Principles and Success Factors of Effective B2B Sales Force Compensation

By Tobias Kuntner and Johannes Voester

Performance-oriented incentive systems are an effective and widespread instrument to motivate and guide salespeople's behavior, particularly in B2B environments. In practice, however, many companies face substantial challenges in terms of designing and implementing incentive schemes. Among the major reasons are that incentives are not aligned with corporate goals, targets are set unrealistically, salespeople do not accept the incentive system, and target achievement is monitored insufficiently. As a result, sales force behavior may undermine, rather than support, objectives, which can lead to frustration among both managers and salespeople. With this situation in mind, this article presents crucial principles and success factors for designing and applying effective incentive systems. Combining consulting experience and recent scientific insights about sales force compensation, this article aims to provide guidance for both practitioners and researchers in the field of B2B selling.

INTRODUCTION

A company's sales force plays a pivotal role in creating and sustaining customer relationships (Krishnan, Peterson & Groza 2015). Therefore, a motivated and well-trained sales team is a valuable – if not vital – asset for B2B companies to increase sales and profitability (Coughlan & Joseph 2011). Most companies are aware of this fact and grant their salespeople considerable monetary incentives. It is no surprise that "sales force compensation represents the single largest marketing investment for most B2B companies" (Steenburgh & Ahearne 2012, p. 71). In total, US companies spend more than $800 billion on sales compensation and an additional $15 billion on sales training per year, which is three times more than their spending on advertising (Steenburgh & Ahearne 2012; Kumar, Sunder & Leone 2015).

To motivate salespeople, a performance-oriented monetary incentive system is a proven and widely applied instrument (Banker et al. 2000). In the US, approximately 40 percent of total sales force compensation is performance related (Zolters, Sinha & Lorimer 2012). The central idea is to make one part of sales compensation performance dependent (i.e. variable), and to specify in a system by which criteria and rules salespeople will be compensated. This concept may sound simple; however, research shows that many incentive plans fail to meet management expectations because they are poorly designed and implemented. The reasons for this are diverse, for example, incentives are not aligned with corporate goals (Colletti & Fiss 2001), performance targets are set unrealistically or lack differentiation (Steenburgh & Ahearne 2012), the new system is not accepted by salespeople (Gerhart, Minkoff & Olson 1995), or reporting and controlling is insufficient (Zoltners, Sinha & Lorimer 2006).

In light of the above, this article summarizes best practices in sales force compensation that provide guidance for both practitioners and academics. Drawing from recent scientific findings in the field of B2B selling, this work outlines the most important principles for designing and implementing an effective incentive scheme (see Figure 1). Utilizing profound consulting experience in sales and compensation plans, this paper highlights potential pitfalls and illustrates success factors for effective and practical implementation.

1. Target definition: Align incentives with corporate goals using the right metrics

The first fundamental principle is to ensure that the incentive system's objectives are consistent with corporate goals. Therefore, the system's targets need to be translated into sales-relevant metrics (Zoltners, Sinha & Lorimer 2012). Metrics, such as units sold,

---

Tobias Kuntner (M.A., Universität St. Gallen-Hochschule für Wirtschafts-, Rechts- und Sozialwissenschaften), Senior Consultant, Simon-Kucher & Partners, Munich, Germany, tobias.kuntner@simon-kucher.com

Johannes Voester (Ph.D., University of Bamberg), Manager, Simon-Kucher & Partners, Munich, Germany, johannes.voester@simon-kucher.com

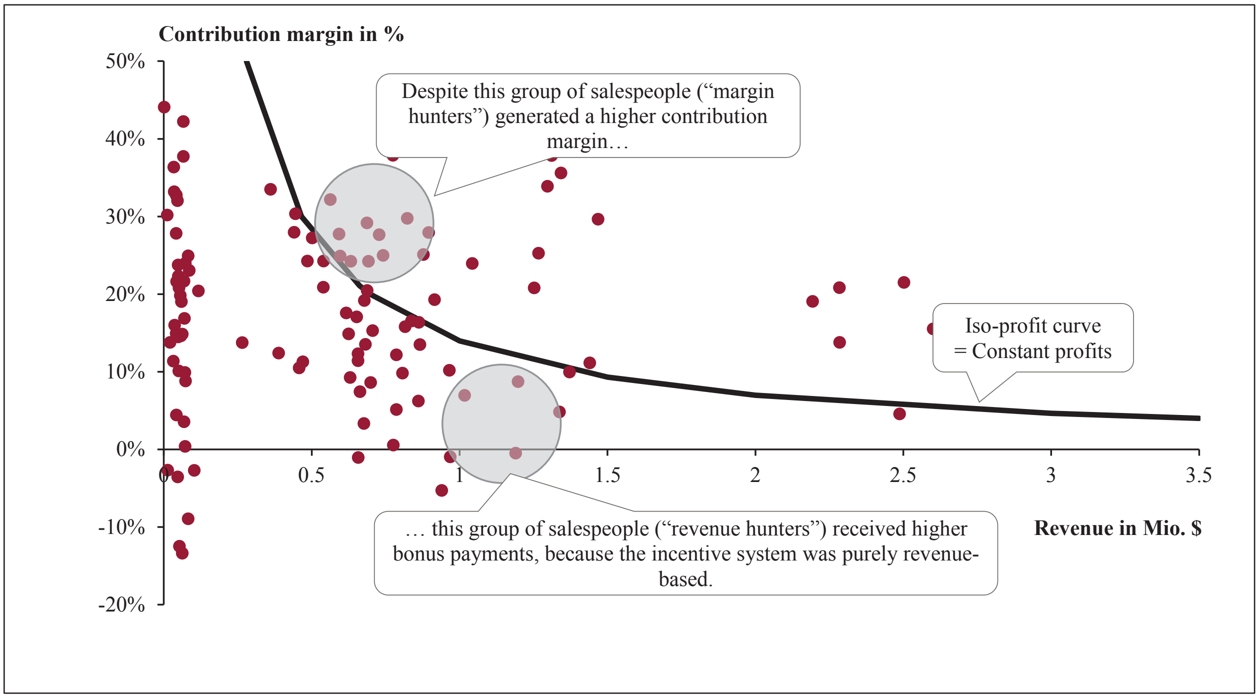
Figure 1. Principles and success factors for designing and implementing an incentive system

	Principles	**Success factors**
1	*Target definition*: Align incentives with corporate goals using the right metrics	▪ Ensure target conformity ▪ Integrate profit-oriented metrics
2	*Design*: Install a performance-oriented incentive system	▪ Avoid (too low) caps ▪ Apply no (or small) steps ▪ Set ambitious, but realistic goals ▪ Choose short payout periods
3	*Differentiation:* Adjust the compensation logic to seller types	▪ Ensure consistency ▪ Select criteria that can be influenced
4	*Communication*: Ensure acceptance through change management	▪ Integrate multipliers ▪ Communicate transparently, completely, and understandably ▪ Highlight changes and their impact ▪ Provide training
5	*Controlling*: Guarantee target achievement through reporting and controlling	▪ Report to the target group ▪ Report promptly ▪ Report cost-consciously ▪ Measure target achievement regularly ▪ Support target achievement ▪ Identify optimization potential

revenue, or market share, constitute the basis for setting and assessing volume-oriented goals, whereas metrics such as profit margin, target net prices, or sales costs focus on profitability goals. Moreover, non-financial criteria such as customer satisfaction, new customer acquisition rates or migration rates, can be used to improve the sales force's customer orientation, which in turn fuels the firm's long-term success (Coughlan & Joseph 2011). The following practices have proven effective in selecting the right business metrics:

Ensure target conformity. The metrics of an incentive system should support, not undermine, the overriding corporate goals. As obvious as it may sound, this principle often receives less attention than it deserves, as the project example shown in Figure 2 reveals: Although the management of an IT service provider listed profit as its number one corporate goal, sales force incentives were solely based on generated revenues. As a result, "revenue hunters" tried to raise their bonuses by granting high discounts while realizing low net prices. In contrast, "margin hunters", who generated higher profits but smaller revenues, were penalized with lower bonus payments. This apparent misalignment of corporate goals and sales incentives had two adverse effects: First, the firm did not reach its profitability target. Second, an increasing number of demotivated salespeople left the company. After integrating the realized net price level as the main component of the compensation system, profitability increased by several percentage points and employee satisfaction clearly improved.

Figure 2. Project example on "ensure target conformity"

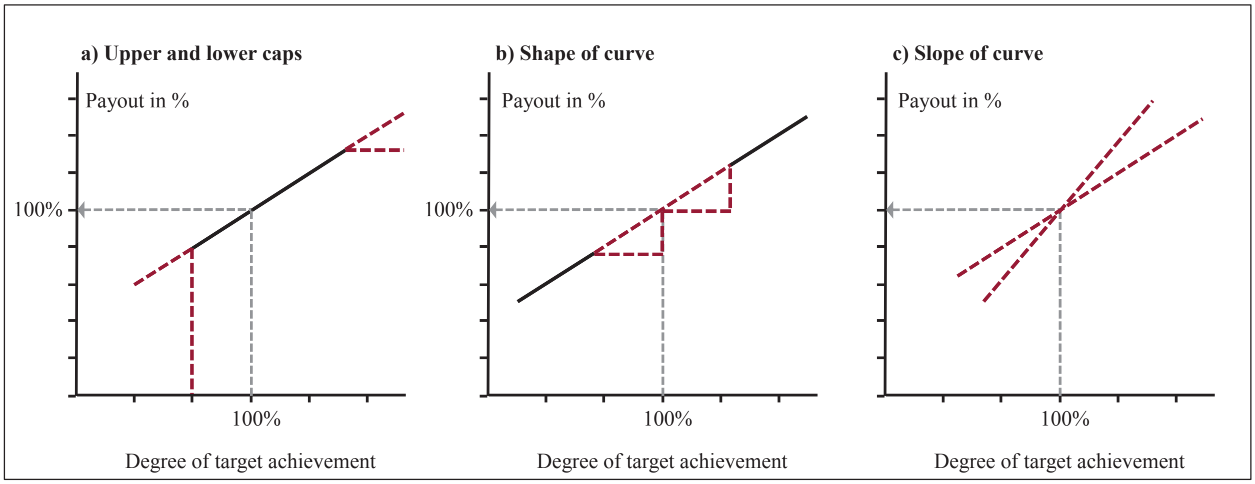


Integrate profit-oriented metrics. A healthy profit base is vital for a company's sustainable success. That's why profitability should be a major goal of every firm, at least in the middle or long term (Nagle, Hogan & Zale 2010). Profit-oriented metrics help to achieve this objective and should consequently be an indispensable element of every incentive system. In reality, however, incentive schemes are often based on purely volume-oriented criteria (Schmitz, Wieseke & Huckemann 2014). A key reason is that these types of criteria can be measured easily, promptly, and specific to individual transactions. In contrast, it is much harder to check the profitability of individual sales transactions in a timely and accurate way. Measuring price realization, for example, requires constantly updating list prices and trade terms (i.e. discounts and rebates) for all products. This is a particularly difficult task in B2B industries with non-standardized products. A practical way to solve this problem is to estimate profitability based on the fulfillment of a contribution margin target within a specific period. In this context, relative targets should be preferred over absolute targets to avoid low price realization from being compensated by higher sales volumes.

2. Design: Install a performance-oriented incentive system

The second principle involves designing a system that regulates sales compensation according to the identified and weighted metrics. Research on this subject distinguishes between commission systems and bonus systems (Kishore et al. 2013). In commission systems, sales force compensation is directly related to a specific metric. That is, a salesperson receives a certain percentage of the contributed performance (e.g. revenue or profit) as an extra payment. In contrast, bonus systems define employee-individual targets or a combination of multiple targets that need to be achieved within a specified period of time, for instance, monthly, quarterly or annual targets. Hence, bonus systems are also capable of integrating incentive components that individuals can influence only indirectly, such as customer satisfaction or targets on a team level (Coughlan & Joseph 2011). The salespeople's overall degree of target achievement is determined by their performance on a single target level. A payout curve then defines how overall target achievement translates into compensation (see Figure 3).

Figure 3. Major decisions in designing a payout curve



In many cases, success depends on how well this compensation logic is defined, but it also poses a major challenge in terms of designing incentive systems. There are certain factors, however, that can help companies determine the system's payout curve:

Avoid (too low) caps. A major decision is whether and how the variable compensation should be capped (see Figure 3a). The main argument in favor of using caps is that compensation is limited to a certain amount if there is extraordinary growth. This mitigates the risk of incurring high personnel costs. On the other hand, caps are likely to dampen salespeople's efforts because they do not benefit from generating additional business. In fact, studies show that revenue can be significantly boosted if caps on compensations are removed (Chung 2015; Misra & Nair 2011). Furthermore, top performers in particular are demotivated by maximum limits and may leave the company (Chung, Steenburg & Sudhir 2014). Although omitting caps bears considerable advantages, the risk of excessive personnel costs should be mitigated. Therefore, the following rule applies: When there is an incentive to boost business (because caps were omitted), the resulting company profits must outweigh the additional costs (i.e. sales force compensation).

Apply no (or small) steps. A bonus system's payout curve can take a linear, declining, progressive or step-wise shape (see Figure 3b). Step-wise curves are popular in practice because they are easy to apply and communicate. However, their main disadvantage is that misplaced incentives may appear at step changes. Nearing a step change, a salesperson may try to generate higher sales at any cost just to reach the next compensation level. This often results in excessive discounts and unprofitable revenues. In contrast, if the next step seems unattainable, a salesperson may not feel motivated to work harder on their current level or manipulate the timing of orders (e.g. delayed selling). To avoid these situations, steps should be avoided or at least sufficiently differentiated.

Set ambitious, but realistic goals. Aside from its shape, the slope of the payout curve needs to be determined (see Figure 3c). The decisive questions are: how much of an increase in performance should be rewarded? Or how much of a decline in performance should be penalized? There is no rule of thumb for these questions. The decision depends on company-specific factors such as industry, culture or sales roles. However, there is one guiding rule: Each level of target achievement should be defined ambitiously, but realistically.

Choose short payout periods. Besides the design of the payout curve, the timing of the payment is an important lever in boosting motivation. A longer period offers employees more leeway to maneuver between the individual sales deals. For example, they may balance out periods of weaker performance with stronger periods. However, research shows that shorter payout periods increase motivation, because employees directly sense the impact of their own performance (Chung 2015). Therefore, ideally payments should be made on time and several times a year.

3. Differentiation: Adjust the compensation logic to seller types

Once a basic compensation logic is defined, managers need to decide whether and how to adapt the compensation plan to the characteristics of seller types. According to a study by Schmitz, Wieseke & Huckemann (2014), 60 percent of companies currently do not use differentiated compensation systems. However, research shows that different compensation elements influence various types of salespeople to a differing degree (Chung, Steenburgh & Sudhir 2014; Ryals & Rogers 2005; Steenburgh & Ahearne 2012). Low-performing salespeople, for instance, are likely to increase their performance most significantly if they receive payments more frequently. High performers, in contrast, should not be demotivated by maximum limits (see principle no. 2). Instead, their loyalty to the company should be strengthened with the appropriate rewards. Finally, average salespeople, who traditionally account for the majority of a sales force, respond especially well to multi-layered targets or to sales competitions. In light of these considerations, the most important success factors in differentiating an incentive system are:

Ensure consistency. Companies need to ensure that the incentive system's metrics are consistent between the sales roles and hierarchical levels. If a sales manager's payout, for example, depends on price implementation success (i.e. profit), then the subordinates' incentive scheme should not be based on revenue targets.

Select criteria that can be influenced. When designing a differentiated incentive system, it is important to select criteria that can be influenced by the sales representative. For example, if a salesperson's discount decisions are often overruled by a superior, price realization should not be a component of the incentive system for this particular sales role. Few things are more frustrating for employees than not being able to personally influence their targets.

4. Communication: Ensure acceptance through change management

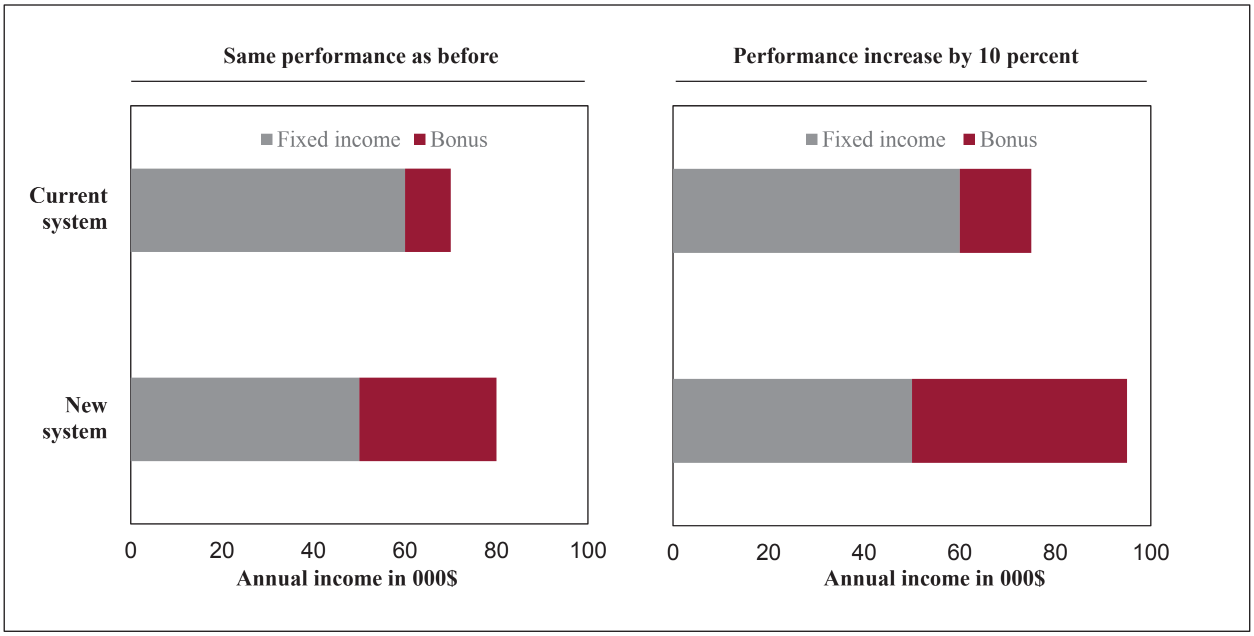
Even the best incentive system is ineffective if it is not understood and accepted by the sales force (Gerhart, Minkoff & Olson 1995). Thus, the success of a newly launched or adjusted compensation plan requires supportive change management to ensure sales acceptance (Colletti & Fiss 2001). Moreover, training can teach the sales force how to correctly apply the new system (Cron et al. 2005). The following success factors make it easier to:

Integrate multipliers. Opinion leaders, such as sales managers and workers' representatives, should be informed on time and be involved in designing and adjusting the compensation system process. These people function as ambassadors of the new system and create trust and acceptance among employees.

Communicate transparently, completely, and understandably. To ensure that a new system is accepted, it needs to be understood. If the sales team does not realize that the previous volume targets were turned into profit targets, they will continue to increase sales volumes with high discounts instead of aiming for margins. This behavior not only endangers company value, but it also lowers the salesperson's income due to missed profit targets. For this reason, the targets and compensation mechanisms of the new system need to be transparently communicated and comprehensibly explained.

Highlight changes and their impact. To avoid misunderstandings and ensure buy-in, managers should clearly demonstrate the changes associated with the new system. A proven way to achieve this goal is to conduct a before-and-after analysis to simulate the profit effects for employees and to point out the anticipated advantages of the new system (see Figure 4). If the goal of the compensation plan is, for example, to lower the fixed income share and to raise the variable bonuses, the company needs to ensure that the expected income for the same performance level is higher than in the former system. A lower or identical pay level will be perceived as unfair due to the increased income uncertainty.

Figure 4. Illustration of before-and-after communication



Provide training. Salespeople can only succeed in reaching corporate goals if they are trained in the new system, that is, if they are familiar with the system's levers and know how to practically apply them. Therefore, training needs to highlight and explain parameters that influence sales (e.g. price) and their impact on compensation-related outcomes (e.g. profit margin). Simple rules of thumb, such as "if the achieved price increases by x percent, the profit margin increases by y percent," help the sales force to understand how they can influence the outcome and thereby reach their goals.

5. Controlling: Guarantee target achievement through reporting and controlling

Once the new system comes into operation, salespeople need continuous support in the field. In this phase, sales controlling needs to give continual feedback on individual achievements to maintain motivation and ensure goals are achieved (Brown et al. 2005; Zoltners, Sinha & Lorimer 2006). Besides attained outcomes such as revenues or profits, a holistic sales controlling also needs to monitor salespeople's behavior to equip them with the right competencies to achieve their targets (Anderson & Oliver 1987; Cravens et al. 1993). Finally, regular assessments for optimization potential should be conducted, even if the system is running smoothly (Chung 2015). In this part of the process, the decisive success factors are:

Report to the target group. Various functional areas require varying degrees of detailed reporting. While sales managers need to supervise the performance of all sales team members and are evaluated based on the overall success, salespeople are primarily interested in their own performance and the resulting compensation. Reporting should therefore be differentiated and the relevant information should be prepared specific to the recipient.

Report promptly. The sales force should receive immediate updates on their performance level – just like in a computer game where players can always track their current score. Ideally, the impact of possible sales decisions should be displayed in real time, as the following project example shows: A service provider developed a software for its sales force's electronic devices. During negotiations with customers, this software directly showed the impact of different service offerings on company profitability and salespeople commissions. Recognizing the P&L impact, and compensation effect in real time, representatives were able to comprehend when deals were still profitable to their organization, while still serving the customer's needs. As a result, the company was able to increase customer satisfaction and profitability by several percentage points.

Report cost-consciously. The costs of individual and immediate reporting should not exceed the benefits. Intuitive and understandable IT solutions, such as extended personnel and pay calculation systems (e.g. PAISY systems) or pay modules of corporate software (e.g. ERP systems) can address this issue. These computer-aided solutions not only help reduce the costs of individual and punctual reporting, but also facilitate their implementation through automation.

Measure target achievement regularly. Sales controlling's most important task is to identify deviations from targets and, if needed, take counter-measures. If a compensation system is not able to achieve management targets, it should be adjusted. Hence, a flexible design should be a high priority already when designing the incentive system.

Support target achievement. Sales controlling should not stop at identifying deviations but it should also provide salespeople with guidance on how to close potential performance gaps. Accordingly, prior research on selling suggests to complement outcome-based salesforce control systems with behavior-based control mechanisms (e.g., Anderson & Oliver 1987; Cravens et al. 1993). While the first mechanism is limited to detecting performance gaps by monitoring objective measures of outcomes (e.g., achieved revenues or profits), the latter mechanism is able to identify potential sources of underachievement by surveilling actual salesforce behavior (e.g., competencies, activities, or sales strategies). Knowing the underlying causes of underperformance facilitates the sales manager's task to bring low performing salespeople back on track, for instance, by providing them with appropriate coaching and training.

Identify optimization potential. While sales is an important revenue driver, it also represents an enormous cost that should be optimized. Optimization potential can be identified, for instance, by conducting experiments (especially A/B tests) or by analyzing field data (Anderson & Simester 2011). These empirical methods give insights into how adjustments in the incentive system affect important performance measures (such as revenues, costs and profits) through their impact on selling behavior. For example, a current study by Chung, Steenburgh & Sudhir (2014) analyzed the field data of a Fortune 500 company and discovered that the company could increase its revenue by five percent if it paid out commissions quarterly instead of annually. To avoid mistakes in conducting and interpreting empirical studies, management should involve experienced scientists with the necessary methodological expertise.

CONCLUSION

This article combines recent scientific insights and consulting experience in sales force compensation to provide guidance for both practitioners and researchers. Specifically, the paper outlines important principles and success factors to effectively design and implement monetary sales force incentive systems in B2B environments. While there are relevant, alternative motivational instruments such as non-monetary incentives (see e.g. Heyman & Ariely 2004), this article focuses on performance-oriented monetary incentive systems, because they represent a widely applied and very effective tool to manage sales force behavior.

As every practice-oriented study, this article is subject to several limitations. While the outlined best practices have proven to support a broad variety of companies to better achieve their objectives, they were primarily derived from project experience rather than from data analysis. Thus, further empirical evidence is needed to validate the presented principles and success factors. For example, analyzing and comparing field data of companies of different industries would be a promising avenue for future research. Furthermore, this article does not provide detailed information on how to tailor an incentive system to a company's individual situation. Due to varying market and/or company realities, designing and implementing the best possible incentive system may require a specific set of performance metrics, a precise communication approach, and a customized reporting and controlling system – all of which need to be defined in a dedicated project.

REFERENCES

Anderson, Erin, and Richard L. Oliver (1987), "Perspectives on Behavior-based Versus Outcome-based Salesforce Control Systems," *Journal of Marketing*, 51 (4), 76-88.

Anderson, Eric T., and Duncan Simester (2011), "A Step-by-Step Guide to Smart Business Experiments," *Harvard Business Review*, 89 (3), 98-104.

Banker, Rajiv D., Seok-Young Lee, Gordon Potter, and Dhinu Srinivasan (2000), "An Empirical Analysis of Continuing Improvements Following the Implementation of a Performance-based Compensation Plan," *Journal of Accounting and Economics*, 30 (3), 315-350.

Brown, Steven P., Kenneth R. Evans, Murali K. Mantrala, and Goutam Challagalla (2005), "Adapting Motivation, Control, and Compensation Research to a New Environment," *Journal of Personal Selling and Sales Management*, 25 (2), 155-167.

Chung, Doug J. (2015), "How to Really Motivate Salespeople," *Harvard Business Review*, 93 (4), 54-61.

Chung, Doug J., Thomas Steenburgh, and K. Sudhir (2014), "Do Bonuses Enhance Sales Productivity? A Dynamic Structural Analysis of Bonus-based Compensation Plans," *Marketing Science*, 33 (2), 165-187.

Coughlan, Anne T., and Kissan Joseph (2011), "Sales Force Compensation: Research Insights and Research Potential," *The Handbook of Business-to-Business Marketing*. Institute of the Study for Business Markets, Cheltenham, UK and Northampton, MA, USA: Edward Elgar.

Colletti, Jerome A., and Mary S. Fiss (2001), *Compensating New Sales Roles: How to Design Rewards that Work in Today's Selling Environment*, New York: Amacom.

Cravens, David W., Thomas N. Ingram, Raymond W. LaForge, and Clifford E. Young (1993), "Behavior-based and Outcome-based Salesforce Control Systems," *Journal of Marketing*, 57 (4), 47-59.

Cron, William L., Greg W. Marshall, Jagdip Singh, Rosann L. Spiro, and Harish Sujan (2005), "Salesperson Selection, Training, and Development: Trends, Implications, and Research Opportunities," *Journal of Personal Selling and Sales Management*, 25 (2), 123-136.

Gerhart, Barry A., Harvey B. Minkoff, and Ray N. Olson (1995), "Employee Compensation: Theory, Practice, and Evidence," *Handbook of Human Resource Management*, Oxford: Blackwell Business.

Heyman, James, and Dan Ariely (2004), "Effort for Payment: A Tale of Two Markets," *Psychological Science*, 15 (11), 787-793.

Kishore, Sunil, Singh R. Raghunath, Om Narasimhan, and George John (2013), "Bonuses Versus Commissions: A Field Study," *Journal of Marketing Research*, 50 (3), 317-333.

Krishnan, Vijaykumar, Robert M. Peterson, and Mark D. Groza (2015), "The Effect of Sales People, Processes and Provisions on Performance: The 4P-Sales Management Model," *Ideas in Marketing: Finding the New and Polishing the Old*. Springer International Publishing, 12-12.

Kumar, V., Sarang Sunder, and Robert P. Leone (2015), "Who's Your Most Valuable Sales Person?" *Harvard Business Review* [online], available at: https://hbr.org/2015/04/whos-your-most-valuable-salesperson [accessed June 9, 2016].

Misra, Sanjong, and Harikesh S. Nair (2011), "A Structural Model of Sales-force Compensation Dynamics: Estimation and Field Implementation," *Quantitative Marketing and Economics*, 9 (3), 211-257.

Nagle, Thomas T., John E. Hogan, and Joseph Zale (2010). *The Strategy and Tactics of Pricing: A Guide to Growing More Profitably*. (5th ed.) New York: Prentice Hall.

Ryals, Lynette J., and Beth Rogers (2005), "Sales Compensation Plans - One Size Does not Fit All," *Journal of Targeting, Measurement and Analysis for Marketing*, 13 (4), 354-362.

Schmitz Christian, Jan Wieseke, and Matthias Huckemann (2014), "Vergütungssysteme im Vertriebsaußendienst," Acquisa Online [online] http://de.mercuri.net/sites/default/files/news/acquisa_online_2014_05_verguetungssysteme_im_vertrieb_huckemann_schmitz_wieseke.pdf [accessed June 9 2016].

Steenburgh, Tohmas J., and Michael Ahearne (2012), "Motivating Salespeople: What Really Works," *Harvard Business Review*, 90 (7), 70-75.

Zoltners, Andris A., Prabhakant Sinha, and Sally E. Lorimer (2006), *The Complete Guide to Sales Force Incentive Compensation: How to Design and Implement Plans that Work*. New York: Amacom.

Zoltners, Andris A., Prabhakant Sinha, and Sally E. Lorimer (2012), "Breaking the Sales Force Incentive Addition: A Balanced Approach to Sales Force Effectiveness," *Journal of Personal Selling and Sales Management*, 32 (2), 171-186.