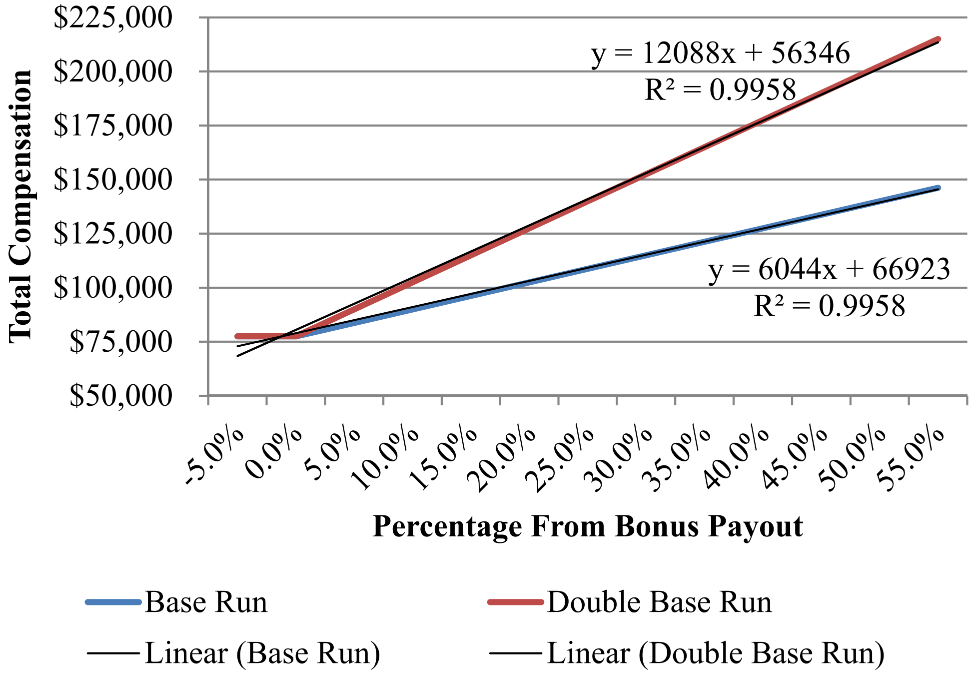
3.1 The Old Sales Compensation Plan

At Miola Outdoors, under the old compensation plan, a salesperson could expect a base salary of $75,000, with a year-end bonus paid on percentage of hitting a sales target on the two primary products sold. The bonus under the old system was largely based on individual performance. The company bonus portion averaged $2,500 per year, which is the figure used in this model. The salespeople were responsible for selling an independent box blind deer stand, and a smaller deer stand mounted in a tree. Since the box blind stand is worth more per unit of profit to the company, the salesperson is paid $6/unit in bonus above 70% of target. The tree stand, which is less profitable for Miola Outdoors, is paid at $1/unit in bonus above 70% of target. Both products would fund independently of each other, meaning if the salesperson only sold above 70% on the box blind stand, they were eligible to receive the bonus on the box blind stand. Since they funded independently, salespeople were more motivated so sell the box blind stand as the per unit incentive was much higher than the tree stand.

Assuming an average territory size of 15,000 units of the box blind stand, and 35,000 units of the tree stand, if a salesperson hit both of these numbers, they would receive $27,000 in bonus on the box blind stand, and $10,500 on the tree stand, making up a bonus of $37,500, which means overall compensation under the old system with base salary, individual bonus, and company bonus is $115,000.

A larger volume salesperson will simultaneously be analyzed. This individual has a similar base salary than an average size salesperson because the volume in bonus will make up any difference in pay. A salesperson in this capacity would have a volume of the box blind stand of 30,000 units and volume of the tree stand of 70,000 units. Assuming 100% goal attainment on both, the salesperson would receive $54,000, and $75,000, respectively, in bonus from each stand, for an overall compensation of $152,500.

Figure 3.1: Old Compensation System



As shown by Figure 3.1 above, the old compensation system was a linear form of compensation assuming the minimum was met to start paying the bonus. It was also more advantageous to have a larger territory, or put in the effort to grow into a larger sales territory to capitalize on a higher base sales number when figuring bonus. The larger territory (double base run), which is exactly double the size of the smaller territory (the base run), earns double the bonus on every 1% above bonus payout, which can be noted in the linear formulas. Therefore, this system highly rewarded effort, which translated into business growth. If a salesperson did not achieve 70% of their sales goal to start earning bonus payout, the size of the territory became irrelevant, as the compensation for both territories would be the same.

3.2 The New Compensation Plan

Under the new compensation plan, salespeople continued to earn a base salary, while the bonus structure of the plan was changed. The individual component was also significantly reduced, now accounting for only 50% of the potential bonus, with team goals becoming more important. For many, the overall bonus was less than in the old plan, so an increase in base salary was given to offset the bonus pay reduction. Under this plan, the salesperson's base salary was raised from $75,000 to $80,000.

The new bonus structure is based off gross profit, or GP, contributed to the company, rather than sales volume in the past. For the example above, the 15,000 units of the box blind stand and 35,000 units of the tree stand would equate to about $6 million in annual contributions to GP, which will be used as the baseline for the new bonus calculations. The two deer stands are now coupled together, and not funded independently as they were before, meaning a salesperson must do reasonably well with selling both stands to obtain a bonus. Additionally, the salesperson's bonus is now figured as a percentage of base salary. The baseline for this calculation is 25%. Of the overall 25% bonus figure, 50% of it is made up of employee contributions to GP, 25% is the sales team's contribution to GP, and the remaining 25% is made up of the regions contribution to GP. If any of the components go above 100%, there is an increased payout. The table below shows the percentage of GP goal achieved and the corresponding payout. The new plan increases the base for bonus to 80%, up from 70% in the old plan, and the relationship between goal achievement and funding is no longer linear.

Table 3.1: New System Achievement vs. Payout

Goal Achievement	Funding
65%	0%
70%	0%
75%	0%
80%	35%
85%	51%
90%	68%
95%	84%
100%	100%
105%	200%
110%	220%
115%	230%
120%	240%
125%	250%

The nonlinear relationship is further illustrated by Figure 3.2, which shows the relationship between goal achievement and effort (where effort is a substitute for the funding percentage from Table 3.1). Figure 3.3 further demonstrates the fact that the new plan is not linear, which means there is a certain range where a salesperson can maximize their effort to compensation, and other places in the plan which are not as lucrative. As shown by Figure 3.3, the largest increase in compensation per percent increases in goal falls between 100-105%. Figure 3.2 also shows the most amount of effort should be put forth in this range. While a salesperson could continue climbing above 105% of goal, the amount of effort required for the compensation gained is diminished.

Figure 3.2: New Plan Achievement Relative to Effort

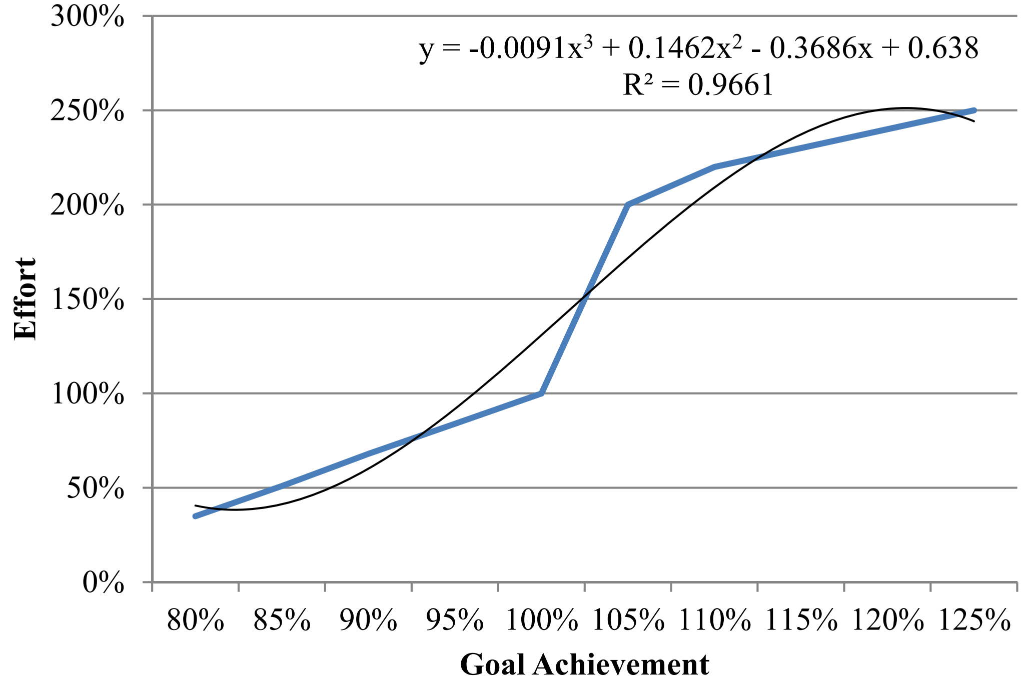
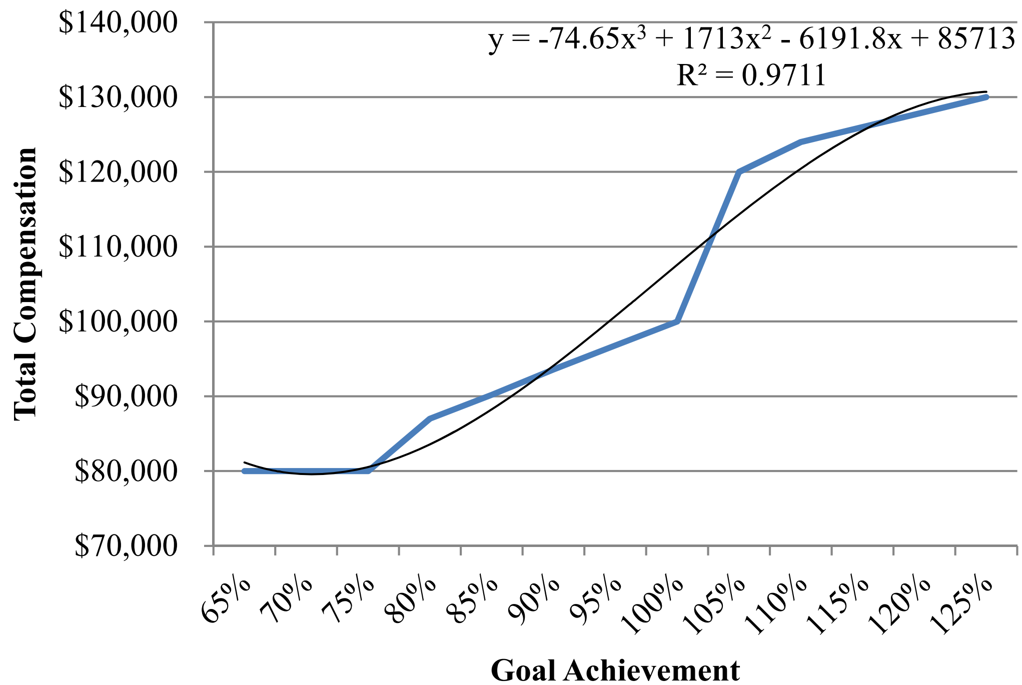


Figure 3.3: New Plan Compensation Relative to Goal Achievement



While the whole new plan is nonlinear, the portion of the plan up to 100% of goal (starting at 80%) is, as shown by Figure 3.4, and for each additional percent of goal achieved, a salesperson will earn an additional $640, assuming the $80,000 base salary. Figure 3.5 shows a more detailed view of the exponential increase from 100-105%, as mentioned above, followed by the quick decline in compensation per percent above goal. In the 100-105% range, the salesperson would increase their salary by $4,000 for every percent increase. Above 105%, there is a gradual decline back to a linear system where each percentage increase gains the salesperson $400, which is even less incentivizing than the 80-100% goal range. Again, effort is maximized from 100-105% of goal, followed by 80-100% of goal, and then 105% and up of goal. Therefore, the company is incentivizing annual growth, but only to a certain percentage (105%) above goal.

Figure 3.4: New Plan Up to 100%

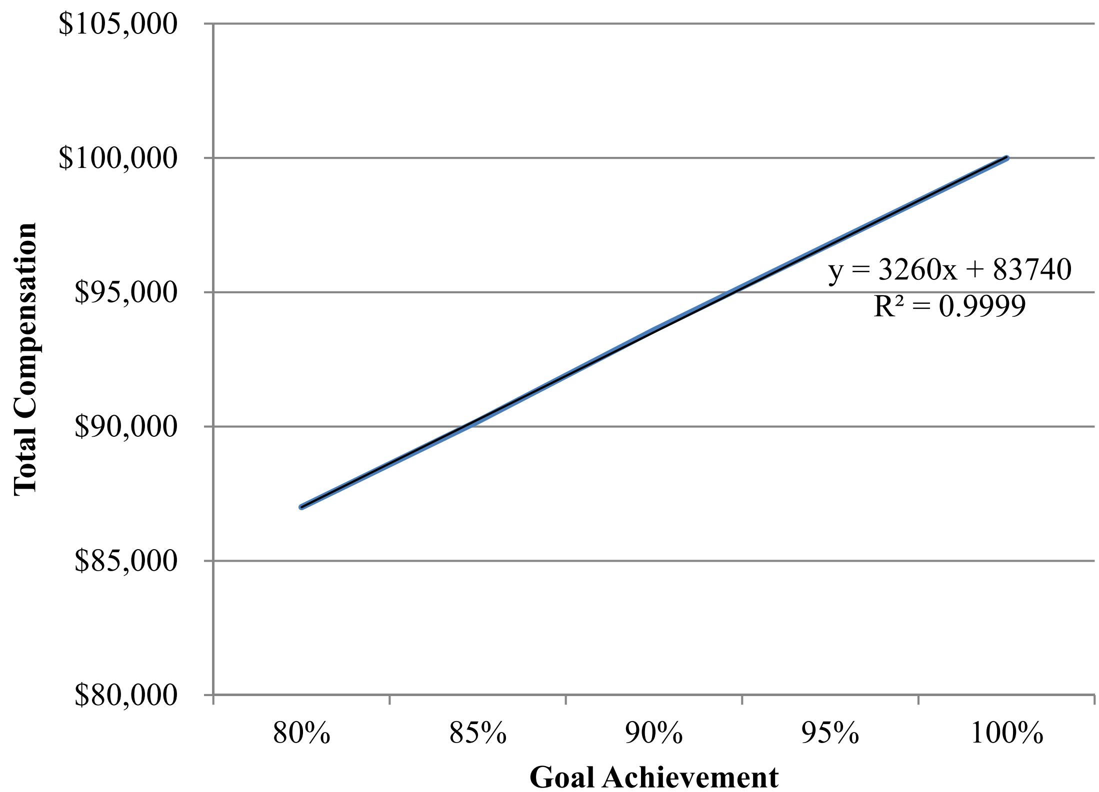
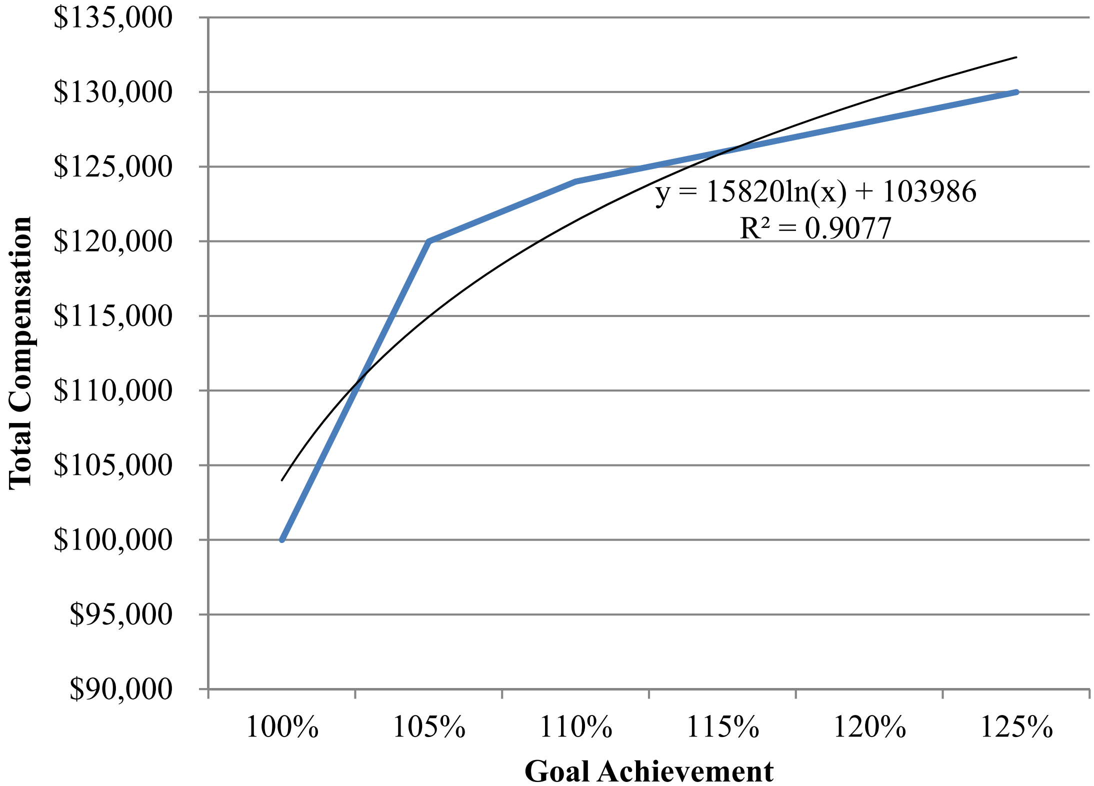


Figure 3.5: New Plan Above 100%



3.3 Sales Compensation Model

This model will analyze the new compensation plan relative to the old one. An average of obtaining 80-125% of the annual sales goal for each plan will be obtained for both the small and large territories. Then, assuming a deficiency in average salary with the new plan, Goal Seek will be used to determine what base salary would be necessary for a salesperson to make the same in total compensation with the new plan as compared to the old one.

For the small territory, the average total compensation was $109,231 under the old plan with a $75,000 base salary. With the increase to $80,000 the new plan gives the small territory an average total compensation of $102,738.46, a reduction of roughly $6,500. For the large territory, the average total compensation under the old plan was $140,962. The total compensation under the new plan would be the same as the small territory as bonus is paid as a percentage of salary regardless of territory size, so the average total compensation would be $102,738.46, a difference of roughly $38,000. If nothing is changed, the new model does not reward the large volume territories like the old plan as shown in Figure 3.1 above. Therefore it is now more beneficial for a salesperson in a smaller territory, as a smaller sales volume can be reached to achieve the same goal percentage, which will take less effort. Therefore, unless base salary is addressed, effort is not encouraged or rewarded under the new plan.

Using Goal Seek, base salary adjustments under the new plan were figured to match the average total compensation of the new plan to the old plan. For the smaller territory, the base salary needed to increase to $85,086, and the larger territory would need a base salary increase to $109,764. These numbers would allow the salesperson to enjoy the same average salary under the new plan.

Figure 3.6, below, shows a comparison of the two plans with the new adjusted base salary of $85,086. While the averages are the same, the old plan is still more advantageous until the salesperson reaches 105%. Then the new plan is more advantageous, but then falls off again on the extreme upper end of sales growth.

Figure 3.6: Comparisons of Plans in Small Territory

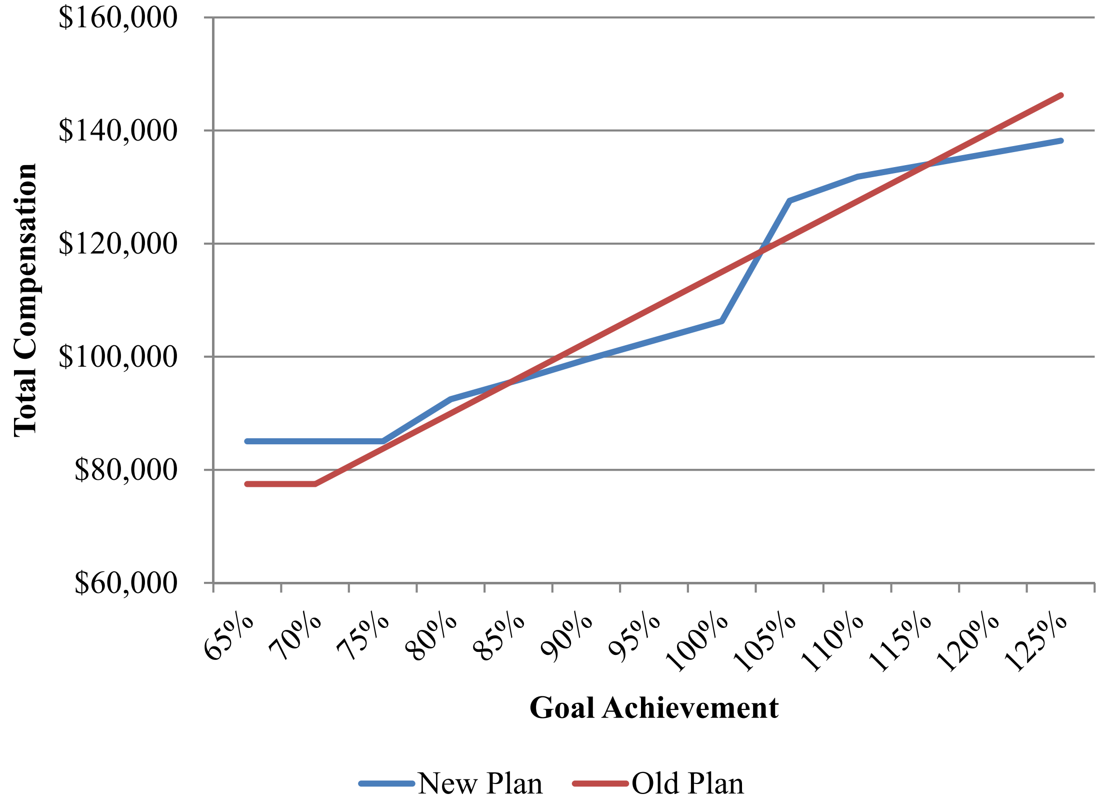


Figure 3.7, below, compares the sales plans with the larger territory. Again, while the average is the same between them, the old plan is more lucrative the majority of the time, as the new plan is only advantageous below obtaining 90% of goal. Anything above 90% of goal the old plan would earn the salesperson more money (although they are equal at 105% of goal). While the new plan protects the downside in a bad year, any upside in growth is not incentivized near as well as in the old plan. Additionally, it can be further seen that the new plan is worse for the larger territory than for the smaller, again emphasizing the point that effort to create and grow a large territory is not properly incentivized.

Figure 3.7: Comparisons of Plans in Large Territory

3.4 Additional Modeling

Above, the model analyzed simple, straightforward averages of sales, with the individual, team and region all being the same. Now, the model will go a step further and analyze the new compensation plan given a certain mix of individual, team, and regional goal achievement, and what base salary would be needed for a salesperson to be able to earn a certain dollar amount in overall compensation, and how this base salary relates to the initial model above.

Several scenarios are analyzed. The first shows the salesperson attaining 105% of GP goal, the team hitting 95%, and the region at 95%. This would be considered an excellent year for the individual, as well as the other groups. With the base salary at $80,000, this would bring compensation to $108,400. Compared to the old plan, the overall compensation for the individual attaining 105% would have been $121,250 for an average salesperson and $165,000 for a salesperson with a larger volume territory. Therefore, the reduction in overall compensation ranges from $13,000 to $56,600, respectively. For a small territory, a salesperson would need a salary of $89,483 and a salesperson in a large territory would need a salary of $121,771 to make the same amount of total compensation under the new plan as the old plan.

The second scenario has the salesperson attaining 100% of goal, the team attaining 95%, and the region 90%. This would be considered a very good year for the salesperson and respective teams. Overall compensation for the employee would be $97,600. Under the old system, an average sized salesperson would have made $115,000 while a larger volume salesperson would have made $152,500, a difference of roughly $17,000 and $55,000, respectively. For a small territory, a salesperson would need a salary of $94,262 and a salesperson in a large territory would need a salary of $125,000 to make the same amount of total compensation under the new plan as the old plan.

A third scenario, with the salesperson and team both attaining 90% of goal, and the region hitting 85% was analyzed. This would be considered a tougher year for the salesperson and teams. Under this scenario, the salesperson would be compensated $92,750. Under the old system, an average sized salesperson would have made $102,500 while a larger volume salesperson would have been compensated $127,500, a difference of roughly $10,000 and $34,750, respectively. For a small territory, a salesperson would need a salary of $88,410 and a salesperson in a large territory would need a salary of $109,973 to make the same amount of total compensation under the new plan as the old plan.

Some trends continue to be seen in the scenarios above first seen in the original model. First, given the original base salary increase, both small and large volume salespeople are worse off under the new compensation system. Additionally, the salespeople with the larger volume are worse off than those with smaller volumes. This could disincentivize the salespeople with larger sales territories, who are bringing in more revenue for the company. It would appear those salespeople contributing the most to the company are now losing the most under the new compensation plan. Another trend is the better the year, the larger the difference in compensation from the new plan to the old plan. The new incentive plan does not reward growth like the old plan. However, since Miola Outdoors is paying off of, and therefore more focused on, gross profit, they are most likely not as concerned about volume growth as they once were. The downside for Miola Outdoors, however, is that good salespeople, especially those with larger volumes, may look elsewhere for employment.

A salesperson could gain some upside in bonus compensation by hoping for more help from their team and regional component of the bonus than what they contribute individually. The issue with this fallacy is most will shirk more as they know their own compensation is out of their hands, and do not have a firm belief others will help get them to their level. It is for this reason the model is not ran with the team or region achievement to target higher than the individual. The assumption is made the individual is looking out for their own self-interest and will achieve the highest award themselves; with diminishing returns the more broad the evaluation is computed.

The most straightforward solution for Miola Outdoors is to raise the salary level for salespeople. The various scenarios in the model show a base salary range of $85,000 to

$95,000 for a small territory and $110,000-$125,000 for a large territory depending on the year, so Miola Outdoors may entertain raises of anywhere from $5,000-$15,000 for smaller territories and $30,000-$45,000 for large territories depending on the salesperson. Miola Outdoors could also look at a merchandise rewards system to accompany the current system if they decide to keep base salary levels the same. This could help offset the financial loss and give salespeople rewards throughout the year as a way of appreciating hard work, rather than the bonus given just once a year. Another component the salesperson must recognize, not taken into consideration in the model, is the tax advantage of base salary versus bonuses. Bonuses are taxed at a higher rate than base pay, so there is some value in a higher base salary but smaller bonus. If nothing is done, Miola Outdoors has performed a compensation downgrade, and as discussed in an earlier chapter, this will result in less effort exerted by the salesperson, resulting in diminished results for the company, and the possibility of the salesperson seeking employment elsewhere.

3.5 Other Factors Influencing Decision Making

If a salesperson for Miola Outdoors is unable to make up any difference in overall compensation from a raise, merchandise program, etc., there are still other factors that will influence if that salesperson decides to stay or leave the company, and if they do, results in turnover for Miola Outdoors. There are two types of turnover; functional and dysfunctional (Boles, et al. 2012). Functional turnover occurs when a low performing salesperson leaves, while dysfunctional is when a salesperson who brings high value to company leaves. Miola Outdoors should be most concerned about the potential for dysfunctional turnover caused by the downgrade in salesperson compensation.

The conceptual model presented by (Boles, et al. 2012) describes levels the salesperson is embedded in, and how those will affect the salespersons decision to “stay or leave". The salesperson themselves is Level 1, followed by the sales team at Level 2, the sales manager at Level 3, the organization at Level 4, and the external environment at Level 5.

When the salesperson experiences a shock, such as a pay downgrade from Miola Outdoors, how they operate, and their feelings towards the levels above them will influence their decision to stay with the company. If a salesperson at Miola Outdoors works well with their team and has good personal relationships with them, and enjoys working for their manager, they may decide to stay with the company given the compensation reduction. If the company culture is positive, this could also have a positive impact on employee retention even though there was a shock experienced. Alternatively, if the salesperson feels disconnected from teammates, or does not get along with the manager, they would be more likely seek alternative employment. The relationship with the manager has more influence than does the relationship with the team. External environments, such as the availability of alternative job opportunities, family, or community relationships also play a role in the decision making process.

After experiencing a shock at work, such as compensation downgrading, a salesperson (or any employee for that matter) must slow down, separate emotion, and think through the entire situation surrounding their job, not just the shock and a knee-jerk reaction to it. They must take into consideration if they enjoy those they work with and the organization overall, as well as the effects a job change could have on their family, or what the prospects of finding a comparable job are. This decision will differ for every salesperson. Miola Outdoors should work towards a strong bond between the salesperson and the other organizational levels mentioned above to help retain good talent if they are going to induce a shock onto salespeople. Losing salespeople to dysfunctional turnover can become very costly as employee replacement costs can be 200% of salary, and a good salesperson can take a book of business with them to a competitor (Boles, et al. 2012).

CHAPTER IV: CONCLUSION

This chapter will provide a general review of the research, as well as any limitations in the research or model and any further research that can be studied.

5.1 Review

Sales compensation plays an important role for the employer and employee, in driving desired business results as well as retaining and properly incentivizing salespeople. It is important for the compensation plan to align with the company (principal) objectives and motivate the salespeople (agent) to obtain those objectives. If misaligned, the agent's motives to maximize their sales compensation may differ from the overall goals of the principal.

There are several different types of compensation for salespeople, with the most popular being a form of quota-based bonus or a commission structure. This is because these types of programs motivate salespeople to not only grow their business, but to do it in the right way, by building and maintaining long-term business relationships with customers. A newer form of compensation system, based around merchandise, is becoming more popular, and some even prefer it to the traditional quota-based or commission strategy, as they are able to choose from different items and defer some tax implications from a cash bonus. No matter what system a company uses, they must make sure their employees are properly incentivized and compensated for the effort they put in; otherwise they run the risk of salesperson turnover, which becomes very costly for a company. While compensation is the biggest factor in determining whether a salesperson will stay or leave, other factors, like company culture and interactions with their team and manager also play a role, and should be kept top of mind for the company as well.

With regards to the case study and model of Miola Outdoors, the new compensation plan put in place does not incentivize effort and sales growth as the old plan did. It does incentivize growth to 105% of goal, but the effort required to go above 105% does not pay off for the salesperson. Additionally, employees do not earn as much total compensation under the new plan as they did under the old plan, and changes to base salary, or the addition of a supplemental merchandise bonus system, may be necessary in the long term for salesperson retention. The new plan also took away the motivation for a salesperson to grow into a large sales territory, as bonuses are now figured on base salary, not sales volume. Salespeople will have to take these changes, as well as the other factors like company culture, cohesiveness with their team and manager, and availability of other jobs into consideration if they decide to stay or leave.

5.2 Limitations and Further Considerations

The model looked at a broad approach to compensation under the plans. An individual salesperson with Miola Outdoors could use the model and tailor it more specifically to their territory and average goal achievement to get a more realistic idea for their specific territory. Additionally, since the new plan is only a year into existence, assumptions were made in the model about individual, team, and region achievement. After a few years of the new plan, a trend may show the scenarios ran are different than where these numbers fall on an annual basis, and the model may need to be adjusted as such. The model also did not take into consideration the tax advantage of earning more base salary and a smaller bonus, as bonuses are taxed at a higher rate. Finally, adding in a merchandise system to supplement the new plans bonus structure could also be examined.

With regards to the research, analyzing the current pandemic and any relation to employee response and effort was not available. In the future, salespeople may evaluate differently their job and their company based on the flexibility and restrictions put in place during the COVID-19 pandemic. This evaluation would be yet another factor outside of compensation needing to be evaluated when an employee decides to stay or leave.

5.3 Conclusion

A sales compensation plan is important, and a company must get it right to properly drive and motivate its salespeople. While compensation is the largest influencer for a salesperson when evaluating a job, there are other factors important as well that must be taken into consideration. A compensation model, like the one used in this research, along with a personal evaluation of the external factors influencing a job, can help companies ensure they are properly motivating, and help salespeople evaluate their current job and any other opportunities available.

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