ZS ASSOCIATES

Maximizing Sales Force Performance and Retention Through MBOs

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Plan designers often have negative associations with Management by Objectives (MBO) sales compensation plans—they may view MBO plans as being too vague and difficult to communicate to the field, posing administrative headaches and lacking the ability to differentiate the best performers from the worst.

But when designed and implemented properly, MBO-based sales compensation plans can be an excellent means to motivate and retain the sales force without the problems listed above. Companies that use well-designed MBO sales compensation plans—and in the appropriate circumstances—can generate superior results.

Table of Contents

Introduction

There are two sure things about sales compensation plans that use Management by Objectives (MBO): Managers are often reluctant to do MBOs, and most will have to consider using them at some point.

A sales compensation plan should motivate the entire sales force, retain top performers and pinpoint weak salespeople. But motivating and evaluating the sales force is not always as simple as measuring sales figures and cutting big checks. Some companies have incomplete or insufficient sales data, which limits their options for measuring sales performance. In other instances, organizations might need to motivate or reward their salespeople for behaviors that do not immediately result in sales.

That's where MBOs come in. MBO-centric sales compensation rewards salespeople for meeting objectives rather than (or in addition to) exceeding sales quotas. These features make MBOs an effective way to motivate the field when other methods may not be sufficient.

Despite MBOs' great utility, plan designers are not always fond of them. They find MBO plans too vague and difficult to communicate to the field, and fear administrative nightmares will accompany a poorly designed MBO plan. Many sales executives feel that MBOs will "pay everyone the same," reward poor performers and result in top performers defecting to the competition.

We have seen some of these issues materialize with MBOs, and realize that MBO plans are not always the right solution. But when the situation calls for them—and when they are designed and implemented properly—MBO-based sales compensation plans can be powerful tools for motivating and retaining the sales force.

Let's look at a technology company preparing for the June launch of what it hopes will be a major product. Although the company had previously completed successful launches with small- and medium-size customers, the June launch would be its first offering targeted at enterprise customers. Sales leadership had to agree on the design of the sales compensation plan for its new enterprise sales force, but the sales team would not immediately generate revenues, and the sales cycle for a single customer could take multiple quarters.

Salespeople would play an enormous part of the launch's success or failure, yet a traditional incentive plan based on sales would not reflect the sales force's work and accomplishments that occurred early after the product's introduction. Company executives decided to solve their dilemma through an MBO-based plan, but first they had to figure out how they would design, implement and govern the plan.

Many companies are in the same situation as the technology company above, with a new product that may generate sales only far in the future, or have an increased importance on customer-facing non-sales roles. This article will explore the situations when MBOs are appropriate for the compensation plan, and examine five key steps to ensuring success. Although MBOs are sometimes not managers' first choice for a sales compensation plan, done properly, they are nothing to fear—in fact, they are something managers can use to drive performance.

MBOs Have Their Time and Place

Well-designed MBOs are an excellent means to motivate and retain the sales force under certain conditions:

- When a company has indirect or insufficient data that limit the ability to measure individual sales performance;
- When promotional activities like direct-to-consumer advertising affect sales results, such as consumer products representatives selling to major chain stores;
- In engagements that include team selling;
- For customer-facing non-sales roles; and
- When a product sales cycle does not conveniently fit a quarter or even a year, yet the company still must motivate its salespeople via incentive pay.

Incentive plans must account for factors like territory potential and size, or repeat versus new business. When a company lacks sufficient sales data, the situation can impede the proper implementation of sales compensation plans, and may even render them ineffective or motivate undesirable behavior.

MBO plans are also appropriate when a company needs to encourage actions that do not immediately drive sales but are key to long-term objectives. This is typical in industries in which national account managers are paid on the basis of customer satisfaction. In these instances, the company needs to reward the selling process, as well as the final sale.

Organizational strategy also plays a role: Many industries depend upon non-customer-facing roles that affect top-line sales. For example, deregulated industries like electric and natural gas are experiencing increased competition, making customer retention as important as customer acquisition in organizational success. For companies in these industries, sales success is directly linked to the retention efforts of both sales and customer-facing non-sales personnel, and the use of an MBO sales compensation plan may be an effective option.

In considering these factors, the technology company was in a situation that made an MBO incentive plan a good fit. It had a long sales cycle and representatives would have to build a customer base from scratch. This required them to spend a great amount of time educating and building a business case to prospective customers but not necessarily logging any early sales. Because the sales force would not generate revenues immediately, leadership decided to include MBOs in the new team's sales compensation plan.

However, the company had many questions, similar to those most managers have about MBOs: *Do we pay salespeople on a forced distribution or everyone the same? Are there "good, bad and average" performers with an MBO? Should the actual objectives come from the top or filter up from the bottom? How many MBOs should we set—and for how long?*

We often hear these questions about MBOs. This paper will address the questions by showing how the technology company answered them, while enumerating the keys to a successful MBO program.

Building a Successful MBO Program

We have found that the process of building an effective MBO program has five steps: Involve the entire team, drive results, develop strong objectives, tie to ratings, and centralize and automate the process. If one step is mishandled or ignored, an MBO-based plan is likely to fall short of expectations.

Each step is worth examining in turn:

1. Involve the entire team. We have found that a collaborative workshop—in which managers work with the sales force to define "good" objectives and ensure tie-in to the account plan—is an extremely effective means to ensure employee acceptance and that objectives meet local needs. Since many companies already hold group sessions each period to review and create business plans, we maintain that adding two hours onto the meeting to create MBOs is an excellent use of time: Doing so not only creates a strong incentive plan, but forces the account plan to be more tangible. (We highly recommend account planning, and if a company does not engage in it, MBOs are an excellent starting point.) By bringing the whole team together, the company can establish a consistent approach to ensure comparable and fair measurements.

When there is customization, it is usually subject to specific locales and customer situations, but typically does not vary much from the MBOs the company has set as a whole. An individual's objectives are essentially corporate objectives customized for separate geographies and the peculiarities of different territories.

2. Drive results. Some organizations may unnecessarily rely upon MBOs when sales may actually be a better measure of performance. If a company can measure performance based on results—and sales representatives' actions directly affect results—it should go this route, and *not* use MBOs.

As reflected in Figure 1, it is important to try to be as results-oriented as possible in designing objectives. The goal is to create objectives that are as close to being *measurable* as possible. Remember: MBOs have their time and place.

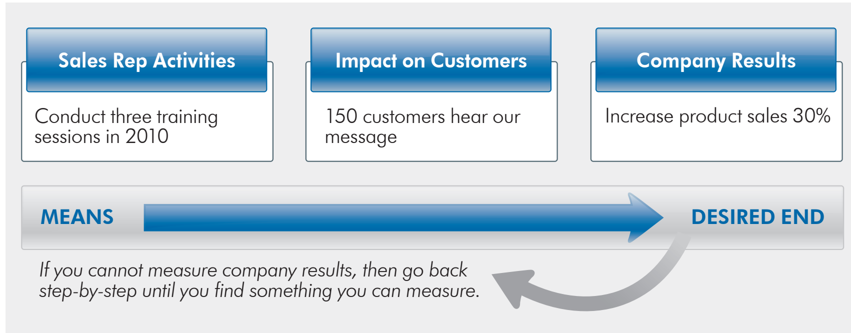

Figure 1. MBOs should be based on results when possible, and impact or activities when necessary. On the spectrum depicted, the best MBOs are set by moving as far to the right as possible, given what the sales person can control and what the company can measure.

3. Develop strong objectives—and the right number of them. Though it may seem obvious, incentive plan designers may overlook the need to develop clear and tangible *objectives*. Because the "objectives" part of MBO strikes some managers as amorphous, they may not put enough effort into developing them. At the heart of developing strong objectives are methodologies like the SMART framework, which help ensure that goals are specific, measurable, attainable, results-oriented and time-bound. (This is also a good time in the process to consider or reconsider overall corporate objectives.) Frameworks are necessary components in developing strong objectives, as they provide structured ways to devise goals that may otherwise become overly general.

It is also important not to have too many objectives in an MBO plan, so that the sales force is concentrating on the most-important objectives. A rule of thumb is to have each objective account for at least 10% to 15% of total compensation. So if a sales force earns half of its sales compensation through MBOs, the company would want to limit the plan to three or four objectives.

4. Tie to ratings. It is generally a good idea to link objectives to personal payouts, but this can be a breaking point for MBO programs. Managers can become frustrated with what they perceive as MBOs creating a "pay everyone the same" culture and an unmotivated sales force. Well-designed objectives must be integrated with a rating scale that allows management to differentiate performance and reward each group based on performance against the agreed-upon objectives.

There are some situations that call for paying on a curve or forced distribution. For instance, if there is a limited amount of money for sales pay, compensating salespeople based on their performance relative to each other may make sense (see Figure 2).

Figure 2. Different levels of achieving an objective will lead to different levels of payout.

Starting Objective	Framework			Resulting Objective	Rating Scale (% MBO Payout)	
Educate target accounts on upcoming launch product	**Specific**	Which accounts?	Tier-one targets	Conduct a client-education seminar or a lunch-and-learn session with seven tier-one targets by July 1	No sessions were conducted by July 1	**0%**
	Measurable	How many?	Seven		One to three sessions conducted by July 1	**40%**
	Attainable	Can they do it?	Yes		Four to six sessions conducted by July 1	**70%**
	Results-Oriented	Does it drive the desired objective?	Yes		Seven sessions conducted by July 1	**100%**
	Time-Bound	By when?	July 1		More than seven sessions conducted by July 1 **or** all seven conducted by June 1	**120%**

Differing levels of achieving an objective lead to differing levels of payout

5. Centralize and automate. Centralization for setting and rating objectives is crucial in MBOs. Programs sometimes fall apart (and, in part, get their bad reputation) when companies have disparate MBO programs across sales teams, each using its own technology, spreadsheets and systems. It is important that companies use uniform processes and rewards for all the salespeople covered by MBOs and have a centralized, automated solution. Centralization also eliminates possible governance and control issues that accompany poorly administered plans.

Because it followed these steps, the technology company was able to answer the difficult questions mentioned above that often stymie executives with MBO plans.

Using corporate objectives refined in workshops, the company had two primary objectives for its enterprise sales team: Educate customers and develop relationships with partners who could handle product delivery and installation. The company decided that customer education and ensured reliable delivery were the most crucial sales-related activities to building a customer base. Limiting the number of objectives to two allowed the salespeople to focus on them, while management could measure their efforts accurately.

The first objective pointed to the fact that the company needed to educate the market about its new product. The sales force was tasked with holding seminars and meetings with potential enterprise customers—

these events or meetings would not necessarily lead to immediate sales, but would lay the groundwork for future purchases once the company had market traction.

The technology company was also intent upon developing strong relationships with delivery partners, stemming from the company's desire to avoid delivery and installation issues that could alienate customers. As a result, one objective was that the sales force needed to forge relationships and map out delivery and installation processes with possible partners in their territories. In addition, since objectives could take time to accomplish, management decided to measure results every six months.

Because the firm used a methodical process to develop objectives, putting them into action was straightforward. It was also relatively easy to rate actual performance; one can imagine how much subjectivity could be inferred from the original objective.

The company wanted to reward good performance without relying upon results as a measurement—thus not ranking salespeople against each other and using a forced distribution of payouts. Instead, the company used payout scales relative to each individual's performance. As a result, it was able to differentiate performance between salespeople.

The company also centralized its MBO operation using a Web-based tool that ensured consistency across sales territories and prevented the administrative nightmares that some managers within the company had feared.

Sales representatives recorded their achievements via an online portal for managers to view (without resorting to multiple e-mails and documents). At the end of the plan's first period, managers rated representatives and received approval on their ratings from the vice president of the enterprise sales division. These ratings were automatically converted to payouts, which the representatives could view online, giving them instant feedback—and additional motivation.

Ultimately, the company established strong customer relationships—and a strong foundation for sales—because it had properly designed and implemented MBOs. The sales force's educational efforts created a customer base of eager first movers who eventually bought the company's enterprise products. And because its sales force had laid the groundwork with delivery partners, the company's new enterprise customers were extremely satisfied with the service and likely to become repeat customers in the future.

Meanwhile, the MBO plan, hammered out in part by salespeople themselves, was so popular among the sales force that the company retained its best salespeople in larger numbers than anticipated.

Conclusion

The technology company example illustrates the positive impact Management by Objectives can have for organizations. Leadership needed to motivate its sales force but was stifled by limited data and low initial sales, as well as by negative perceptions about MBOs. By designing, implementing and managing MBOs the right way, the organization achieved its initial goals, motivated the sales force and rewarded sales people appropriately. Management ran the program without administrative hassles or issues over control.

For many sales executives, MBO-based incentive plans are an acquired taste. But once they implement an MBO plan—and implement it properly—corporate leaders are usually appreciative that they did. One senior manager on an MBO incentive plan in his division commented, "The process and results were excellent. I wish we could do this for every department in the company."

About the Authors

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About ZS Associates

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