



QUANTUM SALES COMPENSATION

Designing Your Plan

(How to Create a Winning Incentive Plan)

Good morning, everyone. Welcome to our third installment of “Master Classes on Sales Compensation Design” with the NBC incentives. This is going to be the third of what is now going to be a four-part series; we added an extra session on to the end so we can make sure we cover all of the plan launch and communications items that are vital to having a successful plan launch.

In today’s session, we’re going to talk about how to design the actual plan, how to look at the numbers that the plan is made up of, how a plan’s going to be calculated, how to come up with the right commission rates for a functional plan.

So to do a quick review of what we’ve seen in the previous sessions, an NBC Commission Plan is going to meet the following parameters:

- It’s going to pay incentives on a territory or customer NBC – that means that costs are going to be taken into account and it’s going to pay for actual profitability.
- It’s going to eliminate incentives for dysfunctional sales – that means it will withdraw commissions or have negative commissions for negative profit sales.
- It’s going to reward the efforts to reform unprofitable business – that means we’re going to have higher pay for people that are working to make the company more profitable and to make accounts that are unprofitable into profitable accounts.
- It’s going to more precisely synchronize the goals of the company and the goals of the sales force.
- It’s going to reduce or eliminate the adversarial component that’s in most sales regimes, where we pay people to bring in dysfunctional or negative profit business and then pay sales managers to stop them from doing that.
- It’s going to be much easier to implement and administer because the calculations of sales become very simple and you can get directly at profitability rather than using other factors to simulate or give indications of what things may be affecting adversely or positively profitability. In an NBC plan, we base the rate on the profit that is.
- It’s the most effective technique for rapidly increasing profitability because it gets the sales force working on the profit issues. That’s because a lot of the profit gains that the company has available to it are on the customer contact’s surface of the business. That’s the domain of the sales force they own the customer relationships generally and we can get them working in parallel on various customer relationships to make the relationship



better for us and for the customer. We're going to pay people without us being done, and that helps increase profit rapidly.

Set Baseline Values and Test

So the first thing we want to do is set some baseline values and then test. The purpose of the baseline is to make sure that the numbers that we're picking for the factors for commission rates, for base salaries, for the other components of the plan are realistic and reasonable and are going to work in the real world. What we're going to do is get NBC production for each of the reps, probably from the previous year, and get the commission pay or the salary, the total take-home pay for the reps for the previous year. We're going to map those two together and find out what the effective rate is that we're paying out.

Then we're going to balance the system. Since we haven't been paying on profitability before, we're going to find reps where we pay more than we should for profits, and other reps we pay less than we should for profits. The numbers that we have, by definition, haven't been working as well as they could be, that's why we want to change the plan or replace the plan. So when we do that, we're going to discover all the dysfunction in the pay system and we're going to try and straighten that out. We're going to wind up using territory realignments, adjusting base salaries or NBC rates and using guarantees to set a pay scheme up that's going to pay the right amount of money in every circumstance or in most circumstances.

Then we're going to be able to back-test with prior actual performance. In WayPoint, that seems very intuitive that we should be doing that, but in the world of high-end compensation design, companies don't always have the budgets to do back-testing, which could be \$100,000 to \$500,000 extra on a project. Companies sometimes don't have the budget for that and can't back-test. They take on some risk in doing that because it will be more difficult for them to account for every circumstance or spot the anomalies that inevitably exist in the sales flow that can have an adverse effect on pay. So we're going to be able to do that; that's going to be a part of what we're working on.

NBC Compensation Sheet

The first thing that I want to show is the NBC compensation worksheet. This is just a picture of it, and I'll explain it here, then we'll pull up an actual worksheet and work a few numbers so we can see what's going on.

In the NBC compensation worksheet, we have three blocks: the top block is what has been, the second block allows us to play with base salaries, the third box allows us to play with



commission rates and work out what those numbers ought to be from those different perspectives.

Each column here represents a particular performance level that is typical of reps in different categories. We recommend, wherever you can, to put every rep into the program so that you can reveal all of the different types of performance levels and pay levels. We also recommend that you take it down to a monthly level so that you can see through the year what the outliers are and make sure that your plan properly accommodates them.

I should say off the top that there is no one mathematical number rate fixture that will apply to all people in all circumstances. You can spend a great deal of time trying to find out magical set of numbers, commission rates, base salaries that will apply in every circumstance. Frankly it would be a rarity for that to happen. So we are not on a search for a perfect set of numbers that will meet all conditions; what we're looking for is a good set of numbers that will meet most conditions and then make sure that we have enough flexibility in our thinking and in our plan to accommodate the outliers so we can get the outcomes we're looking for.

The most successful plans are plans that have the ability to change and the ability to be flexible so that we can get more of what we need when we run into circumstances where what we planned out doesn't make sense in the environment that we're looking at. We're trying to get a good indicator here.

The first block of numbers, we have the NBC that was produced by the reps in the previous year. The second row, we have the actual W-2 pay. We exclude the benefits and other things; those are resources like air and utilities and state matching and whatnot that applies to wide swaths of the company. Trying to factor those in just turns this into a more complex exercise than it needs to be. It also withholds from us the ability to communicate the plan effectively if we are talking about numbers that don't make sense to sales rep because we've inflated them by state matching and benefits numbers. We should be talking to them in the same vernacular; they're accustomed to hearing what their base pay is, what they're going to see on their check. So we should work out the plan accordingly.

The first block has the performance and the pay and gives us an effective rate. This tells us that effectively in the first case that we paid out 33.2% of all the NBC we made in pay for the rep in Case A, 48.3% for the rep in Case B.

Then the next part of the plan allows us to plug in a fixed base salary. What it will do, of course, is tell us how much incentives we need to pay in order to bring the pay up to last year's W-2 and it will also tell us what the NBC rate would be in order to accommodate the fixed base that



we've set. So we have a \$55,000 base rate here, we have a 4.2% NBC rate to arrive at the same result. Over here a \$45,000 base salary wind up with a 10.8% NBC rate. As you can see, if we have these fixed bases set for these two reps, we're going to necessarily need different NBC rates in order to accommodate the bases that we have.

It is okay to pay different rates for different people, but as your sales force gets broader, that gets a little bit unmanageable and leaves a lot of opportunity for people to twiddle numbers somewhere that won't be noticed. So, we don't recommend that you come up with individual rates for each person, but it's a useful exercise to find out what the rates are. Just going by the first two here, I can say, well, maybe a 7.5% rate will sort of split the difference and we can start working the base salaries in order to have a 7.5% rate that would work.

So that gets us to the third block here where we'll get to plug in an NBC rate and then it will tell us what base salary we would need in order to accommodate that particular rate. What's interesting here is if I just take 10% as a round number and plug it in, we get an adjusted base rate of \$44,000 here, \$46,000 there, to wind up with the same pay for the same results. What we've seen is here is by adjusting the rate upward and the base salary downward and synchronizing them a little more closely, we wind up with a single rate that would apply fairly well in both territories. That can give us some indicators where we may go forward.

So let's switch now to the actual live spreadsheet and look at what that would tell us. Here we have all the reps in a particular branch. We have their names, their NBC from last year, the W-2 from last year, and what the NBC rate is. This shows a more typical view of the mathematics that actually go on when you're coming from a pay scheme that is not based on profitability but is based on gross margin or gross profit. These numbers can reveal the real dysfunction in the prior system and the thing that we're trying to fix, and we have some good examples here.

We have a rep that's actually generating a negative NBC but is being paid very well for having done so. So we have a rate that's actually unworkable, there's no indicator where we can go in the future, and we have some extra work that we have to do in a territory like this to come up with the right numbers.

Let's move on to the B column where we have Anders. Anders generated \$272,000 NBC and that produced for us \$121,000 in pay. What this sheet shows us is that we have about a 44% NBC rate in order to maintain that kind of pay level. So we can plug in various base rates and come out with various commission rates. If the guy is on a \$4,000/month base salary, that would be \$48,000 a year, then we can plug that in and see that we need about a 27% rate for him.



Let's go find somebody else that's sort of in the ballpark. Let's go to Britney Salerno at the end. We're going to work on the most reasonable accounts first to get a baseline for the kind of performance we want. She's getting \$68,000 for \$131,000 of performance; she gets about a 52% rate. If we wanted to have her make last year's pay and we give her, say, \$3,000/month base, which is \$36,000, then we've got a 24.7% rate. When we compare this 26.9% and 24.7%, it looks like maybe 25.5-26% might be somewhere in the range and that might be an appropriate pay level. So, let's just plug in 25% for a round number and then apply that to all of the territories and then we can see what base salaries we would come up with. So if we want to pay a 25% base rate, we can give \$53,000 base to Anders, \$35,000 base for Salerno, and this gives us an idea of where the pay ought to be in order to accommodate this.

Now you can see in the rep list that we have, we have some where the numbers are completely dysfunctional, places where the territory is underwater and the rep is still being paid, places where the rep requires more than all the profit in the territory just to make their living. There are two ends to the discussion to go in there:

The first thing, or I guess the first realization, is that it reveals a dysfunction in normal gross profit pay processes, where we're actually paying good salaries for people to bring us no or negative profitability. That's one of the things we're trying to fix.

The second thing is that the territories themselves probably are composed of an inappropriate balance or combination of customers and that is what is driving the thing so far negative. Territory realignments are the key to getting a set of numbers that's going to be functional, so part of what you may wind up doing is rebuilding or realigning the territories at the NBCs for newly aligned territories and plugging them into this model so that you have someplace that you can go.

One last thing that's important to remember is that the territories heretofore have been unmanaged on an NBC basis or profitability basis. Anything that has never been managed and begins to be managed just a little bit will see enormous improvement by having a little bit of attention paid to something that affects the profitability. For that reason, you should be aware that the salespeople have the ability to change the territories pretty substantially in short order, and so the amount of pay that we're planning on paying using this model may wind up being increased pretty substantially as they start to affect the profitability of each of the customers in the territory. There's no reason to worry about this because a good NBC program always pays out of profit that you gain. That means that the gain in pay will be paid out of the increases in profits that you achieve, and so the company will not be underwater through the pay increases.



Territory Reassignment

Okay, let's return to the slide deck and go on to the next item, so let's talk a little bit more in detail about this territory reassignment.

The purpose of the territory reassignment is to build territories that are functional for each of the reps. When Merrifield does it at its most ruthless level, what he will do is go through an exercise of categorizing the sales reps. In the A pile, he'll pick all the reps that he feels they're terrific guys, they really are doing the job, they really do manage the customer accounts and manage to do negotiation that gets a benefit for the company and for the customer. They're top guys and you want to have more like them. You put them in the A pile.

Meanwhile, you look at the reps and you find people on the other end of the spectrum—"My gosh, if we had to do it all over again, we probably wouldn't hire this person"—and you put them in the C pile. Then you just let everybody else, by default, go into B.

What Bruce may do is take an accumulated profit report out of WayPoint ranked on the NBC. He will recognize that he needs, let's say, \$200,000 of NBC to pay his top guy, or let's say \$400,000 NBC to pay his top guy, and run down here and say, "If we don't have geographic issues and everything is in one place or within the territory, we can work and we need \$400,000 to pay the top guy," then we can say the first nine accounts get us to \$392,000. We can have a guy that used to have 130 accounts and wasn't getting to most of them and he can focus in on enough accounts to give him the kind of pay he needs and then can spend more time working on those accounts and penetrate them more deeply, finding more things that they can buy, finding better ways that you could integrate with the customers so it's more profitable for you and for the customer and generating increased NBC, and he can be totally focused on that.

You may add some negative accounts into the mix, and we can talk about that in a moment, but you wind up with a finite number of accounts that belong in that territory. Then you can say you need, say, \$300,000 of territory for the next guy. So if you run down here, you take all the accounts from #10 all the way down to 70 or something like that to get enough accounts to cover the base for the guy, then you have him fully paid.

Then you're sort of running out of accounts that make money and then you have to wonder, what are these other guys going to do? Do they wind up being transferred into more of a tele-sales role where they're working on smaller customers on a more remote basis and not driving out in cars, knocking on doors? Or do they have other purposes or do they just not need to be there?

The scope of what we're talking about here is not how to rejigger the sales force and let people go, but ultimately you're going to wind up having a certain amount of NBC that has to generate



enough income for the people. If you have a branch where the whole sales force is underwater, what the numbers are really telling you is you have too much money going out for too little profit coming in. How do you fix that? Part of the solution is obviously have less money go out on accounts that are losing money or not making money.

So the other element that I talked about is scanning down to the bottom list and looking at a certain number of money-losing accounts. So when we talked about the A guy and needing to have enough pay to cover the base, we might also include maybe the five most money-losing accounts in there, adding a few more from the top to wind up with that \$400,000 total, but to give him some negative accounts to work on to help increase the profitability of the business. In doing so, you covered two bases that are very important.

The first thing is that you give him some room to grow so he can do some things that increase the profitability of the business and increase his own income at the same time. If you have your top guy that's probably the opinion leader in the sales force saying, "Wow, this is a great program. I'm so much more successful because I have so much more focused on the things that matter," other people are going to take the lead and start focusing more on what they're doing and you're going to have somebody else that's helping encourage people to do the right things to make the plan work for themselves and for the company.

The second base that you're covering is there's probably nobody really working hard to turn negative accounts into positive accounts right now. If you're paying one of your top people to do that exact thing, then you're most likely going to get that kind of result. Since the numbers are so big, the incremental gain that you get will be very large as well, and this is going to move the dial quickly.

NBC Commission Report

Let's now take a look at the NBC Commission Report generated by the WayPoint Sales Compensation Calculator. This particular report is interesting because it allows for negative commissions. So for Linda Towns, she had positive NBC on accounts and negative NBC on other accounts; they're all ranked here. She wound up with a total of \$2,000 NBC for the period and she winds up with \$1,000 worth of commission, which makes sense. That was composed of almost \$1,000 of commission on her best account, another \$200 on her second best, but she lost \$176 of commission on her worst account which was underwater in NBC level.

The report provides a couple of interesting things. This is actually a report that gets printed out and put in with the paycheck. It tells the HR people how much the pay is supposed to be and it tells the sales rep what they got paid on and why. So, the total commission was \$1,021. The total

commission would have been, if she had no money-losing accounts or if they at least broke even or came out to zero, she would have made \$1360. If all of her accounts are running at what the average NBC rate of her profitable accounts were, she would have made almost \$1,800. So she could have made 80% more in this month if she had worked on her underperforming accounts and brought them up at least just to the average of her money-making accounts.

This gives a clear indicator of how much money is available. On a monthly basis, it reminds people what they should be doing, what they shouldn't be doing, which accounts are helping with their commissions and which ones are harming. This can be very good information so that you know exactly what to work on.

Benefits of an NBC Plan

So finally, the benefits of an NBC program using the mathematics we're talking about here:

- It's going to drive profit growth, if the sales force engaged in repairing underperforming accounts and helps make sure that they're focused on bringing in accounts that are going to bring in profit, not just the accounts that bring in volume.
- The reps are only going to get rewarded when the company is making money so that it provides all kinds of benefits in terms of keeping the reps onboard, having the company and the reps team up to go and accomplish an important goal, making sure that the company is not harmed by a desire by certain reps to bring in accounts, whether they make money or not.
- It also motivates the top reps because the best reps are going to have above average earnings. Particularly when you launch the program and you start managing the previously unmanaged aspects of profitability in the accounts, there's usually big gains, and that means big gains in income for the reps. Fortunately it's all funded out of profit gains that the company realizes so the company's budget is not blown.
- It also promotes high morale because it makes sure that people that are top performers get rewarded for being so and people that are underpaid are being underpaid because they're underperforming, and there's a relationship there. So people can see that the company cares whether people perform or underperform and that the reps are really masters of their own success, in terms of being able to pick and choose what they work on and how they work on and how they get to success themselves.
- Finally the low performers will be low-paid and they may turn to fire themselves and that will save you from having to swing the ax. If people that are really not cut-out for their work find themselves better jobs doing something somewhere else, they'd be happier and

you won't have the load. You also won't have good accounts in the hands of bumbling reps.

- It protects against runaway commissions. You can only get increased commissions if you get increased earnings so you wind up staying within the budget and you get performance insurance because on balance, if your people are properly motivated and people are the right people, that is, people that are motivated by incentives, you will always wind up with increased performance for the company, which means increased performance for the stakeholders and the company and for the management throughout the company.

That's it for today. In the next session, we'll be talking about launching your plan, how to put together communication elements, how to go through the plan process successfully, and what kinds of things you have to be aware of post-launch in order for the plan to be successful.

I want to thank you for spending time with us today. I'd like to wish you success, happiness, and profitability in what you do, and I hope that what you learned today will help you put together a very successful and productive plan for your company so that you can begin to drive performance that has never been seen before.

Thanks and have a great day.