Value-Based Management:

Using Sales Compensation to Drive Distributor Value

"Compensation is a powerful and under-developed tool for directing and motivating sales employees in beer distributor operations. Some companies rely too heavily on commission-based structures..."

–Lamont Seckman

While companies have improved the structure of employee compensation systems over the last few years, sales compensation remains a strategic tool with benefits eluding most wholesalers.

Over the years I have been fascinated by the different takes you get on the effectiveness of distributor compensation plans when you talk to the administrators of the plans compared to the feedback from those who participate in the plans. Often top managers are perfectly satisfied with compensation structures which are either viewed benignly by the sales force at best, or at worst actually act as a de-motivator of performance.

Similar to many other operating environments, it is easy for owners and top managers of beer distributor operations to lose touch somewhat with the needs, desires, and motivators of various employee levels - particularly those in the field providing account-level activities. And it is perhaps most important that effective compensation programs be developed for precisely these employees.

Am I Getting Bang for My Compensation Buck?

John Wanamaker, an early pioneer of the department store concept, used to say that half the money he spent on advertising was wasted. "The trouble is I don't know which half." Similarly, it is difficult to precisely identify which component of a total labor pool is being ill-spent. For any given distributor operation, it is a relatively straightforward process to identify the total amount of labor dollars required to provide all necessary in-store activities. The more difficult questions relate to how the pool of dollars is made available to best allow management to: a) direct sales representative performance; and, b) motivate sales representative performance.

Based on my discussions over the years with managers and employees here is my list of "red flags" indicative of compensation plans that have room for improvement (see if any apply to your business):

1. Some sales representatives cannot even tell you the exact commission percentage they receive.
2. You get different descriptions from different people in the organization as to how the sales compensation program even works.
3. Some sales representatives do not consistently turn in paperwork necessary to qualify for incentive programs.
4. Monthly objectives used to drive incentive programs are not sufficiently customized to be specific to route, geography, or customer segment.
5. Incentive monies are too small a percentage of the total compensation package to adequately impact behavior.
6. Too many sales objectives are used to drive sales incentive programs resulting in a relatively low marginal impact of each objective.
7. There is little variability from the lowest to the highest paid sales representatives in the

Lamont Seckman is the president of Colorado Distribution Consulting. He can be reached via e-mail at LESeckman@aol.com.

same organization.

8. There is not sufficient correlation between pay levels and actual performance.

9. Second tier suppliers have too much direct influence over sales representative activities through monthly incentives.

10. Suppliers' share-of-mind with the sales force does not correlate to the profit contribution/potential of the suppliers.

11. Periodic performance objectives often are used to drive short-term volume with questionable long-term impact or consistency.

12. Corporate strategy is disconnected from the account-level activities the sales compensation structure seems to encourage.

It is worth repeating, that an effective compensation system allows management to more precisely direct employee performance - and to motivate performance to higher levels (i.e. get more "bang for the buck").

Directing Performance

You may own a high performance automobile, but if you don't know where you're going, your competitor can beat you with a jalopy. Similarly, you cannot design and implement an optimized compensation program without a clear understanding of where you want it to take you. Sales compensation mainly is a tool to support a well-developed and well-communicated corporate strategy for brand portfolio management. As such, the program should better align two things. First, the expressed corporate strategy should better align with day-to-day, account-level activities. Second, corporate objectives should better align with objectives at the individual sales representative level. In this environment, sales incentive pay should better correlate with actual corporate performance.

Motivating Performance

The biggest opportunity for improving the use of performance objectives lies in refining the "bandwidth" of achievement levels. Performance objectives are not going to provide optimum motivation if they are either too easily achieved - or if they are too unrealistic. Too easy, and incentive pay related to objectives begins to be viewed as an entitlement. Too hard, and people give up. Defining what achievement levels are too easy or too difficult is perhaps more art than science, but this should not prevent managers from tracking such a key performance indicator. Obviously, if 100% of objective monies available are earned, the program is too easy. A zero percent achievement level indicates a program that is abusing the "stretch goal" concept. So the right answers are somewhere in between. I find generally that a 75-80% achievement level is indicative of a program providing the right balance of challenge and motivation.

Is such a statistic even measured in your company? If not, you may find that the variability of pay levels between high and low performers in your business is too low. Most pay-for-performance programs err on the high side providing sales representatives with high incentive money payout ratios. This leads to little pay variability within the sales force and, correspondingly, a reduced correlation of pay to actual performance. Representatives often become too comfortable in such an environment.

Many managers assume that a commission pay structure by definition takes sales reps out of their "comfort zone" and provides a sufficient directional and motivational tool. In many cases, this is an incorrect assumption. Commission, as the sole or primary means of injecting variable pay, routinely fails to provide either effect.

Think of it this way. Imagine your best sales rep transferred into a different market territory that is declining at a rapid pace. Conversely, imagine transporting your worst sales rep into a new route booming with new construction and rising incomes. In this thought experiment your best sales person could be doing everything right and cutting volume declines in half. In most commission-based structures that rep would not earn as much as your worst rep in boomtown whose income is likely rising - even while his/her ineptitude is likely leaving distributor profits on the table. Clearly, paying both of these sales reps on volume is a mistake and has little to do with correlating pay to performance.

Compensation systems based mostly on commission payments may often provide less-than-optimal directional and motivational effects. Consider that distributor sales reps never actually sell a case of beer. The "sale" of course occurs when a customer buys the product from a retail account. The role of the distributor sales rep is really to create the right environment in retail accounts that best facilitates the later sale of the products he/she is representing. Displays, shelf space, POS, positioning, features, and the like are the activities that create the optimum environment for the later sale. Because of this, more and more companies are moving toward pay-for-performance compensation systems that are tied to such activities. In the theoretical case of the best and worst sales rep, the best rep will outperform, and out-earn, the worst sales rep even with volume declines if performance objectives are developed and measured based on the specific hand each was dealt (i.e. the quality and potential of the accounts inherited). Such objectives can include volume objectives, but variable pay programs should not be exclusively tied to volume (or percentages of revenues or even gross profits).

From the thought experiment, two keys emerge. First, move away from commission-intensive models to ones that factor in the account activities needed to create the environment that leads to volume. Second, ensure that objectives are route-specific, and incent and challenge the sales rep to improve the specific conditions on his/her route (i.e. they can't be too hard or too easy).

Distributor operations in the process of changing compensation plans should consider that such changes typically have more downside potential than upside. In other words, poorly designed and/or implemented compensation plans have more potential to create morale problems in organizations than correspondingly good programs have to increase motivation in participating employees. Therefore, changes in compensation need to be well-considered - and implemented correctly.

Summary

Compensation is a powerful and under-developed tool for directing and motivating sales employees in beer distributor operations. Some companies rely too heavily on commission-based structures mistakenly believing such programs are variable in nature and, therefore, equivalent to "pay-for-performance".

Invoice and/or volume-based commissions can be used effectively, perhaps as part of a hybrid approach to sales compensation. However, pure commission structures effectively compensate distributor sales representatives for something they never actually do. Distributor sales representatives never actually sell a case of beer. The "sale" of a case of beer only occurs when a consumer comes into a retail outlet and makes a purchase. The role of a distributor sales representative is to create the best environment possible in retail accounts to drive consumers toward the purchase of a particular distributor's products. Distributors arriving at this understanding, and developing effective sales compensation systems that precisely direct and motivate these activities, will receive significant strategic advantages in the marketplace. ■