

Determining the Right Salary/Incentive Ratio for Your Sales Jobs¹

by

Jerome A. Colletti

Mary S. Fiss

Colletti-Fiss, LLC

www.collettifiss.com

- Definition of “mix” (aka salary/incentive ratio)
- Diagnostic tool to use to arrive at “mix”
- Tough questions about “mix” and suggested answers

“*What is the right salary/incentive mix for our sales job?*” This is one of the most frequently asked questions by both business owners/general managers and their sales managers. Too much pay at risk – that is, a relatively low salary and the opportunity for a large incentive payment – can cause the sales force to be shortsighted when it comes to investing time and effort to win the right type of business. Too little pay at risk – that is, a relatively high salary and limited opportunity for a large incentive payment – can cause the sales force to “under-achieve” relative to the sales potential in their territories. Unfortunately, there is no one right answer to all questions about the right mix. There is, however, a process and tool that top managers can use to arrive at the most appropriate mix for a job or jobs in their company

Definition of “Mix” (aka Salary/Incentive Ratio)

The salary/incentive ratio defines the manner in which cash compensation is delivered—that is, the percent of target total compensation paid in salary versus the percent “at-risk” through the incentive pay arrangement. The exact salary/incentive ratio for a particular sales job is based on the influence of the job in purchase decisions. Job definition, therefore, is the key to success in the plan design process. A clear definition of the job's role, responsibilities, and expected performance outcomes must be available before you design any plan.

¹ Adapted from Jerome A. Colletti and Mary S. Fiss, *Compensating New Sales Roles: How to Design Rewards That Work in Today's Selling Environment, Second Edition*, New York: AMACOM Books, 2001

For example, the more important the salesperson is in the buying process and the shorter the time to complete a sales transaction the more likely it is that the incentive component will be high. Industry surveys suggest that an average salary/incentive ratio is 70/30. Jobs paid with a 50/50 ratio indicate that the employee has a significant influence on the customer's buying decisions. Conversely, a job paid with a 90/10 ratio suggests that the employee is only one of many factors affecting the buying decision.

Diagnostic Tool To Use To Arrive At “Mix”

To determine the mix appropriate to a specific sales job, you must look at several criteria including:

- The role of the salesperson (or any other customer contact job) in the sales process, including:
 - The nature of the product or service being sold.
 - The extent of price competition (weak or extensive).
 - Customer loyalty (to the company or to the salesperson).
 - The expertise required to be effective in the process.
 - The types of sales objectives (strategic objectives or pure volume).
 - The type of selling required (consultative/complex or transactional).
- Management style or practices the company uses in directing or working with the salesperson:
 - Is the salesperson a team member or individual contributor?
 - Is the salesperson the factor or one of many variables in the sales process?
 - Is the relationship between the salesperson and the company one based on loyalty and respect or on finances (i.e., an agent relationship)?

A simple way to approach determining salary/incentive mix is to use a rating chart like the one in Figure 1 ([click here](#) / Adobe required). Many companies customize the criteria to their own situation and complete an exercise with their management team to ensure that the mix for all sales jobs is consistent with each job's charter and performance expectations. This exercise can then be used as a timely check to confirm that everyone's expectations for the job are the same and that all stakeholders in the job think of the relationship of the salesperson to the company in the same way.

A systematic approach to confirming the salary/incentive mix for each sales job is an important first step in developing the right sales compensation plan for your company. The "mix" decision really defines which element of pay has the highest visibility to the employee in a sales job. Since the manager can use each element differently, it's important to be sure that the right element receives the higher weight, based on what the sales job is expected to accomplish.

Salary: Salary recognizes the skills, experiences, and development that a job requires. It is the currency that provides sales managers with the opportunity to ask for behaviors, activities, and results that may not be immediately measurable or paid by the incentive plan.

Incentive "at-risk" compensation: Companies use two types of variable compensation, "at-risk" and "add-on." Incentive compensation for sales roles is generally at risk, that is, some people may not receive any and some may receive more than the "target" amount. At-risk pay means that a person's salary is not intended to be their total cash compensation and that they can increase their total through significant over-achievement.

Another type of variable pay is an add-on incentive. Add-on incentives are *not* considered part of a "target" total compensation, and therefore are not included in the "mix" determination; they are "added on" as an additional cost to the organization and there is no

additional upside opportunity. Contests, “spot” awards, and recognition awards are add-on incentives, rather than at-risk pay.

The mix of fixed pay to variable (incentive) pay delivers a powerful message to the salesperson. As Figure 2 shows, the more aggressive the mix, the more autonomously the firm expects the salespeople to act. Very low mix (10 percent or less of pay at risk) is really “retrospective” pay: the message is, “It looks like you did a really good job there.” A median mix (20 percent to 40 percent of pay at risk) is “prospective”; the message is, “I really believe you can do a great job and when you do, you’ll be financially recognized for it.” With a very aggressive mix (more than 50 percent of pay at risk), the message is, “Do what you got to do; we’re not going to get in your way.” In fact, one manager has told us that a very high mix is really “anti-sales management,” while a very low mix is “long-term and strategic.”

Figure 2: Balancing Mix and Message

Percent Variable	Impact	Message
Less than 10%	Minimal to none	“Recognize performance”
10% - 15%	Performance reminder	“Prompt”
15% - 25%	Directional	“Motivate to action”
25% - 50%	Highly directional	“Stimulate positive consistent action”
Over 50%	Independent action	“Act autonomously”

Tough Questions About “Mix” And Suggested Answers

Business owners/general managers and their sales executives frequently struggle with common, tough questions about mix. Some of those questions and our suggestions about how to address them follow:

How much incentive is required to be motivational?

As companies begin to design the pay plans for new sales roles, this is frequently the first question managers ask. The motivational value of pay varies by individual; however, a reasonable rule of thumb is that 10 percent of base salary is a good starting point. Employees in new roles may perceive any less as “interesting,” or “a nice reward,” but it does not have the motivational impact of a higher percentage of pay at risk.

Illustration: For a \$60,000 sales job with a 90/10 salary/incentive ratio, the target bonus would be \$6,000 or 11 percent of salary. For most people, \$6,000 would be sufficient to be motivational, i.e., an individual would put forth the effort required to achieve performance results associated with the target incentive pay opportunity.

Of course, it is critical for the plan designers to determine the right mix based on defined criteria, but there are no absolutes. An adjustment up or down of 5 percent may be the difference between a program that effectively supports the new role and rewards for success and one that does not.

When the mix is altered, particularly from a low salary/high incentive to a higher salary/lower incentive, aren't you actually reducing the motivation for sales people to perform at high levels?

Typically, when managers alter the mix in a manner that reduces the incentive and increases the base, they do so because they are trying to address fundamental changes in the manner in which the buying/selling process operates, and roles involved in the process, and how success in those jobs should be addressed.

Illustration: A major cable TV company grew rapidly as a result of substantially expanding its base of advertisers to include small and mid-size businesses. The corporation accomplished this in part with a sales force that was paid 40 percent salary and 60 percent commission. Shortly after the company announced the best ad sales year in its history, top management was confronted with some serious challenges. First, sales managers reported that many of the customers the company booked when they were small were now quite large in terms of their advertising needs and the demands they were placing on the account executives' time. The account executives were spending more time acting as a "business advisors" to their current customers. This meant that they actually had less time available to sell to new accounts because they were so busy servicing current accounts.

Second, the Human Resources department reported that it was becoming more and more difficult to hire talented new sales people at the base salaries—40 percent of the total compensation opportunity—the company offered. The level of experience and talent the company sought was simply not available at the salary level the company was paying. Finally, in some metro markets, the company's competitors were recruiting and hiring its people by offering higher salaries and slightly less incentive pay. For these reasons, top management shifted the salary/incentive ratio from 40/60 to 60/40. While this shift did increase fixed costs and reduced the upside earnings opportunity for the account executives, on balance, it resolved all three major challenges—namely, it enabled account executives to spend more time with

current customers because proportionately less pay was at risk; it enabled Human Resources to attract both more and better candidates; and it slowed turnover because the new salary levels were more in line with labor market practices.

When and why would mix shift from more to less salary, from 100/0 for example to 90/10 or 90/10 to 70/30?

Typically, this happens when the company *adds* responsibilities to a sales job or creates a new role in the marketing and customer relationship management processes. This kind of change generally implies that “selling” has gained a more prominent role in doing business with customers. For example, as customers have more choices, the role of personal selling can be more influential in attracting and retaining business with customers.

Illustration: The most extreme example of an increase in choices is when an industry deregulates. The breakup of AT&T in the early 1980's meant that the long distance telephone industry, once deregulated, provided both residential and business customers with the opportunity to select their phone company. Today, the electric utility industry is going through a similar change, one that will offer businesses and consumers the opportunity to select an energy provider. Before deregulation, customer service representatives in both industries—sometimes called account executives to imply a sales responsibility—essentially serviced captive demand. There was no need to persuade; the providers—AT&T and the local electric utility—had monopoly. Deregulation changed this. Companies needed “sellers” to explain to customers why they would be better off staying with their current service provider rather than switching.

Summing Up

One of the potential strengths of a sales compensation plan is the incentive opportunity. The right level of incentive opportunity is a result of determining the appropriate salary/incentive

ratio (aka “mix”) for a particular sales job. To either supplement or complement competitive information about “mix” practices in a particular industry, top managers should engage in exercise to arrive at the salary/incentive ratio that they are confident is appropriate for the sales job under consideration. Doing so can build support among managers and sales people for the sales compensation plan.

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