DISTRIBUTION STRATEGY GROUP

Sales Force Compensation in Distribution: Challenges and Solutions

By Mike Emerson

Distributors can't afford to design sales compensation plans in a vacuum. Instead, compensation plans should be part of a broader strategic process geared toward aligning sales compensation with the economics and profit of the business itself.

While most distributors understand this in theory, it is complicated by the changing nature of how and where we sell. Distributors now face a mix of shopping and buying methods. Their opportunities to influence prospects and turn them into customers have multiplied but have also grown more complex. Many buyers are now more than content shopping without human interactions — especially if the product or service is a repeat purchase.

Many distributors are exploring introducing new or refined sales approaches in this brave new world. It makes it an ideal time to also look at compensation structures that attractively compensate our evolving sales teams, but that also fit within the bounds of risk, reward and overall costs.

Where to Start

We've learned that sales compensation is an indicator for distribution companies. A good sales compensation redesign process can uncover many root causes affecting the results of a distributor's business.

Historically, distribution companies undertook sales compensation changes for two reasons:

1. The cost of the program was preventing profit.
2. The compensation program wasn't driving growth but somehow impeding it.

Typically, there is misalignment around what the program is driving and the commercial results of the business model. However, distribution sales have grown increasingly complex, so gaining consensus around what the new comp model is going to do for the company can be challenging. It is a vital part of compensation redesign, but one that's often missed.

DSG
© 2023 Distribution Strategy Group | distributionstrategy.com

There are three critical steps:

1. Define what success looks like for the sales rep and the company.
2. Define selling roles.
3. Design a performance structure.

Step 1 – Define Success

Define success so it benefits the organization and the individual. Distributors must look holistically at their business in the long term and measure their goals against how sales compensation will affect costs, business growth and profit margins.

Consider:

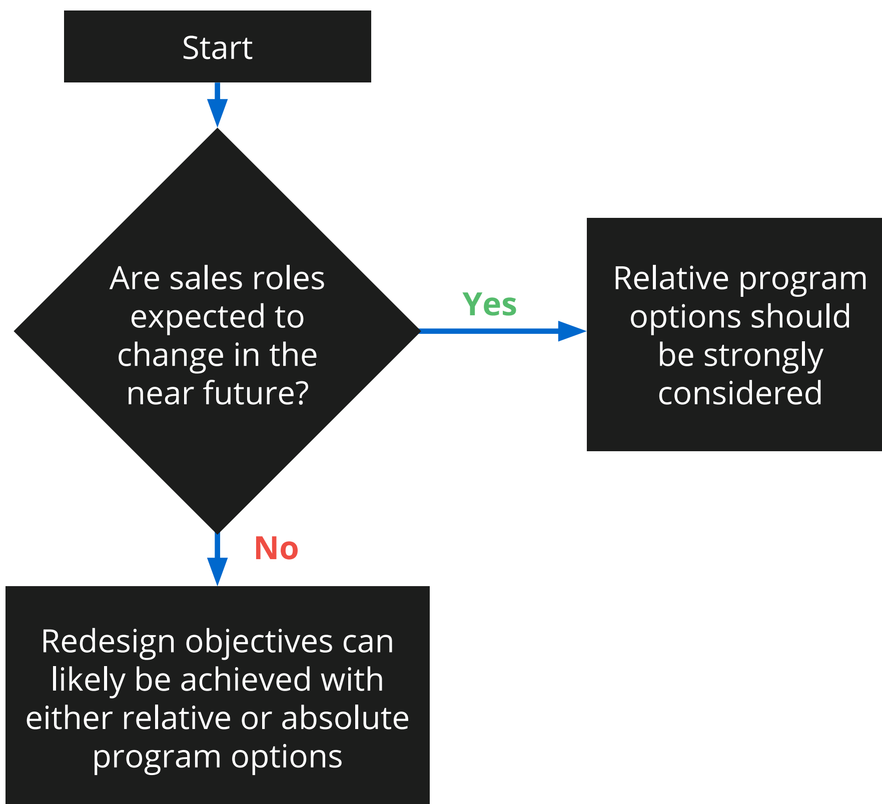
- What are the target selling costs next year and for the long term?
- Where do you plan to focus sales, and where will you compete in the future?
- What kind of growth are you striving for in quantity and quality across your customer base and products?
- What are your profitability goals (including gross margin and the costs of doing business)?
- What turnover is acceptable, and what are the costs of replacement?

The goal is to define sales success consistently across the organization. This process is less complicated than it might sound, and sales reps will benefit from reliable income reflecting new market realities while helping the organization achieve its goals.

© 2023 Distribution Strategy Group | distributionstrategy.com

Step 2 – Define Selling Roles

Sales roles are changing, but the question for your organization is how much? If you expect little change in the coming months, an absolute performance model can factor into the compensation design.



Absolute Commission Structures

Absolute performance pays against revenue produced in gross profit dollars. It says, "You will be paid $___ for each ___." An absolute model works well when there is little GP$ differentiation from the company's perspective and limited changes in selling roles are expected.

The emphasis in these comp models is on GP$ production and usually isn't tied to a quota. It's an eat-what-you-kill model that typically rewards based on overall dollars generated for the company. Growth and objectives have little influence on this model, making it ideal for companies expecting little change in the coming years. It will work well if you have an inside sales team tasked with researching and closing new customers.

© 2023 Distribution Strategy Group | distributionstrategy.com

However, we're seeing fewer of these compensation structures simply because change in distribution sales is so common now. In most cases, a relative commission structure is more appropriate.

Relative Commission Structures

Relative pay means performance is relative to the goals of the sales representative. A relative performance model pays reps based on performance against their quota, usually in addition to salary. Relative commission structures do not tier for growth; the motivation is simply to sell more for higher commission. Management defines the quota or objective, and the pay is variable.

A relative commission structure has critical decelerators and accelerators to incentivize higher performance. Ten to 15 years ago, most distribution companies went to market with a somewhat generalist sales organization. Today, the importance, relevance and value of a field sales rep ebbs and flows as measured against their cost. Customers also want self-service benefits that can't be supported by a field sales force. A relative commission structure is better for today's multichannel hybrid sales organizations.

For example, you may task new inside sales reps with bringing on two new customers a quarter. Depending on the market, that may be just as challenging as an established field sales rep targeting an existing customer base. While their end-of-year contribution to gross profit dollars (GP$) may be lower, the inside reps contributed a considerable amount to grow the organization by adding new customers and generating more revenue over time. Depending on your goal, these inside reps could potentially be the highest paid.

We like relative commission structures because of these inherent complexities in distribution sales. It's an excellent model if you anticipate the need to shift accounts and sales responsibilities to achieve your growth objectives. You can gradually increase quotas for emerging markets or add accelerators not only to commissions but to salaries depending on what's happening with the business. Finally, relative commission structures can align organizational financial and operational fiscal targets.

© 2023 Distribution Strategy Group | distributionstrategy.com

Step 3 – Designing a Relative Performance Program

Before tackling your new sales compensation model, consider this key point: Complexity is a sales compensation program's No. 1 nemesis. Don't overengineer your sales commission structure. Balancing complexity against value is critical.

Build the primary relative performance model around three variables, which determine the correct pay mix between a fixed salary and at-risk variable pay (commission/bonus):

Base vs. incentive pay – what portion of income is salary vs. variable commission?
The data you've captured on previous commission-based compensation plans will help you determine the average pay of each sales rep. You're looking for the salary sweet spot, which is "assured" and typically not at risk. The analysis should consider seasonal fluctuations. Also, analyze beyond earnings, looking at key performance indicators (KPIs) like the number of sales made, customer satisfaction, new customer generation —whatever is important to your organization.

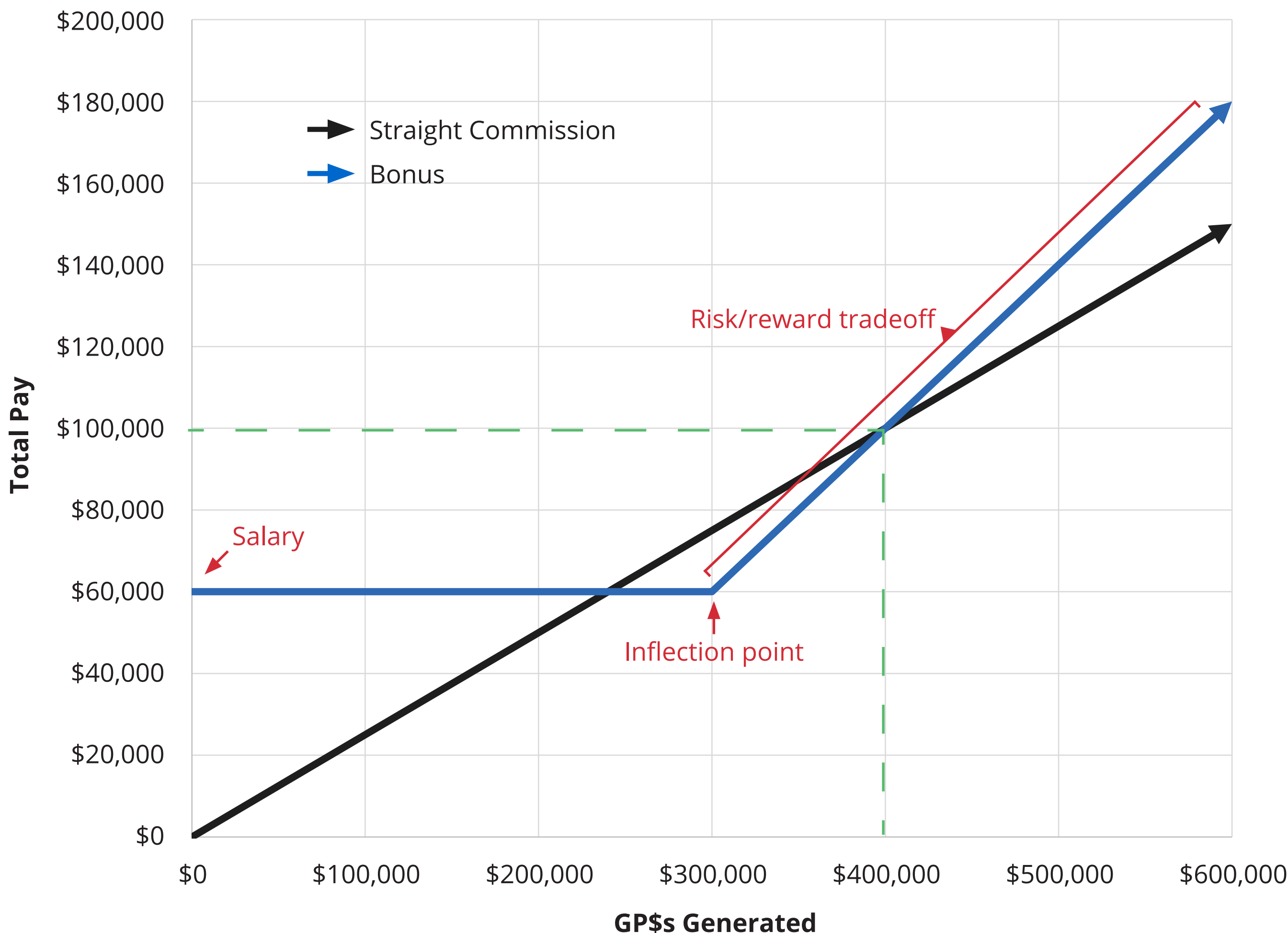
Window of performance – when does variable pay kick in?
The inflection point is like the straw that broke the camel's back. What is the point where business is expected vs. going above and beyond that mark? When the sales rep hits the inflection point, the graph begins to trend upward, and that is the point where variable pay kicks in. Note that the inflection point can signal an increase in a base salary as much as a commission structure. Both can incent the sales rep to achieve above-average performance beyond the inflection point.

Risk vs. reward — To change behavior, you must increase the element of risk. You can translate this into a compensation model by asking a basic question:

How does variable pay decrease if rep is below goal and increase if they are above it?

That is the risk vs. reward part of a good sales compensation structure. Distributors must balance their risk against sales rewards to create a win/win. However, the new compensation structure should exceed the existing plan. Why? The human psyche is more motivated by the potential for losses than obtaining a win. In other words, sales reps will be more motivated to avoid the possibility of lost income

than they will the potential to earn more. That's why distributors must properly introduce risk into the compensation model. Simply producing the same amount as last year in distribution is like going backward. Your goal is to introduce higher risk and more lucrative rewards in the new comp model. If you look at these three variables on a chart, it will look like this.



The three variables are:

- Salary amount (the Y-intercept)
- The inflection point, where commission kicks in
- The risk/reward tradeoff (the slope of the graph)

© 2023 Distribution Strategy Group | distributionstrategy.com

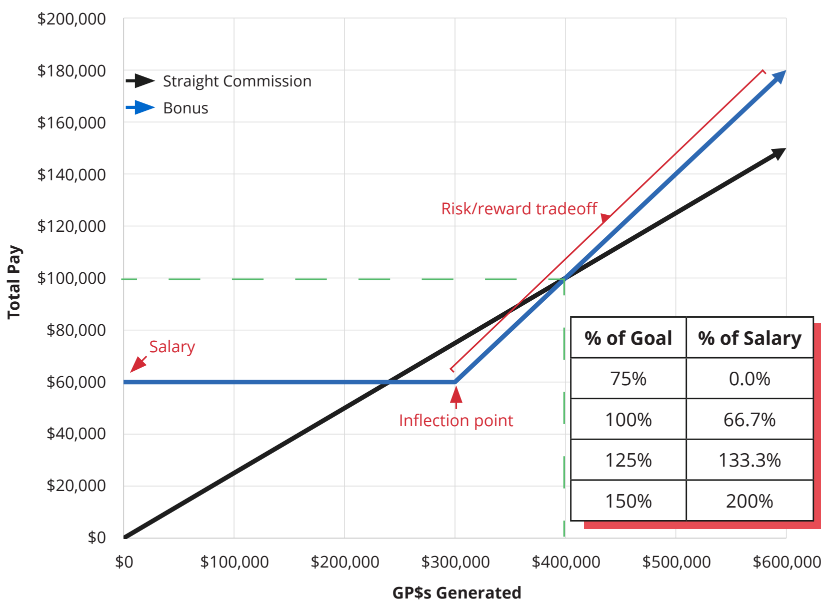
Determine Performance Measures

What performance factors will determine your success? There are typically two performance measures: Single-factor and multi-factor.

Single-Factor Payout Structure

Typically, the single factor is the GP$. If the sales rep hits their gross product dollar amount, their salary (or a percentage of their salary) is assured.

For example, if you hit your goal (GP$s generated), you get two-thirds of your salary. That's the inflection point.



% of Goal	% of Salary
75%	0.0%
100%	66.7%
125%	133.3%
150%	200%

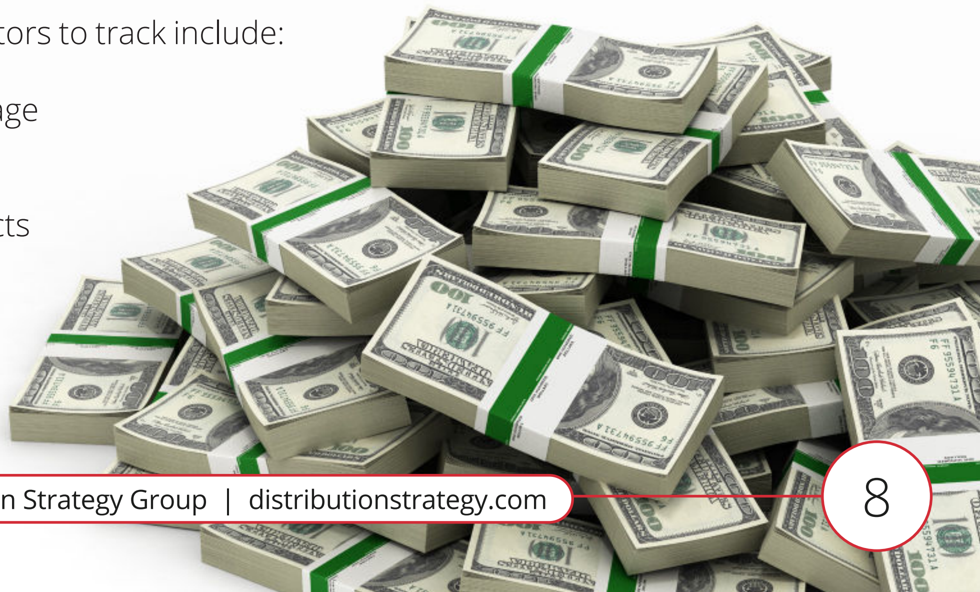
That may be sufficient initially, but as companies (and sales reps) get more comfortable, it's appropriate to introduce more factors to increase the complexities, risks and rewards. How do we introduce other variables into the sales compensation program?

Multi-Factor Payout Structure

You don't have to start from scratch. The easy way is to introduce additional categories within the single-factor payout structure. Only introduce up to three factors; the complexities will be challenging to track and could frustrate your sales team.

Some examples of factors to track include:

- Margin percentage
- Digital sales
- Rebates
- Strategic products



© 2023 Distribution Strategy Group | distributionstrategy.com

% of Goal	% of Salary		
	0 of 2 Hit	1 of 2 Hit	2 of 2 Hit
75%	0%	0%	0%
100%	50%	66.7%	83.3%
125%	100%	133.3%	166.7%
150%	150%	200%	250%

With growth, goals should increase. This phenomenon is a benefit of a relative pay program.

For example, if the sales rep closed $1 million last year, they may face a 6% growth target this year. Hit the growth target, and the bonus kicks in for 100% of the salary. But the inflection point continues to move to the right, and the salary percentage adjusts, as well. **This approach is significant for distributors because it gives us a way to reduce selling costs over time.** When commissions are a percentage of GP$, the payout increases in correlation with growth.

© 2023 Distribution Strategy Group | distributionstrategy.com

In addition, distributors should pay commissions on a rolling average, to make up for seasonal curves or months when the rep just isn't hitting the numbers.

Two last points that seem initially counterintuitive to developing a successful sales force compensation program:

The first is that merit increases are critical. Salary should go up as individual goals increase, but also annually.

Say you give a sales rep a 2 or 4% increase based on inflation. But the sales rep grew your GP$ significantly past that number last year. Being paid the same or less than the prior year never sits well with a salesperson. At the same time, you may feel pushback from the CFO, who understandably may balk at giving an 8% salary increase. Your CFO may consider that an unnatural act, as it falls outside of the scope of the generally accepted practice of giving merit increases based on inflationary numbers. However, if you do the math, you'll end up with a higher GP$ return for the investment.

Finally, consider including digital channels in your compensation plan. If you don't, the sales reps will do whatever they can to dissuade customers from using those channels. Creating an incentive for sales that happen online with the rep's customer base is a great way to drive sales to that platform.

Implementing Your Sales Force Compensation Plan

The clearer you are that you've got your salespeople's best interests in mind, the better and smoother things will be.

Explain the program, why it's changing and how this aligns better with where the company is going. The most significant failure point with sales compensation programs is surprises. It's devastating when you roll out a new program, and then three or six months later, it needs to change. Sales teams view this as highly disrespectful to their work.

Designing an aligned program means nothing if your sales reps don't understand it. The good news is that you will have your team's attention on this topic more than any other. They will listen and closely watch your body language. It's an excellent opportunity to discuss where the company is headed and the changes you're

making — including the sales compensation program. As much time as you invest in the program's design, invest more in sitting down and ensuring people get it.

For each new, changed or hybrid sales role, have a playbook employees can easily understand – particularly for deep specializations. They should understand their responsibilities, how their role fits into the bigger picture, how this new plan will work to their advantage – and how to ensure it does. This effort will increase their willingness to change.

The Bottom Line

As businesses grow, sales comp plans typically need to change. Something that worked when a company was a third of its size may not hold water down the road. While there will always be detractors from the model you initiate, distributors can balance the risks, rewards and costs to create a sales compensation model that achieves business goals and rewards their sales teams.

© 2023 Distribution Strategy Group | distributionstrategy.com

About the Author

Mike Emerson is managing partner of Indian River Consulting Group. Mike has been with the firm since 1998 and has specialized in supporting the firm's distributor clients on go-to-market strategy initiatives. He is an expert in distributor sales compensation and has authored two books on the subject for the National Association of Wholesaler-Distributors (NAW).

DISTRIBUTION
STRATEGY GROUP

About Distribution Strategy Group

Distribution Strategy Group's thought leadership, research and consulting services are provided by a team with decades of experience in the distribution industry. They have helped more than 70 distribution companies build a solid foundation to win in today's changing market.

Distribution Strategy Group offers strategic guidance for distributors in the face of disruption, including:

- Independent expert content
- Digital and ecommerce strategy
- Customer lifecycle management strategy
- Customer analytics

Contact us:
distributionstrategy.com | 303-898-8626 | contact@distributionstrategy.com

© 2023 Distribution Strategy Group | distributionstrategy.com

Thank you to our sponsors:

whitecupsolutions.com

sap.com

Sales Leader Sam

VP of Sales

My reps can't see all relevant details for their customer.

Sound familiar?

White Cup can give your team a complete customer scorecard at a glance, with top products, the latest quotes and orders, fulfillment status and account balance so you can have more effective conversations.

WHITE CUP

White Cup CRM, BI, & Pricing offer the most critical, complete, and collaborative solutions tailored to your distribution business.

Learn more at whitecupsolutions.com