

Strategic Initiatives in Sales Compensation

Do They Make Sense for Your Organization?



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Objectives-based or strategic performance measures in sales compensation attempt to balance the short-term delivery of financial results with longer-term sales growth and increased customer value. If used properly, strategic initiatives — or “management by objectives” (MBOs) — have both qualitative and quantitative expectations and outcomes. Determining whether they make sense for a sales organization requires an assessment of their rationale, pros, cons and requirements necessary to implement and manage their use.

Issues to Consider

Strategic initiatives can be important in reinforcing the behaviors required for a company to achieve its business goals. They help to focus the salesperson on targeted opportunities with limited short-term results, but significant long-term potential. Strategic initiatives also can initiate and reinforce strategic behavior (e.g., account management practices, business case analysis) to improve overall sales organization performance and profitability.

Strategic initiatives incorporate key performance indicators (KPIs) into the sales compensation plan. KPIs are the activities or results that differentiate an average performer from an outstanding performer. While performance against stretch sales targets often is a daunting task, the types of sales made, sales processes employed and accounts targeted may be the important differentiator in determining profitability. Strategic initiatives designed, implemented and rewarded appropriately in the sales compensation plan help to create this type of focus. Because no two sales territories are the same, strategic initiatives allow management to focus sales activities on strategic goals specific to both the salesperson and his or her territory. The sales manager then can reward one individual for "missionary work" with a new market segment, and focus another individual on a customer partnership opportunity. In the past, salespeople would not get paid to execute these sales activities unless there were sales transactions that took place.

Arguing against strategic initiatives would seem to counter the interests of the organization. However, using this type of sales performance measure is not without risk. Their effective use requires management discipline, clear and well-defined strategy and continuing commitment to their use. There are several issues to consider.

Measurement

Because of the qualitative nature of strategic initiatives, they are not easy to evaluate and measure empirically. The traditional sales performance measures of revenue or gross margin lend themselves to assessment, in that they can be summed or calculated from information entered into the company financial or order entry systems. However, the key with any performance measure, especially if one intends to link it to compensation, is the ability to measure it accurately, consistently and objectively. For this reason, it is important

that strategic initiatives encompass both qualitative and quantitative measures. If the strategic initiative to penetrate a new market is to sign three agreements within two years, with "foundation" customers upon whom to build further sales, then definitions are required to assess the salesperson's performance. What is a "foundation" customer? If defined as an account with a minimum of \$500,000 in first year sales, with the active participation of "key" decision-makers, then the contract value becomes part of the quantitative measure. Evidence of attendance at key meetings and the signature of, for example, the customer's president on the initial purchase order agreement may satisfy the qualitative component.

Goal Setting

Targets/quotas must be established. This is relatively simple for the quantitative elements, however the qualitative components require a detailed description of the activities required to execute at each level of performance (it should indicate expected outcomes or deliverables). Project milestones or specific tasks should be specified (e.g., completion of account analysis with identification of specific product penetration opportunities). Establishing detailed and documented goals will diminish the subjective component of the evaluation. Goal setting and evaluation of strategic initiatives also could be tied to some other formal performance management system (e.g., The Balanced Scorecard).

Administration

In recent years, most organizations have undergone some form of staff reduction with the consequential role expansion for remaining employees. The work hasn't gone away but, rather, has been spread across those who remain or ... it just doesn't get done. Because of this change, there has been a significant push in sales organizations to streamline sales performance measures and integrate systems so data can

be extracted from internal sales or enterprise resource planning (ERP) applications for reporting, rather than requiring manual documentation or raw data manipulation from spreadsheets. Spreadsheets, while good for conducting single case analysis, are poor practice as a performance measurement system because of the high potential for error when manipulating data. The extract process works well for the quantitative component of the strategic initiative, but does not address the qualitative element.

The qualitative factor requires documentation of accomplishment. This can include letters, memos, visual evidence or anecdotal reports. Because these methods of determining performance and achievement are not easy to collect, store and assess, organizations have avoided using strategic initiatives for compensation purposes. Make no mistake: strategic initiatives require more administration than simple quantitative measurement. However, they also can potentially deliver longer-term, consistent and profitable sales streams. As with many resource-based decisions, there is a tradeoff between the costs (in terms of administration) and the benefits (in financial and strategic results). In the use of strategic initiatives, there also is an additional burden in the form of management time required to create, monitor and evaluate the effectiveness of the salesperson in executing the initiative. This has become a considerable issue in the adoption of strategic initiatives. As embarrassing as it may seem, when asked about their willingness to approve strategic initiatives as a compensation measure, a number of sales executives cited a lack of confidence in their sales management teams to agree on, implement and manage as the primary drawback.

Criteria for Payout

When compensation is involved, sales performance evaluation is more than personal; it is critical to the salesperson's lifestyle and their ability to meet their

financial obligations. Calculating achievement for the quantitative component to determine payout is relatively easy. Percentage of quota achievement, number of units sold, dollars of revenue or gross margin all can be determined accurately and consistently. Whether to payout on a sale to a new customer, where adherence and execution of a new business development process is a qualifier, is a different matter. How well did the salesperson follow the required steps? Did he or she target the key decision-maker? How complete was the customer information collected before the sale was completed? These factors are much more difficult to evaluate, and often are lost in the euphoria of getting the order. They may, however, be critical to the replication of the feat in future opportunities and, therefore, should be essential in the evaluation and payout.

Getting consensus on the proper criteria for evaluation is difficult, as is creating the metrics to determine the degree of achievement and how much to pay out for the level of performance. This is especially true in those cases in which the strategic activities have a longer-term sales cycle and organizational payoff. In these cases, the payout may be based upon execution of activities and milestones rather than orders and financial results.

Thresholds and Overachievement

To assess achievement on strategic initiatives, it is important to determine the points at which you want to deliver an incentive payout for the expected performance. One option is to have an all-or-nothing payout, which requires a judgment as to whether the target level of performance has been achieved. If not, then no payout occurs. If met, then 100 percent payout is made, but usually without further upside opportunity. This method typically is used when there is limited measurement capability. Other variations on this theme include a threshold level of performance that results in less than 100 percent payout (perhaps 80

percent). The key is to set the threshold level performance expectation and differentiate that from target performance (at 100 percent) to warrant the additional 20 percent payout. One method often used in this paradigm is to base the threshold payout level on quantitative performance criteria, and to base the additional 20 percent of payout to target level on both the quantitative and qualitative elements. The individual who exceeds the target level of performance and delivers exceptional quantitative results *and* demonstrates overachievement on the qualitative expectations reaps upside opportunity, as strategic initiatives usually are tied to overachievement on the quantitative measurement component.

An alternative design is to set a cap at 120 percent of target payout for overachievement on either the qualitative or quantitative components and at 150 percent if both the qualitative and quantitative components both are exceeded. However, any measurement and payout for overachievement requires the metrics to identify what constitutes outstanding performance.

The Pros of Using Strategic Initiatives

Strategic initiatives are not for every organization or for every sales role. They work most effectively when used to ensure that sales are made and that those sales are executed in a particular manner or focused on an appropriate customer. Following is a discussion about the positives surrounding the use of strategic initiatives in a sales compensation plan.

Behavioral

Strategic initiatives support the qualitative delivery of sales execution with desired behaviors and using processes that deliver better long-term results. The intent is not to force conformity and take away from the creativity or personal selling skills of the salesperson. Improved results are delivered via planned implementation of a formal approach to business

development (with demonstrated historical success) that can be replicated across accounts. Achieving consistency in sales behaviors (e.g., account management process, customer relationship management implementation, etc.) also is critical in achieving better execution on customer management, resource deployment and integration of new salespeople or sales forces in mergers and acquisitions.

The base salary component of a salesperson's target total cash opportunity usually is described as payment for tasks that are "part of the job" (e.g., administration, relationship management, etc.). The objective behind strategic initiatives is different; their purpose is to reinforce the completion of longer-term "key" sales activities that tie into the overall financial success of the company. Strategic initiatives are the tools that enable management to target desired behaviors.

Focus

Strategic initiatives help create focus not only on the delivery of short-term financial results, but also on longer-term strategic deliverables. If sales activities focus solely on the delivery of quarterly numbers, then each future quarter will be as hard to deliver as the preceding one. However, the right combination of short- and long-term sales focus will result in improved short-term results, easier delivery and sales growth in future quarters.

Also, achieving incremental or exponential growth versus just maintaining existing salary levels necessitates targeting and delivering accounts with significant potential. Executing against these types of customer opportunities often requires a considerable investment of time and effort without much in the way of actual sales. If the sales compensation design rewards for short-term revenue or gross margin delivery then, to achieve his or her expected level of earnings, the salesperson will focus on those accounts and opportunities that can be closed immediately — at the expense of those that have significant long-term growth potential. Is that truly the

desired focus? No, but that is what the compensation plan communicates as an organizational goal.

Addressing Territory-specific Issues

Strategic initiatives provide management with a major lever to address territory-specific sales issues or objectives. Some organizations opt for common strategic initiatives that are the same for all territories. Others create unique measures that precisely deal with problems or opportunities in each territory. The difficulty with this approach (although not a show stopper) is ensuring that territory-specific initiatives are equitable in terms of effort required and contribution to the organization, and that each initiative can be measured and rewarded accurately and fairly. Unique strategic initiatives also require greater administration. One option is to create one or two common initiatives (at the national and/or regional level), then a third initiative that is specific to the salesperson and their territory.

While adding complexity and administration to the sales compensation environment, territory-specific measures can create the focus on sales and customer issues that differentiate sales success from mediocre performance. These are not insurmountable problems, but they do require management attention and a framework or structure to ensure equitable treatment.

The Cons of Using Strategic Initiatives

Many sales forces don't use strategic initiatives because they are not easy for sales organizations to implement or manage. While the sales organization may be in dire need of the benefits that can be gained from the use of strategic initiatives, if senior management, field sales management and salespeople are not prepared to dedicate themselves to the development and implementation process (at least for the first few years), then it is not advisable to tackle them in the sales compensation plan. Consider the following factors working against the use of strategic initiatives.

Consistency

Unless there is consistency in the evaluation criteria (from rep to rep), measurement (from manager to manager) and payout, strategic initiatives are difficult to use. This is why performance management has not been the hallmark of the sales organization: If they deliver the numbers, then their performance is good. If they don't, then they are gone.

If this is the culture and organizational philosophy, there will be significant long-term retention problems. Short-term results can be realized with a "sink-or-swim" philosophy, but this approach results in regular sales force turnover. In the future, with the supply of well-qualified, skilled salespeople expected to dwindle and the expectations of the sales role anticipated to grow in terms of skills and knowledge, keeping good sales performers will be critical to organization success.

Therefore, it is imperative to develop sound evaluation systems for sales that include results *and* quality of delivery.

If the development and implementation processes include clear, well-communicated guidelines and require review and signoff by senior management, many consistency difficulties can be avoided. But if consistency in the measurement of strategic initiatives cannot be obtained, implementation should be put on hold until that consistency is achieved.

Program Administration

Many organizations do a reasonable job at the design and development of the sales compensation equation. However, they lose considerable credibility when, months after implementation, performance cannot be assessed against objectives with accuracy or certainty. Strategic initiatives require more administrative systems and overhead to track and report on performance (sometimes significant in the beginning). Stakeholders in the administration process include salespeople in the field, sales management, finance, payroll and human

resources. The result for many companies is that they tend to pay out without demonstration of performance. In doing this, the opportunity is missed to use strategic initiatives for what they are intended: to initiate and reinforce strategic results. The time, resources, systems and financial requirements for program administration should not be viewed as a cost, but as an investment in the improvement of sales execution and long-term organizational performance.

Sales Management

Lack of management support and participation is the primary reason that these performance measures fail. The reason lies in the definition of the sales management role. What is the strategic role of sales management? Is it to solve the problems of their salespeople? Is it to take on and execute the difficult tasks that the salesperson is struggling with so that the required quarterly results are achieved? Is it to sit in meetings and make customer decisions that should be made by field salespeople or their first level sales managers? If so, then sales management is doing its job.

This should not be sales management's role. The primary function of sales management should be to create an environment in which salespeople are directed and motivated to deliver short- and long-term sales results. Strategic initiatives are a tool to help management achieve this goal. However, they require sales management to take an active and committed role in their design, implementation, monitoring/evaluation and feedback to participants. If management has a short-term focus on the business, or does not see sufficient value in strategic initiatives to invest personal time and effort, then the use of strategic initiatives is ill advised.

Requirements for Using Strategic Initiatives

As mentioned, implementing strategic initiatives may not be the right move for all sales organizations, and it

is not easy to accomplish. However, the positive sales and profit benefits that result from their implementation make strategic initiatives a valuable tool.

Strategic initiative rewards allow the salesperson to do the right things (and be paid for accomplishing them) for the company and the customer, and make future sales more profitable and, hopefully, more plentiful.

Following are several elements that must be present and empowered to implement strategic initiatives effectively and efficiently.

Senior Management Commitment

Committed senior management, ready to support the program both through their approval, participation in development and in their actions and decisions is required for success. If management expects salespeople to take a strategic approach to their selling activities, then they also need to ensure that they maintain a longer-term focus on sales activities. Clear vision and management consensus on the strategic direction also are critical.

Roles and Responsibilities

Any competent sales compensation plan designer will tell you that the core principle in designing a sales compensation plan is ensuring that it is tied to the role and accountabilities of the salesperson. The first mistake in implementing strategic initiatives is to address the problem rather than the role of the sales individual in solving the problem. Before developing strategic initiatives for the organization, make sure roles and responsibilities are confirmed, documented and aligned with sales strategy.

Framework Development

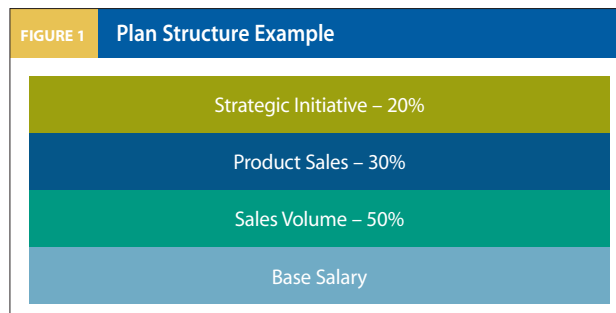
Most people work better when they operate within boundaries that set expectations and define choices. Sales management is no different. Many sales managers don't want boundaries, saying they stifle their creativity

and flexibility in responding to the needs of their salespeople and markets. On the contrary, working within a framework for strategic initiatives allows the sales manager to customize a solution to specific issues in the field, but in a consistent and organized manner. The framework includes the common elements required to efficiently develop and manage the strategic initiatives process.

Plan Structure

To incorporate strategic initiatives into sales incentive plans, the weight of this performance measure needs to be determined. As a rule of thumb, an incentive plan should not have more than three or four performance measures, with any one measure not accounting for less than 10 percent of the overall incentive opportunity (anything less results in a small payout that may not motivate performance). Especially in their first year of implementation, the strategic initiatives performance measures should be given a weight of 10 percent to 20 percent. Once administrative and tracking procedures are proven effective, and sales representatives and managers are comfortable with the process, this weight can be increased. The amount of the increase will depend on the type of role and how many performance measures are in the incentive plan.

When determining weights, it is important to remember that the salesperson's focus must be on delivering financial results. The majority of incentive (variable) components in the plan should be based on the salesperson's financial performance measures. It also is wise to include a "qualifier" (minimum level of acceptable performance) that based on financial results that must be achieved before any payouts are earned. An additional qualifier that indicates a cap on the financial measure portion of the plan at a specified level of performance until the strategic initiatives objective has been met may also be desired. (See Figure 1.)



Patience

Patience is necessary to weather the difficulties and controversy that inevitably will occur in the first year or two of the program's implementation. Strategic initiatives are not always easy to create, and attaining organization-wide consistency in their development and evaluation will take time to resolve. It is important to focus on the long-term benefits while the bugs are worked out.

Information Systems Support

Systems support is required to identify tracking and reporting requirements, to document systems, determine network and Web requirements and make changes to accommodate new measures, as well as integration with other legacy systems. It is essential to make the administration and data collection process as automated as possible, or the manpower required to administer the program will increase the cost and decrease the benefit.

Administration

Administrative support during implementation and initial rollout are necessary to ensure that sales transaction tracking and payment are accurate and well-documented. Even after the program is put in place, some administrative support is necessary to manage the qualitative documentation.

Education

Training field salespeople and field sales management is important to their understanding of the rational and

potential benefits behind the use of strategic initiatives. As well as the potential benefits from a successful implementation, it also is a good idea to be honest with these players and tell them what to expect and how hurdles will be handled during and after implementation. (See Figure 2.)

FIGURE 2 Sample Strategic Initiative Objective	
Objective: Targeting one or more specific "key" or major accounts, in a new market to achieve product penetration.	
Payout Opportunity: \$4,800 = Threshold Level (80% of Target) \$6,000 = Target Incentive Opportunity \$7,800 = Overachievement (130% of Target)	
Expected Results: 1. Increase in market share of 5% 2. Product revenue growth increase of 20% 3. Demonstrated commitment from Senior Management	Timeframe: December 31, 2003
Required Activities: 1. A detailed customer analysis report must be completed, with a schedule of planned activities 2. One or more product demos per quarter, with a minimum attendance of 5 people 3. Successful launch of Marketing program	Timeframe: Quarterly Quarterly Q1 2003
Criteria for Evaluation: Achievement of Target: Completion of Required Activities and Expected Results <ul style="list-style-type: none"> Attendance/demo evaluation records must be submitted on a quarterly basis Record of President/Senior Management attending demos/meetings Threshold Performance: Minimum market share increase of 2% and product revenue growth of 10%, plus completion of Required Activities Overachievement Performance: Minimum market share growth of 10% and product revenue growth of 30%, plus completion of Required Activities	

Fostering a Valuable Tool

Strategic initiatives are a valuable management tool to initiate and reinforce desired behaviors in sales execution. Initially, they are administratively burdensome and require some polishing and refinement to ensure that they focus on the right situations and behaviors. The sales organization will experience some angst and disharmony until it becomes accustomed to creating

and executing against strategic initiatives, and management will need to clearly communicate the intent and expectations for the program to be successful.

Organizations that have invested the time and resources — and have stayed the course until they have practiced and improved their competency in using strategic initiatives — swear by them and have the results to prove their worth. [WJ](#)

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