8 | 09 workspan
The Magazine of WorldatWork®

Sales Compensation and the Fairness Question

By Chad Albrecht, ZS Associates

A 2003 study showed capuchin monkeys displayed a stark aversion to inequity. When they were offered the same reward (a cucumber slice) for doing the same task, 95 percent "participated," or completed the task for a reward. But when some monkeys were offered a more appealing reward (a grape) in view of others, the percentage of those willing to perform the task for the cucumber slice dropped to 60 percent. And when one group received grapes for doing less or no work, the number of monkeys willing to do the task for cucumbers dropped to 20 percent.

The capuchin monkey experiment can teach us something about sales behavior: While there may be other contributing factors at work, when sales

QUICK LOOK

- Salespeople who feel they are being paid unfairly will complain openly within the organization about their "poor" treatment.
- If management can have an open dialogue with salespeople, the salespeople will usually specify what, exactly, they believe to be unfair (and hopefully will say what is fair) about the current incentive plan.
- In many cases, the perceived bias is shown to be false. Even when that happens, sales leadership must still manage expectations because a perceived bias has negative effects, even if it is false.

TRANSPARENCY

can lead to a dynamic in which sales employees, rightly or wrongly, judge the fairness of their incentive compensation. When they hear how other salespeople are being paid, they judge the fairness of those people's pay in comparison to their own.

incentive compensation is unfair — or is perceived to be unfair — the salesforce's motivation shrivels up. And that can hurt both employer and employee.

This article will explore how to keep such a scenario from developing by underscoring the importance of fairness within the sales compensation plan as well as offering advice for ensuring fairness.

Background

By definition, good salespeople are social creatures. This openness extends to the workplace, as salespeople often freely reveal how much they earn to other salespeople inside or outside the company. Whether their motivation is to validate, commiserate, boast or just share, salespeople like to talk about what they earn. This makes them unique compared to every other role in an organization.

Not surprisingly, this transparency can lead to a dynamic in which sales employees, rightly or wrongly, judge the fairness of their incentive compensation. When they hear how other salespeople are being paid, they judge the fairness of those people's pay in comparison to their own. The salesforce's perceptions and reactions can cause major problems within a company. Salespeople who feel they are being paid unfairly will complain openly within the organization about their "poor" treatment. Their motivation may drop. In more drastic situations, they may defect to a competitor. This dynamic can exist at all levels within a sales organization and in virtually every industry, and has particular resonance among salespeople, as the notion that they are getting a "fair shake" underlies their motivation to work. Given these issues, sales compensation professionals must ensure that their sales incentive pay arrangements are not only equitable externally but also internally, regardless of each salesperson's relative territory size, market opportunity, market share and selling environment.

Fairness Defined

Managers at many companies are aware they must pay fairly to recruit and retain quality people. However, while these managers are tuned into the *external* pay fairness of their incentive compensation plan, they may neglect to assess the plan's *internal* fairness.

What is "internal fairness?" Essentially, it means that incentive pay is a function of each salesperson's efforts and abilities, regardless of any other factor, such as the geographic makeup of his or her territory, the number of accounts assigned or the sales potential of the territory. A salesperson has little or no control over these variables, so when a peer is rewarded due to "unearned" advantages, resentment among the entire salesforce can spread quickly.

Many corporate leaders are not confident they have established "fair" incentive plans and quotas. Other executives are not even aware they have a problem until key salesforce personnel defect to the competition. And sometimes, the salesforce perceives equitable plans as unfair due to a lack of transparency. Whatever the cause, it is crucial to address the problem so salesforce motivation remains high.

Ensuring Fairness

A critical step in ensuring fairness is understanding the salesforce's perceptions of fairness. It is important to talk to salespeople and sales managers. If management can have an open dialogue with salespeople, the salespeople will usually specify what, exactly, they believe to be unfair (and hopefully will say what is fair) about the current incentive plan. This could be done in several ways, including surveys, focus groups, interviews or a roundtable consisting of salespeople respected within the company. Salespeople will tell management if they think quotas are equitable. They will say what territories are perceived to be the best and, if given the choice, which territory they believe would maximize their income.

IF MANAGEMENT

can have an open dialogue with salespeople, the salespeople will usually specify what, exactly, they believe to be unfair about the current incentive plan.

Salespeople will inevitably raise issues that aren't about compensation plans. These issues are often the result of other sales team processes (such as account alignment or the selling model) and, as a result, HR cannot address these issues without the involvement of leaders in sales and sales operations. Still, HR should help the teams dealing with these issues to make sure the compensation plans respect these operational realities.

Feedback from employees, obtained casually or formally, provides more than an opportunity for salespeople to vent their frustration. It can offer valuable insight into the precise reasons the incentive compensation plan, quotas or both are believed to be inequitable.

For example, the feedback can be used to test payouts to see if the perceived unfairness is indeed true. Salespeople may have said that territories with high baseline sales are treated unfairly. Or they may have said that territories in urban areas receive advantageous treatment compared to those in rural areas due to lower driving time. For each of these variables, management needs to obtain and validate data at a territory level.

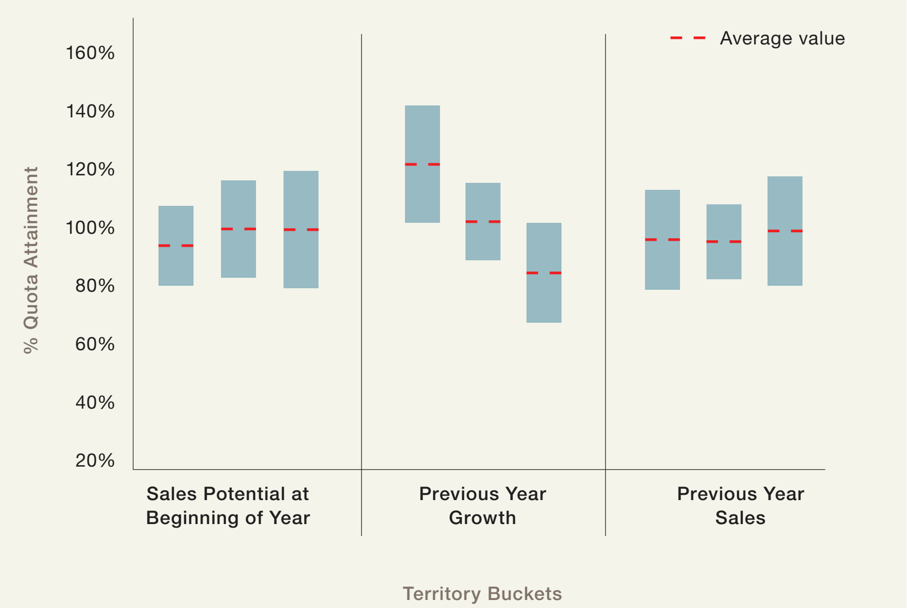
Once you have reliable data, test the perceptions in the field. Figure 1 shows an example of a fairness test conducted on three known territory characteristics that could be factored into the quota-setting process: total sales *potential* in a territory, total sales *volume* in a territory and sales *growth* in the previous year.

The fairness test segments territories into "high," "medium" and "low" categories on each of the dimensions. For example, if sales potential in a territory at the beginning of the year was ranked low to high, the bottom third of territories are "low," the middle third are "medium" and the top third are "high." After doing this ranking, calculate the average percent of quota for each of the groups to see if there is an inherent bias in one of the characteristics.

In this example, the fairness test shows territories that grew significantly last year are having a difficult time reaching their goal in the current year. This implies that quotas are unfairly penalizing salespeople who grew significantly in the prior year.

If the perceived bias is real, management must dig deeper into the quota-setting methodology to find the cause. The usual culprit is one of the following:

FIGURE 1: **FAIRNESS RESULTS**



- **Lack of Sales Potential Data:** Territories are not all created equal — even in an optimally balanced territory allocation, territories will vary in the amount of sales potential in their assigned geography by +/-20 percent. It is critical to ensure that the relevant sales potential metric is factored into quota setting.
- **Inappropriate Weighting Between Sales Potential and Last-Year Sales:** Companies that use sales potential data may not use it in the correct ratio with the previous year's sales. The appropriate weight (importance) placed on last year's sales depends on the sales "carryover" — the amount of sales that happen automatically in the current period regardless of salesperson effort. Products that depend little on salesperson effort (for example, branded cola products) have high carryover, and therefore a high weight should be placed on historical sales. Products that are completely dependent on salesperson effort (such as capital equipment) have low or no carryover, and therefore historical sales should be ignored in quota setting.

In many cases, the perceived bias is shown to be false. Even when that happens, sales leadership must still manage expectations, because a perceived bias has negative effects, even if it is false. It is essential that the true degree of equity is validated and communicated to the field. An effective approach may involve sharing the analysis itself to show salespeople that their concerns are taken seriously, that there is an objective process for assessing equity and that the results show a gap between their perception and reality.

Conclusion

Simply benchmarking your salesforce to the market to ensure you are being fair from an *external* perspective is no longer sufficient, but ensuring that your plans are fair from an *internal* perspective is equally (if not more) important. By testing your plan to ensure it is fair and communicating the results to salespeople, you will increase field salesforce engagement, improve retention and help your company become more competitive and profitable. ws

ABOUT THE AUTHOR

Chad Albrecht is an associate principal at ZS Associates in Evanston, Ill. He can be reached at chad.albrecht@zsassociates.com and 847-492-3651.

RESOURCES PLUS

For more information related to this article:

www.worldatwork.org

Type in any or all of the following keywords or phrases on the search line:

- Sales compensation plans
- External equity
- Internal equity.

www.worldatwork.org/bookstore

- *Sales Compensation Essentials: A Field Guide for the HR Professional*
- *Sales Compensation Math*
- *Designing Sales Compensation Plans: How-to Series for the HR Professional.*

www.worldatwork.org/education

- Elements of Sales Compensation Certification Course: C5
- Sales Compensation Design — Developing Next Year's Plan, Seminar
- Sales Compensation for Complex Selling Models, Seminar.