Selling Rewards
Paying for performance in your sales force

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Introduction

Sales employees play a key role in organisations (Milkovich, 1988). They are the main public face of the organisation, with primary responsibility for generating sales – hence profits – and for initial customer service. The quality of the salesperson can be the difference between making a sale and not. Hunter et al. (1990) found that top performers in jobs of medium complexity, such as sales clerks, are 12 times more productive than bottom-level performers, while the best in the most complex jobs, such as insurance sales and account management, are 127 per cent more productive than an average performer. Superior performance is in part linked to individual personality and skills. Seligman (1998), for example, found that new insurance salesman who scored highest on a test for 'learned optimism' – that is, viewing setbacks as temporary, and learning how to overcome problems through effort and ability – sold 37 per cent more life insurance in their first two years than 'pessimists'. And in part, it is due to motivation. Companies commonly assume that money is the key motivator for salespeople. 'Get the incentives right and good performance will follow' has been the generally accepted wisdom.

As Armstrong (1999) points out, the nature of sales means that rewards have traditionally been more results-driven than for other employees. As a result, reward packages for sales staff are often designed and operated quite separately from the rest of the workforce. Variable pay or 'pay at risk', such as bonuses and incentives, has generally been a feature of the compensation package for sales staff. Equally, commission – paying a proportion of what the contract/sale is worth, say ten per cent for every 100 per cent of gross sales – is a common element of sales force compensation. Donaldson (1998) found that 66 per cent of UK companies use a combination of salary and commission for their sales staff, because they assume that incentives linked to performance outcomes will stimulate effort.

Over-reliance on variable pay, or a poorly designed incentive scheme can create problems. Variable rewards can mean that employees focus on what will achieve the best outcome, ignoring equally or more important behaviour. Rees (2006) points out that though commission is 'simple and effective', high levels of commission – over 50 per cent of base salary – can 'distort employee behaviour to an acute degree'. Several energy companies, for instance, have been criticised for making commission the main feature of their remuneration strategy for doorstep sales staff. Energy regulator Ofgem reported in 2003 that consumers were being left confused and overwhelmed by pushy doorstep salespeople, whose rewards were overly based on getting as many households as possible to switch suppliers. Hope (2004) reported a study by the Institute of Customer Service at Aston University Business School, which examined how 22 organisations rewarded and recognised the performance of their customer-facing staff. The majority used performance-related pay, including bonuses, to encourage staff to make as many transactions in as short a time as possible. This was sometimes regardless of customer satisfaction.

There is evidence that sales force compensation has changed very little over the past few years, even though the role of many sales professionals has done so. Weilbaker (1999) suggests that though the role of the salesperson has changed, compensation had not. He found that a significant proportion of individual pay was still linked to sales volume despite the sale process increasingly being a collaborative effort by an account team. According to Ryals and Rogers (2005) this is a paradox – ‘transactional reward structures still seem to be mainstream despite the increasing number of salespeople migrating to account management roles that require long-term results and a team approach’.

Getting the right combination of base salary, variable pay and non-financial rewards right depends largely on the nature of the sales process, together with the type of company and the products and services it sells. It also needs to acknowledge that individuals tend to be motivated by different things, and that these change throughout a person’s career.

Background

Overview

Sales is a catch-all category, and includes staff engaged in direct selling, either face-to-face or, increasingly, via the telephone, account managers responsible for a number of customers, and staff providing technical support, such as sales engineers. The overall 'sales' workforce in the UK is predominantly female and relatively low-paid, though there are pockets of high-earners, and in some industries, men form the majority of the sales force. The sector tends to suffer high turnover.

The diverse nature of sales means that compensation packages for sales staff vary greatly, with a number of organisational factors influencing both the type and level of rewards on offer. The products and services being sold, as well as the types of customers, will impact on how sales personnel are remunerated. Firm demographics, such as size, sector and length of time in business, also play an important role in the design of compensation schemes for sales staff. The extent of the role of an individual sales employee in the actual selling process – compared with the other factors commonly influencing customers' choice, such as price, advertising, product quality and wider customer service – is another factor in determining remuneration, as is the amount of time spent selling relative to non-selling activities. The sales cycle in relation to the product offered also impacts on the reward strategy for sales staff. Remuneration is likely to be shaped by sales volume (influenced by how long a period is necessary before clinching a deal) and the size of any sale (affecting the type of commission).

Reward theories, rooted in economics, have attempted to understand sales force compensation. Agency theory – which is based on the notion that the interests of principal (the organisation) and the agent (the sales person) may conflict without the right incentives or measures in place to ensure they correspond – has been widely applied by the marketing community to the remuneration of sales personnel. To ensure the agent acts in the best interests of the firm, the principal needs to either gather reliable information on the sales person's behaviour or link his/her compensation to sales results or outcomes. Transaction cost analysis, which is based on the assumption that contracts will be incomplete because one or other of the parties fails to fulfil their obligations, has also been applied to sales force compensation. It asserts that a sales person, for example, has assets that are valuable to the organisation, which has to develop mechanisms, usually behavioural control measures, to minimise the cost of these and ensure he/she performs their duties in the desired way.

There is evidence that the performance of some sales personnel is significantly better than others, and, because their marginal contribution to organisational performance is superior and can significantly impact on organisational success, the most productive sales personnel should receive a higher reward. Agency-type theories then lead some organisations to try to manipulate the behaviour of staff to obtain the results they want.

The sales workforce

The sales workforce comprises a wide variety of different roles, and this diversity influences rewards for sales personnel. Armstrong (1999) says that sales people can be divided into the following three broad categories:

- direct sales – those that sell directly to customers in a territory, such as via the telephone or over the counter
- account managers – those who develop and maintain relations with accounts, often on a national or sector basis
- technical support – those who provide continuing technical support, such as sales engineers and technical sales representatives.

Around 12 per cent of female employees (1.6 million) and five per cent of male employees (780,000) in the UK work in sales and customer services occupations, according to the latest *Labour Market Review* from the Office for National Statistics (ONS 2006). Around a quarter of the workforce in one of the fastest-growing employment sectors, the call centre industry, which employs around 850,000 workers in more than 6,000 centres in the UK, are engaged in selling (Holman and Wood 2002).

People in sales occupations are, on average, the lowest paid group of workers. The most recent annual survey of hours and earnings (ASHE) shows that the median weekly pay of full-time employees in sales occupations was £245, compared with an overall average of £431 (ONS, 2005a). A 2006 survey of retail sales staff by Mercer Human Resource Consulting (2006) found that sales supervisors and assistants earn around £17,250 and £12,900 a year respectively.

Sales also has a relatively high level of labour turnover. Labour Force Survey data from winter 2002–03 show that half of all those employed in sales and customer service occupations had been with the same employer for less than two years (ONS, 2005b). The annual *Salary survey of sales and marketing staff* from Remuneration

Economics (2005) reveals that in the year to September 2005 the rate of turnover among junior level staff in sales and marketing was 15.8 per cent, while the 2005 recruitment and retention survey from the *Grocer* reported that overall staff churn in retailing was 29 per cent (reported in IRS 2006). The survey results from Mercer Human Resource Consulting (2006) found that average annual turnover of retail sales assistants is particularly high, at 32 per cent.

Organisational factors influencing rewards for sales staff

Aside from the diversity of the workforce, there are a number of other factors that affect the compensation package of sales staff. The products and services being sold, as well as the types of customers, will impact on how staff are paid and the level of remuneration. Armstrong (1999), for example, says: 'sales representatives who promote ethical pharmaceutical products to doctors will clearly require different qualifications and abilities from those developing new outlets for fast-moving consumer goods and taking orders from existing ones.' The use of the word 'ethical' here also indicates an issue: to the seller the product might be viewed as ethical and necessary, but not necessarily to the buyer. Regulation of health care products throws up many instances of difference in perception. Certainly, the complexity of the product will affect the skill requirements of the job, but so will whether the product is perceived as useful/necessary by customers and whether the method of selling is deemed suitable (think of the direct selling methods of charities and the reaction that can produce). Krafft *et al*. (2004) found the ease with which products can be explained had a direct impact on the proportion of salary in the total compensation plan. Research in Canada by Tremblay *et al*. (2003) revealed that the service industries, including retail and finance, tend to pay sales personnel a higher proportion of variable pay than do manufacturers. However, Stroh *et al*. (1996) found that manufacturing industry was more inclined than other sectors of the economy to pay sales staff a salary, claiming that this was because they are more capital-intensive, something that is inversely related to the use of variable pay. The authors also note that organisations in the same sector tend to adopt a similar reward strategy for sales staff.

Misra et al. (2005) found that firm demographics of the firm play an important role in the design of the optimal compensation scheme for sales staff. According to the authors, organisational size is a key driver, with smaller companies less likely than larger ones to allocate a large proportion of pay to incentives. The scale of the selling operation is also significant, with sales staff operating internationally or nationally likely to be rewarded differently from those working in specific location, such as a department store. Balkin and Gomez-Mejia (1990) show that maturity of the form is an issue when determining sales force compensation, with more mature companies favouring salary-based rewards, while newer businesses include a high level of variable pay.

The range of selling activities is another factor in the design of a sales force's remuneration package. Armstrong (1999) assigns the various types of sales activities to one of three following broad groups:

- customer identification – following up leads, cold calling and local market analysis
- customer development – direct selling, demonstrating, merchandising, providing a consultancy advice, overseeing customer service delivery, handling queries and complaints
- direct selling – face-to-face, telephony or written communications.

The role of the individual sales person in the selling process will also dictate how he/she is rewarded. Moynahan (1991) identified 'sales prominence' as the measure of a person's impact on the customer's buying choice, compared with the other factors commonly influencing the decision, such as price, advertising, product quality and wider customer service. He found that role of the individual was more prominent when, among others:

- there is significant price, quality and service competition
- the company has a poor corporate image
- there is low product acceptance
- a new product or service is launched
- a firm seeks to expand into a new area
- there is little advertising or promotional support
- there is little or no repeat business.

Churchill et al. (1985) developed a model of 'prescriptions' to indicate the mix of salary and commission for sales staff, including:

- When performance is hard to assess, salary should be the preferred mode.
- The higher the impact of selling on sales, the higher the role of commission.
- The bigger the sales force, the greater reliance on salary.
- Uncertainty and risk should increase reliance on salary.
- Instilling a long-term orientation requires salaries.

Ryals and Rogers (2005) point out that selling is only a small part of the job for an increasing proportion of employees involved in the selling process. The authors provide figures for the US showing that the number of account managers who nurture all of a customer's needs – not just a sale – is rising, and say a similar trend has taken place in Europe. Account managers tend to rely on a team of staff to furnish customer needs, which will also influence the reward strategy. Tremblay *et al*. (2003) also highlight the fact that sales personnel increasingly engage in non-selling activities. Where teams collaborate to make a sale or where sales staff perform a range of non-selling activities it is very difficult to assess individual contribution, which, in turn, makes it difficult to devise an appropriate compensation plan.

Another factor influencing the reward strategy for sales personnel is the sales cycle – that is the period between making initial contact and closure of the sale. A prolonged period makes it difficult to reward individuals on the basis of the sales volume they generate. It is also likely that more than one person will be involved. The introduction of technology as a tool for sales personnel is impacting on compensation strategies (Misra *et al*. 2005). Sales force automation software that enables firms to better track and monitor sales staff, coupled with improved communication (mobile phone and Internet) has increased productivity, which has led to a rise in incentives relative to salary.

The combination of organisational factors impact on individual behaviour, and this in turn affects organisational performance. A survey of 841 sales professionals in 500 companies by consultants Watson Wyatt Worldwide (2006) uncovered substantial differences in the behaviour and attitudes of sales staff in high-performing companies, and those is less successful organisations. It found that sales personnel in the top firms spend 40 per cent more time each year with their best potential customers, and an extra three to four hours each week in high-value sales activities than sales staff in low-performing companies. In addition, sales people in successful enterprises spend 30 per cent less time on administrative tasks than their counterparts in low-performing firms.

Reward theories and sales force compensation

Agency theory

The theoretical framework underpinning much of the literature on sales force compensation is provided by agency theory (Tremblay *et al*., 2003). Like executive pay, to which it has also heavily been applied, agency theory is based on a contract between the two parties: the principal (the organisation) and the agent (the sales person). It rests on the notion – called the agency problem – that there is a conflict of interest between the principal and the agent, as, without the right incentives, the latter may focus on his/her own economic self-interest, which may not coincide with those of the organisation. As Tremblay *et al*. (2003) put it: 'For the principal, the main objective is to maximise profits, while the agent strives to maximise his or her utility.' At the same time, the theory suggests the principal has difficulty verifying how the agent is actually behaving. Agency theory also assumes that the parties have a different attitude to risk (Eisenhardt, 1989). This is referred to as the risk-sharing problem.

To ensure the agent acts in the best interests of the firm, the principal needs to either gather reliable information on the sales person's behaviour or it can link his/her compensation to sales results or outcomes. In theory, an organisation confident that it knows how its sales force is behaving, can pay them a fixed salary to overcome the agency problem. Where there is a lack of observable information on behaviour, the agency problem is commonly countered by offering sales staff a results-based contract that pays commission or a bonus related to sales volume. The main problem with offering substantial incentives is that risk is transferred to the agent, increasing his/her uncertainty, and, even though they work hard, little reward if a lead does not produce an actual sale. Where the level of uncertainty is high, agents will demand a high premium – that is, higher commission – to compensate for the higher-level of risk. An alternative, which involves the organisation shouldering some of the environmental risk, is a 'hybrid' contract comprising a fixed salary plus a variable sales-related commission element.

In terms of compensation design, agency theory suggests that where behaviours can be precisely defined and the transformation process between sales force inputs and sales outcomes is well known, there is likely to be a larger fixed-compensation component in the reward package. Anderson (1985) discovered that the choice of using a salaried sales force as opposed to a largely commissioned-based one depends on how well the organisation can objectively measure sales force performance – for example, sales and costs. Tremblay *et al*. (2003) acknowledge that 'the choice between salary compensation and compensation with a substantial commission component is influenced by the level of uncertainty in the sales environment and the capacity or willingness of the salespeople to accept financial risk.' Misra *et al*. (2005) say that a selling job that requires more sales calls to close the sale, provides more opportunities to lose the sale, so increases the uncertainty in the selling process. Krafft (1999) found that where there is a high level of sales instability, extreme difficulty in forecasting sales accurately and a high level of uncertainty over task and sales outcomes, sales staff tend to be salaried with managerial control exercised by focusing on behaviour. Research by Basu et al. (1985) also discovered that the proportion of salary to total compensation increased with uncertainty. Similarly, Tremblay *et al*. (2003) conclude that a high level of uncertainty in the sales environment is likely to increase the role of salary in the total remuneration package. However, some factors, including flexibility over product price on the part of the sales personnel, and expense accounts that cover some of the expenses incurred by sales staff, may have the opposite affect, however, with variable pay making up a large proportion of total compensation.

Several investigations have validated the agency theory prognosis in relation to sales staff. Using data from 286 companies in 39 different industries, Coughlan and Narasimhan (1992) found broad support for the agency approach. Research by Lal *et al*. (1994) among sales staff in one organisation, and the study of the impact of uncertainty on the design of compensation plans by Joseph and Kalwani (1998), also strongly supported agency theory.

Specifically, Tremblay et al. (2003) found that where the organisation is able to exercise considerable control over its sales force they are paid a higher percentage of salary. Their research, which examined sales personnel in the Quebec region of Canada, concludes that mainly office-based sales staff (where sales managers can exercise a higher span of control) were predominately salaried, while the pay of sales personnel working mainly outside the office or on the road (where sales managers are unable to observe behaviour) included a higher proportion of commission. Anderson (1985), who examined data from 13 electronic component manufacturers covering 159 US sales districts, found that the greater the difficulty of evaluating a salesperson's performance, the more likely it is for a firm to substitute surveillance as a control mechanism – that is, to use a direct sales force (employees) rather than manufacturers' representatives.

Transaction cost analysis

As with the agency model, transaction cost analysis (TCA) is based on economic theory. It differs from the agency approach by focusing on governance structures designed to minimise transaction costs (Tremblay *et al*. 2003). TCA assumes that contracts are incomplete; that one or other of the parties, either because of self-interest or opportunistic behaviour, will fail to fulfil their obligations. A key feature of the theory is 'transaction-specific assets', which are defined as elements held by one of the parties upon which the other is dependent – the importance of the task to organisational success, brand or customer knowledge, and the level of skill specialisation required to perform the task, are examples of such assets. These assets render the holder powerful and in a position to cheat the organisation. The organisation has to develop mechanisms, usually behavioural control measures, to minimise the cost of these elements. As a result, the organisation bears a transaction cost, including investment in behaviour observation mechanisms to ensure sales staff perform their duties in the desired way. In this way, the firm can reduce its level of uncertainty regarding the performance of its sales force. Where a high level of uncertainty does not exist and the organisation does not rely overly on the transaction specific assets of its sales force, it is likely to use a results-based control system, using commission, for example, to limit the risks of opportunism on the part of its sales staff.

Rousseau (1989) says TCA gives rise to two types of contracts in the workplace: transactional contracts and relational contracts. The former tend to be short-term and focus on monetary exchanges, while the latter is long-term and involve investment in Human Resource activities, such as career development. In terms of reward strategies, transactional contracts focus on short-term results, so commission is the commonest method of payment. By contrast, relational contracts are related to a larger salary component. Tremblay *et al*. (2003) found that rather than the presence of a formal career path, compensation for sales staff was most strongly influenced by actual prospects for promotion. So, where there are several reporting levels in the sales function, there are more opportunities for promotion and better future salary prospects.

The 80–20 rule

The so-called Pareto Principle is a generally accepted rule in the sales profession that 80 per cent of revenue is generated by 20 per cent of the sales force. There is the evidence presented in the Introduction that, indeed, the top performer out-performs the bottom producer to a considerable extent.

Both Krafft (1999) and Coughlan and Narasimhan (1992) contend that the most productive and experienced sales personnel should receive a higher proportion of variable compensation, because their marginal contribution to the organisation's profits is above average – that is, greater than their weaker colleagues. And, as they control a vital resource (sales income) they are in a better position to receive a portion of the value they add to the company through the pay system. Such individuals are also highly sought by other organisations, making it hard for a company to replace a high-performer and, hence, increasing their marketability.

Research by Tremblay *et al*. (2003) found that high-performing sales staff receive a higher proportion of their overall compensation from variable pay, and that their superior performance makes them wanted by other firms. 'This result may be explained by the fact that the best performers are generally more attractive and have better opportunities on the market . . . [so] can find its easier to migrate to a rival firm or start their own business. Sharing organisational success with these employees apparently represents a sound compensation strategy to retain these valuable sales people,' say the authors.

Measuring performance

Organisations have essentially two ways of ensuring sales staff perform adequately. They can opt for an outcome control system, which means sales personnel are held accountable for their results but not behaviour (Eisenhardt, 1985). Alternatively, an organisation can use a behavioural control system that makes sales staff accountable for their behaviour – with results eventually expected to follow. So, outcome systems monitor the final results of the selling process, while behaviour systems monitor the individual stages of the process (Anderson and Oliver, 1987). In the former, there is very little monitoring of the salespeople by managers and very little direction of their activities or effort. Sales staff are simply covered by straightforward objective measures, which are used to evaluate and compensate, rather than measures of how they achieve results. Behaviour-control systems involve considerable monitoring of sales staff and high-levels of managerial direction and intervention. Such an approach is also associated with more complex and subjective evaluation of performance, including what the individual brings to the selling process (such as aptitude and product knowledge); their activities (such as the number of calls); and their sales strategies (Anderson and Oliver, 1987). The implications of using a behavioural-type approach is that sales managers can more easily direct staff to perform specific activities with unspecified payoffs, such as undertaking market research, or direct them to pursue more long-term goals, including new market penetration and improving customer satisfaction.

Outcome control systems are associated with a high percentage of commission, whereas behaviour-control systems tend to be linked with a higher percentage of base salary. Both approaches require an effective way of measuring performance.

Outcome measures include:

- Orders
  - number of orders
  - average size of orders
  - number of cancelled calls.
- Accounts
  - number of active accounts
  - number of new accounts
  - number of lost accounts
  - number of overdue accounts.
  - number of prospective accounts.

More sophisticated outcome measures include sales volume and volume growth; sales share by customer type or territory; customer retention and satisfaction, and number of repeat orders; order size growth; selling costs to sales; and sales over quota.

Input measures include:

- Calls
  - number of calls
  - number of planned calls
  - number of unplanned calls.
- Time and time utilisation
  - days worked
  - calls per day
  - selling time versus non-selling time.

- Non-selling activities
  - letters written to prospects
  - number of formal proposals developed
  - advertising displays set up
  - number of meetings held with distributors/dealers
  - number of training sessions for distributors/dealers/customers
  - number of service calls made.

Some of these measures might be described under the behavioural control heading, but many are simply means to achieve sales success. The key difference with the outcome-based measures is that they aim to influence how sales are developed rather than rely upon evidence of success.

Sales personnel operating under an outcome-control system tend to not look beyond the following week; they often work hard; are more interested in tangible rewards, such as money; and are more likely to sell on personal relationships and closing techniques. By contrast, the characteristics of sales staff operating under a behaviour-control system include taking a more long-term outlook; they often work smarter; are more interested in non-tangible rewards, such as feeling of achievement and personal growth; and are more likely to sell on expertise.

Care has to be taken that the measures are not easy to manipulation. Compensation and Benefits Review reports that measures of leads generated can lead to sales people copying names from directories or that measures based on orders placed may lead to customers being pushed to put in orders that they soon cancel (Buchenroth, 2006). But equally, the targets must be reasonably achievable, otherwise sales people may move to jobs where they perceive the targets are easier to reach.

Paying Your Sales Force

Overview

According to Zingheim and Schuster (2004), the maxim 'you get what you pay for' is especially true in sales compensation. Kahle (2001) warns that most sales compensation programmes work against effective corporate strategy because they encourage the sales people to do what is easiest – sell the easiest item to sell, to the people who most like them – rather than what is in the best interests of the company. He believes that every sales compensation decision encourages and discourages certain behaviour. Straight commission, for example, encourages the quickest, easiest sales, but discourages strategic behaviour that has a long-term payoff, such as acquiring new customers and emphasising certain strategic product lines. By contrast, straight salary encourages staff loyalty, steadiness and attention to service, but discourages individual initiative.

The main elements of the sales reward are basic salary, commission, bonus and non-cash incentives – rewards in kind in the form of gifts, travel vouchers and competition prizes, for example. Getting the right combination depends largely on the primary objectives. Zingheim and Schuster (2004) advise setting realistic goals, warning that too often a firm will set selling targets based on what it needs – or hopes for – rather than what is possible.

Armstrong (1999) says the factors that affect choice between the main reward methods are:

- basic salary only, when the aim is to build and maintain long-term relationships with customers through non-selling activities
- salary plus commission, where a more flexible approach is required and non-selling activities are important
- salary plus bonus, where flexibility in providing rewards for different aspects of the sales task is important and where attention needs to focus on more profitable lines, and various selling and non-selling activities which contribute to effective sales performance

- salary plus commission and bonus, where the company wants to get the best of both worlds – a clear link between sales revenue and reward and the scope to modify behaviour by rewarding particular aspects of the sales representative's performance. However, this approach can be unduly complex.

Salary

Salary-only compensation for sales staff is relatively rare, particularly for top performers involved in direct selling and where sales volumes and achieving sales targets, rather than wider customer service, is the primary goal. There is intense competition for high-performing sales staff, so to retain such individuals, firms must ensure total earnings are at least comparable on average with what other companies are paying, whether the remuneration package consists of straight salary or straight commission or a mix of the two. Watson Wyatt Worldwide (2006) found significant differences in compensation between the top firms and the less successful ones, with salespeople in the former receiving around 40 per cent more of their total cash compensation in the form of variable pay, than sales staff in the latter – 38 per cent of total compensation versus 27 per cent. Moreover, sales staff in the top performing firms are twice as likely as sales staff in the poorer performing companies to receive stock, stock options and other equity pay – 36 per cent versus 18 per cent.

Nonetheless, salary-only compensation is appropriate in certain circumstances, though such a strategy will need to be accompanied by good prospects for development, including promotion and training opportunities, if it is to retain staff. Armstrong (1999) highlights research showing that companies are more likely to adopt salary-only compensation for sales staff in the following circumstances:

- there is a high incidence of non-selling is the sale person's job
- direct selling is secondary to representing the company
- sales staff have little or no influence on sales volume
- products or services are demand-led.

Other reasons for using salary-only compensation are where sales fluctuate considerably due to the seasonal nature of the product or service, and where there is little opportunity for creative selling, such as with repeat or regular orders. Zingheim and Schuster (2004) say that where the role of sales staff has changed to a more consultative selling one, with greater responsibility for developing relationships with customers (co-ordinating a selling team to solve customers' problems, for example), then the reward mix may need to be made up of more base pay and less incentive. They also believe greater salary in relation to incentives is consistent with developing and emphasising new behaviour and capabilities.

Case study: Vehicle importer
Brown (2001) reports how and overseas car manufacturer importing into the UK altered its sales force compensation to link with its changing business strategy. Rather than operate in the highly competitive mid-range car market, with wafer-thin margins and huge overcapacity, the firm decided to move upmarket to sell fewer but more expensive models. To achieve this aim, it introduced new models and improved its customer service in the dealerships. It also replaced the existing pay structure, which, as is common in the industry, consisted of a base salary of around £6,000 with the remainder earned as commission on product margin. This meant that sales staff were earning about £50 in commission for selling a new £15,000 car, and the only way for them to make a decent living was to compete with each other for customers, and sell high-margin accessories and financing deals. To support the new business strategy, the company substantially increased base pay levels – which were related to the demonstration of the key competencies required to build long-term relationships with high net-worth customers – and reduced the level of individual commission. It also introduced a new bonus scheme that incorporates customer performance goals as well as statistics on repurchase rates, and rewards both team and individual contribution across all aspects of the dealership's activities.

Table 1 summarises the main pros and cons of relying solely or mainly on salary to reward sales staff.

Table 1: The benefits and disbenefits of rewarding sales staff via basic pay

Advantages	Disadvantages
Encourages customer service	Limits the ability of the company to use pay as a means of shaping or modifying behaviour
Discourages too high-pressure selling	Results in high achievers subsiding low achievers
Helps in team selling situations where it is difficult to apportion the credit for sales between team members	Increases fixed selling costs because pay costs cannot be varied in line with business results
Avoids the problem of over- or under-rewarding staff who are lucky enough to have been allocated a good territory or unlucky enough to have been landed with a poor one	May attract unadventurous, under-achieving sales representatives
Protects income when sales vary considerably for reasons beyond the sales person's control	
Gives sales managers more scope to change the territories or responsibilities of sales representatives	

Source: Armstrong M (1999), Employee reward, Institute of Personnel and Development, London

Variable pay

Variable pay for sales staff typically consists of commission payments, bonuses and non-cash incentives. The purpose of such rewards is to align the employee's goals with the organisation's objectives (Poppo, 1995). A key factor in any variable pay arrangement is that those covered by it must be able to achieve their targets and goals under their own control, which makes bonuses and commission highly suitable for sales force compensation. The other necessary feature of an effective variable pay scheme is the existence of clear 'line-of-sight' between what individuals and teams do and what they will get for doing it (Lawler, 1990). Commission and bonuses, for example, channel attention to what needs to be done to receive the payment. Such arrangements usually have a short-term focus and tend to be based on specific 'line-of-sight' financial and operational measures, with payouts ranging from one month to one year.

Case study: B&Q

The store-team bonus scheme operated by DIY retailer B&Q provides a clear 'line-of-sight' between what staff do, how they behave on a day-to-day basis and a store's financial performance. As reward manager Will Astill explains: '[Staff] can increase profits by cutting costs, such as shrinkage, as well as increasing sales. And [staff] might be able to encourage a customer to buy something, but if they don't have a good experience they won't come back.' (Work Foundation, 2003)

While the rewards from variable pay schemes can be substantial, employees are forced to shoulder more of the business risks – rewarding the 'upside' and penalising the 'downside' of performance. The relatively large potential reward makes variable pay schemes appealing to many employees, while the link to performance and their ability to promote a common interest between staff and management make such arrangements increasingly attractive to employers.

Although performance targets, such as sales volume, that are linked to reward will encourage employees to pursue the behaviour and actions that trigger the payout, it is often at the expense of other, equally important, business objectives. Hope (2004) reported that a study by the Institute of Customer Service at Aston University Business School, which examined how 22 organisations rewarded and recognised the performance of their customer-facing staff. The majority used performance-related pay, including bonuses, to encourage staff to make as many transactions in a short a time as possible. This was sometimes regardless of customer satisfaction. For example, there was a three-minute customer time limit in one contact centre, which encouraged staff to terminate calls in mid-transaction.

Ryals and Rogers (2005), who looked at the impact of variable pay on account managers, concluded that it can be highly problematic, as the nature of the work of this group of sales staff is to cultivate long-term relationships with customers, so high levels of commission or bonus can 'confuse and demotivate'. They also say that variable pay can lead to sales staff concentrating their efforts on 'picking low-hanging fruit rather than on strategic sales'.

Nonetheless, there is evidence that commission and bonuses for sales staff are common. The Work Foundation (2003) found that of the 365 organisations it polled, almost a quarter (24.2 per cent) use incentives payments such as sales commission. Joseph and Kalwani (1998) reported the growing use of bonus payment in sales force compensation plans, to improve sales productivity and to achieve a variety of organisational objectives. Misra et al. (2005) show that advances in information technology have resulted in productivity improvements that have led to changes in the make-up of the overall compensation package for sales staff. They found that widespread use of IT and the falling cost of technology has coincided with firms moving to more incentive-based compensation plans, because it makes calculating rewards so much easier. The study covered the years 1986 to 1996, and revealed greater use of incentives for sales staff in the 1990s than was the case in the previous decade. The authors, highlighting a 2001–02 survey by *Sales and Marketing Management*, say the trend to more incentive-based has continued.

Commission

> *'Commission is the simplest form of incentive. For every 100 per cent of gross sales – however these are defined – an organisation might pay ten per cent (or less) to a sales employee. This may be in addition to, or instead of, base pay.' (Rees, 2006)*

Commission ticks all the right boxes for what makes a good variable reward strategy. There is a clear link between what a sales employee can deliver in sales, and what they receive in commission, and it focuses employees' attention on the primary goal by encouraging a high level of selling effort and sales success. Sales force productivity is often superior when commission is part of the reward equation. Rao et al. (2005) estimated that if an average firm that had been using commission switched to salaries, its per-employee productivity would fall from $597,000 to $432,000.

Commission percentages vary based on a number of factors, such as gross profit, cost of sales, length of the sales cycle and the complexity of the sale. Rees (2006) warns that the planned commission percentage should be affordable, and that firms can test this by modelling the impact of the cost through the business profit and loss. If the percentage is set too high, the more the sales force sells, the less profitable the organisation is. Unless there are clear rules governing what is revenue or sales, for example, there is always scope for sales personnel to 'distort' the figures and make the scheme unworkable.

An alternative to straight commission is the concept of 'draw', whereby the amount of monthly commission for each sales representative is predetermined, with the hope that he/she sells enough to reimburse the company. Some companies will recover any shortfall from future commission. Recoverable draw offers less financial exposure to a company, but non-recoverable draw will be more attractive to sales personnel, who will enjoy some degree of earnings stability.

Case studies

Carphone Warehouse

The pay structure at Carphone Warehouse is based on low base pay, but aims for total pay (base + bonus) to be in the upper quartile of the firm's highly competitive market. The company identified its unique selling proposition as building and delivering on customer trust. All of its activities are based on the following 'five fundamental rules':

1. If we don't look after the customer, someone else will.

2. Nothing is gained by winning an argument, but losing a customer.

3. Always deliver what we promise. If in doubt, under promise and over deliver.

4. Always treat customers as we ourselves would like to be treated.

5. The reputation of the whole company is in the hands of each individual.'

The business has developed a bonus structure to reinforce this approach and which includes an individual element based on commission. The sales force receive the same amount of commission for each network, which means it is easy for the employee to advise the customer of what is right for them, rather then being driven by thoughts of higher or lower payments according to the network chosen. In addition, there is also a team element to the scheme, which ensures that the store team pulls together to achieve wider goals, such as customer satisfaction (measured by mystery shoppers) and TalkTalk customer penetration (the landline company).

Carphone Warehouse have clearly identified what drives their business: sales, repeat business, and trust from their customers, and have built a bonus plan around it, to make it simple for employees to treat the customer as they would like to be treated. (Rees, 2006)

Cisco Systems

More than half of the UK-based Cisco workforce (total workforce 2,250) are sales staff. Their role involves the sale of complex 'end-to-end' networking solutions to organisations. As such the sales teams build close working relationships with senior management in client companies. The nature of the sales role demands a high level of technical and business knowledge and sales staff are well qualified in their field. Not unusually, sales people are treated as a distinct group for reward purposes. Although Cisco applies the same philosophy of paying-for-performance to its sales staff as the rest of its workforce, a higher proportion of their earnings are variable. The main elements are basic salary plus commission, or on-target-earnings. There is potential to earn commission over and above 100 per cent of salary if the individual delivers exceptional results that exceed preset targets. The salary-plus-commission plan is dominated by hard sales targets that relate to measures such as the volume of business generated. Customer satisfaction is a key component of the variable pay plans at Cisco, so the sales salary-commission mix also allows sales people to spend time building long-term relationships with clients to develop high levels of customer service. As well as reflecting its corporate strategy, this approach aims to avoid the high-pressure selling and short-termism that can result from commission-only reward plans. (Suff, 2001)

Table 2 summarises the main pros and cons of overly relying on commission to reward sales staff.

Table 2: Benefits and disbenefits of rewarding sales staff via commission

Advantages	Disadvantages
Attract high-performing sales people who are willing to share the risks of the business	Encourage sales people to take a short-term view, 'milking' mature territories or good customers and neglecting to pursue new sales opportunities
Provide a direct financial incentive to maximise sales	Focus the attention of representatives on sales volume rather than on profitable sales
Ensure that selling costs vary directly with sales results	Can lead to high-pressure selling which does not take into account the real needs of customers
Convey a message to poor performers that they might do better elsewhere	Provide the same payouts irrespective of the time taken to secure the sale, thus offering no incentive to quick sales
Eliminate the need for close supervision	Lead to lack of identification on the part of representatives with the company or its products

Source: Armstrong M (1999), Employee reward, Institute of Personnel and Development, London

Bonuses

IDS (2003) reported that incentives in the form of bonus payments have proved popular with retailers as a way of encouraging sales and levels of performance among employees without permanently increasing the paybill. The same year, ONS (2003) revealed that the incidence of incentives in retail was second only to the use of such arrangements by employers in the financial intermediation sector. ONS reported that in 1992 incentive pay for sales staff was, on average, worth 43.1 per cent of salary – compared with 9.2 per cent across the economy as a whole.

Joseph and Kalwani (1998) found that bonuses were probably effective in improving higher sales productivity because of their flexibility in tying rewards to performance. They also said such arrangements may help to direct the efforts of sales personnel toward specific organisational objectives, such as promoting new product sales or sales to new customer groups, as well as increasing customer satisfaction and retention. Rees (2006) says that direct bonus plans can work extremely well in sales, where clear, objective, measurable targets can be designed and achieved.

Brown and Armstrong (1999) report the trend towards linking rewards, such as bonuses, to measures of customer service. They illustrate this development by revealing that 50 per cent of the bonus of IBM's sales staff now reflects customers' views of the salesperson, adding that the company had calculated the profit value that favourable customer views add to the business. As well as customer service and overall sales volume, Armstrong (1999) lists the following various elements of the sales role that may be linked to a bonus:

- sales of selected new products
- sales of new accounts
- reviving moribund accounts
- the incidence of bad debts
- volume of repeat or continuing business
- the number of productive calls made
- product knowledge and technical expertise
- the provision of information on competitors
- working effectively with other members of the sales team
- effectiveness in running a sales territory, including the timeliness and quality of reports, and the control of expenses.

Most employers were positive about the impact of their bonus arrangements. For example, Marks & Spencer, which operates a store-based arrangement that focuses on sales growth as well as motivating and retaining staff, told IDS (2003) that employee feedback on the scheme revealed increased motivation and team spirit.

There are potential problems, however. External events can wreak havoc on the best-formulated bonuses schemes. Stredwick (1997) reports how a new bonus scheme for sales staff at a financial services company failed to live up to the expectations of either the employees or the company because its introduction coincided with a recession in the financial markets. As a result, bonus targets were not met and levels of bonus paid in the first four quarters were much less than predicted, being only 70 per cent of 'on target' earnings. The firm was unhappy because sales productivity was lower than forecast, so cost of sales was over budget, and staff were unhappy and demoralised because the promises of higher earnings did not materialise.

A US reward consultant claims that too often 'incentive programmes [such as bonuses] fail miserably because of innate complexities either in recording systems or in how rewards are won', so advises that when designing such schemes, companies keep it simple (Shearstone).

Case studies

Asda

Introduced in 2000, Asda's all-colleague bonus scheme is a single-factor, profit-related bonus plan that operates at a local level. The size of the bonus is determined by store or depot performance against its annual business plan and set profit target. The store's performance must meet a minimum level to trigger a bonus payout. If a store hits its business plan profit target, 90 per cent of the bonus is payable. If it exceeds its plan, the maximum that is payable is 120 per cent. The bonus period runs from January to December, with payment the following February. In 2004, the average payout was £226.73, but staff in the 156 best performing stores received ‘super bonus’ payments worth £300. (Suff, 2001)

Boots the Chemist

The company introduced its Mystery Customer Report (MCR) bonus scheme in 2002 and covers around 39,000 staff in 1,400 stores. The MCR pays out a lump sum on a quarterly basis. An on-target score triggers a payment worth three per cent of salary. Staff in stores rated as ‘over achieving’ get a bonus worth five per cent of salary. Specific targets are set at regional level, and come within the following four performance areas:

- operations: targets that measure operational efficiency, such as staffing requirements
- customer experience: targets that focus on what’s important to the customer, including staff behaviour, customer-interaction and product knowledge
- on-shelf availability: whether key products and stock lines are available and easy to find
- seasonal selling: targets are linked to in-store availability of seasonal products, such as sun protection creams in the summer months.

‘Mystery shoppers’ visit stores twice a month. Visits follow a set scenario and reflect two different types of customer service: ‘indulgence visit’, where the shopper is not in a hurry and may need assistance; and a shopper in a hurry who requires a specific product. (The Work Foundation, 2003)

B&Q

The store-team bonus was introduced in February 2003, replacing a profit-sharing scheme. Under the new scheme, employees receive a fixed payment of three per cent of salary every six months if company profit targets are met. There is also the potential to earn a further 6.75 per cent linked to store and company performance, plus a lump sum £250 if customer satisfaction levels improve. Each quarter Gallup interviews 3,000 randomly selected customers and a customer service index (CSI) compiled for each store. A store league, consisting of five divisions, ranks each one, with the top 20 per cent of outlets in the premier league. Rankings are re-calculated each month according to sales and stock-loss performance. If company profitability is 105 per cent of target, staff in the top performing stores (premier league) will receive the full 6.75 per cent in addition to the guaranteed six per cent annual profit-sharing payment, while staff in a division four outlet will get 2.25 per cent plus the yearly profit-related payment. The maximum variable bonus, including the CSI payment, is around 15 per cent. Under the old profit-sharing scheme, it was 12 per cent. (The Work Foundation, 2003)

Halifax Direct

Bonuses are linked to a combination of individual, team and whole centre performance. The four key elements of the bonus scheme include individual sales targets, customer service ‘hurdles’, team sales and call centre performance. The team component is worth 2.5 per cent of individual salary for on-target performance, rising to five per cent for ‘exceeding’ targets. (IRS, 2000)

Table 3 summarises the main pros and cons of using bonus schemes that rely on a number of objectives to reward sales staff.

Table 3: Benefits and disbenefits of rewarding sales staff via bonuses

Advantages	Disadvantages
Provide flexibility in determining the basis of reward	Can be complex to administer and hard to understand
Can be used to define expectations and modify behaviour by highlighting the key results areas of the sales person's job and indicating priorities in terms of what should be sold and non-selling activities	Do not have the clear-cut relationship between results and rewards which exist in commission plans and bonus schemes that are based entirely on the achievement of sales targets
Enable management to change territory structure and sales targets easily while preserving adequate levels of incentive	May confuse sales representatives, who could be diverted from their main task of generating profitable sales
Can be adapted to reward sales teams as well as individuals	May be perceived by sales people as unfair because they seem to rely on subjective judgments by management on their performance
	Lead to lack of identification on the part of representatives with the company or its products

Source: Armstrong M (1999), Employee reward, Institute of Personnel and Development, London

Non-cash incentives

Aside from commission and bonuses, non-cash incentives, such as vouchers, are commonly used to motivate sales personnel. According to Armstrong (1990), such incentives provide tangible rewards and a means of recognising achievement, which can usefully reinforce or supplement cash payments. He also notes that the fact the 'prize' can often be shared with the winner's family or friends may increase its motivational value.

The one major drawback of non-cash incentives is that high performers may continually take the top prize, which will demotivate those doing a good, but not spectacular job. Similarly, competitions can demotivate those who do not win, so must be designed to ensure everyone has a fair chance of winning.

Case studies

Volvo

With the help of motivation and performance agency P&MM, Volvo Car UK introduced a 'simple ring-and-win' scheme for its sales staff, enabling them to get a guaranteed minimum value reward for selling a specific car. Once a car was sold, the sales person would call a special hotline with its details. One of the P&MM team would then roll a tamperproof dice to reveal their reward for the sale, with the number of the dice determining how much in reward vouchers the sales person had won. In addition, if the car was sold using Volvo Finance, there would be a further enhancement by 50 per cent, meaning that staff would get a potential £375 per vehicle. All rewards are paid into recipients' reward bank accounts, to be redeemed against vouchers, holidays, merchandise or experiences. Following its introduction, there was a ten per cent increase in sales performance compared with the same period the previous year, and an 18 per cent rise in Volvo Finance sales. (*Human Resources*, 2006a)

Carphone Warehouse

Over the past few years, Carphone Warehouse has operated a points-based scheme to drive sales by its 4,000 staff directly engaged in retail and online sales in the seven-week period in the run up to Christmas. The ultimate prize is for the top 40 sales personnel to go on a week-long activity break together – Australian in 2004 and Hawaii and San Francisco in 2005. There are also smaller prizes, including 800 weekly and 'tactical' rewards, such as a table at the BritAwards and iPods. (*Human Resource*s, 2006b)

MBNA

Credit card company MBNA worked with awards consultancy Maritz to develop a way of motivating its 2,600-strong sales team and increase productivity. The scheme, called HITS!, offers weekly, monthly and bi-annual prizes, ranging from iPods and CDs to tickets for live concerts and other events, based on performance. In the first three months of the scheme, entrants and subsequent winners made up a quarter of all participants – far exceeding previous qualification rates of 12 per cent – and the company achieved its revenue targets and stabilised retention rates. (*Personnel Today*, 2006)

Conclusions

Selling products and services can be fraught with uncertainty and risks for both the organisation and the sales representative. As a result, the most appropriate sales force compensation package is one that combines sufficient incentives to ensure staff are prepared to shoulder some of the risk with some level of guaranteed payment so staff do not feel all their efforts are wasted should a sale fail to materialise. Consequently, a combination of salary and commission or salary and bonus or salary, commission and bonus is fairly typical. Straight commission, while effective in improving sales force productivity, encourages them to focus on selling the easiest item rather than what is in the best interests for the company's long-term future or the bottom-line. Such an arrangement can also encourage unethical behaviour, pursuing high-pressure selling tactics that can alienate customers and damage corporate reputations. Straight salary, while good for generating both sales personnel and customer loyalty, discourages innovation and prevents the firm from easily modifying the reward strategy to alter behaviour. It also increases the fixed costs of selling and means the company shoulders all of the risk. Sales bonuses, while providing flexibility for the company to alter the basis of reward, are often complex to administer and understand, and can, if accompanied by several objectives, blur the clear line-of-sight between results and rewards.

Part of the problem with identifying the right compensation mix for sales staff – and why sales force rewards are often different to those covering the rest of the workforce – is that the nature of sales work means that managers cannot exercise complete control over sales personnel, who may want to maximise their own self-interest rather than pursue the interests of the firm. Reward is used to ensure sales staff act in the best interests of the business. Agency theory, an economic-based framework that, in the absence of suitable incentives to ensure their interests coincide, envisages conflict between the principal (the organisation) and the agent (the sales person), has been used to explain sales force compensation. Agency theory also suggests that the principal has difficulty verifying how the agent is actually behaving. This makes it difficult to measure performance effectively. One way is to opt for an outcome control system, which means sales personnel are accountable for their results but not their behaviour. Such an approach is consistent with making commission a large part of the overall compensation package. The alternative is to use a behavioural control system, which makes sales staff accountable for their behaviour, with the hope that results will eventually follow. A behavioural-control system is associated with a salary being a higher percentage of total remuneration.

Ultimately, the choice of reward strategy for sales staff will depend on the type of company, its size and how long it has been in business, the products and services it offers to customers, the nature of the sale – whether it is a quick sale or a prolonged process involving more than one person, for example – and the extent of the role of the individual in the selling process, compared with other factors influencing customer choice, such as price, advertising and product quality.

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