Navigating The Turbulent Seas Of Sales Compensation

GCCBA Meeting: May 24, 2017

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Introductions

- Joe Clarkson
- Chicago
- Global practice leader
- 20 years consulting
- 15 years industry
- 25-30 client engagements/year
Integrated advisory, broking and solutions designed to meet our clients’ risk and people needs

- Broking
- Investment, Risk and Reinsurance
- Corporate Risk and Broking
- Integrated offering around people and risk
- Human Capital and Benefits
- Exchange Solutions

Scale, diversity and financial strength:
- $8.2 billion revenue

A deep history:
- Dating back to 1828

39,000 colleagues
- In 120+ countries
We are global and local

Sales Effectiveness & Rewards Team:

- 80+ consultants
- 35 cities across 22 countries
- 200+ sales compensation projects annually
- >35% with global sales forces
- Access to the world’s most comprehensive databases of pay levels and practices
Converting strategy into results through your human capital programs

Willis Towers Watson’s Model for Sales Effectiveness

- Right People With the Right Skills
- Focused On the Right Opportunities
- Highly Engaged and Motivated

Business & Sales Strategy

Sales Effectiveness

Business Results and Sales Force ROI

Change ManagementTools and TechnologyGovernance
Multiple disciplines need to be synchronized

Sales compensation is just one tool in the arsenal
Today’s agenda

Objective: to address contemporary issues that are creating challenges

- Streamlining the planning process
- Leading contemporary trends
- New accounting challenges
What today is not about

- Building a sales compensation plan
- Common design challenges
- Assessment of effectiveness
Streamlining the planning process

- Leading contemporary trends
- New accounting challenges
What’s the challenge?

There’s just too many people wanting to get involved

We can never get our plans out on time

Everyone has a different agenda of priorities

The plans are all messed up; there’s too many changes and too many plans

We can’t get everyone at the table together

We blew the compensation budget

Why do we start so late? There’s not enough time
Key ingredients for success (and failure)

**Leadership commitment and ownership**
Top executives, not process owners

**Multi-functional stakeholder participation**
Operations, Sales, Marketing, HR, Finance, IT

**Defined work plan, timeline, accountabilities**
Proven process; rigorously iterative decisions for design elements

**Field/local input and challenge teams**
Listen to plan participants initially and before implementation

**Define strategy, let tactics follow**
Requirement specifications from strategy; tactics in the plan design

**Active participation of your project team**
Build buy-in and consensus; transfer tools, techniques and process

**Well-planned and executed communication**
Multiple media focused on first line supervisors as communicators
Leadership involvement is complex

<table>
<thead>
<tr>
<th>What leaders should be involved?</th>
<th>PRIMARY</th>
<th>OTHERS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Sales</td>
<td>• Marketing</td>
</tr>
<tr>
<td></td>
<td>• Sales Ops</td>
<td>• Manufacturing/R&amp;D</td>
</tr>
<tr>
<td></td>
<td>• Finance</td>
<td>• CEO</td>
</tr>
<tr>
<td></td>
<td>• HR</td>
<td>• COO</td>
</tr>
</tbody>
</table>

| What is their role? | • Steering committee: Direction/guidance |
|                     | • Project team: Hands-on |
|                     | • Challenge team: Review and react |

| What are their priorities? | • Sales: Top line |
|                           | • HR: Pay levels, talent attraction/retention |
|                           | • Finance: Costs, ROI |
|                           | • Others: Working capital, utilization |

| How best to manage them? | • Identify **ALL** stakeholders |
|                         | • Assign a role: Steering committee, project team, challenge team, ad-hoc updates/feedback |
A common approach to the process

Phase 1: Assessment and Strategic Context
- Develop a fact-based case for change
- Identify strengths, weaknesses and opportunities for improvement

Phase 2: Detailed Design
- Develop detailed plan designs
- Model the plans for fiscal impact
- Consider transition requirements

Phase 3: Implementation
- Effective rollout of new incentive plans

A collection of inputs
Participative and interactive
Choreographed events with collateral material

Most organizations wait until late in the year to start – why?
Business strategy and job role definition are key drivers of sales incentive plans

Validate your business strategy and job

Validate This

Strategic Requirements
- Strategy
  - Corporate Objectives
  - Channel and coverage model Sales and Service Strategy
  - Compensation Strategy and Philosophy
- Roles
  - Account Responsibilities
  - Product Responsibilities
  - Sales and Service Process Responsibilities
  - Rules of Engagement

Sales Compensation Philosophy
- Job Value
  - Target Total Compensation
    - Pay Philosophy
  - Incentive Mix
    - Personal Influence
    - External Practice
    - Nature Of Sales and Service Process (Length, Complexity, etc.)
- Incentive Delivery System
  - Measures and Weights
    - Alignment
    - Control
    - Focus
    - Feasibility
  - Plan Mechanics
    - Bonus vs. Commission
    - Thresholds
    - Accelerators, Decelerators, Caps
    - Linkages
    - Measurement Period
    - Payout Frequency
    - Crediting Rules

Review and Redesign This
Phase 1 is a collection of data inputs

General Fact Gathering
- Organization charts
- Incentive plan documents
- Goal setting and goal management processes
- Crediting rules
- Administrative processes and systems capabilities and limitations

Data Analysis
- Historical pay and performance data analysis
- Market benchmark data

Interviews & Survey
- Executive Leadership and management
- Incumbents across roles in scope

This can be conducted much earlier than the typical project start
Mapping roles streamlines the design process

**Transactional**
- Purchase decision is simple
- Sales cycle is short
- Price is key
- Focus on efficiency

**Consultative**
- Purchase decision is complex
- Sales cycle is long
- Value is key
- Focus on solution

**How Customers Buy**

**“New Business Acquisition”**
- New business acquisition
- Cold calling or prospecting
- Little post-sale effort

**“Territory Management”**
- Grow territory revenue based on good relationships with customers/prospects
- Growth comes from building a reputation in the territory
- Some post-sale effort

**“Account Management”**
- Retain and grow accounts
- Identify and address customer needs
- Significant post-sale effort
- Penetrate customers with new services/products
Streamlining the planning process

Leading contemporary trends

New accounting challenges
Leading contemporary trends

- Simplify
- Diversify
- Guide
- Communicate
1: Simplify

“There is nothing wrong with having a single measure”

- Wireless: Activations
- Insurance: Premium
- Payments: Volume
- Medical Device: Sales
- Technology: Bookings
1: Simplify (Cont.)

“We have 4 payout curves for all our sellers around the world”

<table>
<thead>
<tr>
<th>Performance</th>
<th>Payout Curve 1</th>
<th>Payout Curve 2</th>
<th>Payout Curve 3</th>
<th>Payout Curve 4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% Quota</td>
<td>% Payout</td>
<td>% Quota</td>
<td>% Payout</td>
</tr>
<tr>
<td>Threshold</td>
<td>85%</td>
<td>50%</td>
<td>75%</td>
<td>50%</td>
</tr>
<tr>
<td>Excellence</td>
<td>120%</td>
<td>200%</td>
<td>135%</td>
<td>200%</td>
</tr>
</tbody>
</table>

Situation

- Large global sales force selling in very different markets
- Sales incentive plan participants assigned a “payout curve” based on market characteristics (supported by historical data analysis)
2: Diversify

“Sales compensation is only one of the dials that can be tuned to drive sales effectiveness”
“Managing sales people is easy; I’ve been doing it for years”

- Sales employees are money-motivated and self-managing
- Strong producers will thrive and stay with the company
- Weak performers will either find a way to improve or exit

Darwinian Belief

Is this a smart strategy?
“Pay is NOT a driver of sustainable engagement…which is what you need to earn the extra effort to get people to go above and beyond”

### 2: Diversify (Cont.)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Attraction Drivers</th>
<th>Retention Drivers</th>
<th>Sustainable Engagement Drivers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Pay</td>
<td>Pay</td>
<td>Supervision</td>
</tr>
<tr>
<td>2</td>
<td>Job security</td>
<td>Opportunities to advance in my career</td>
<td>Clear Goals &amp; Objectives</td>
</tr>
<tr>
<td>3</td>
<td>Organization's products or services</td>
<td>Trust/Confidence in senior leadership</td>
<td>Senior Leadership</td>
</tr>
<tr>
<td>4</td>
<td>Flexible work arrangements</td>
<td>Job security</td>
<td>Image &amp; Integrity</td>
</tr>
<tr>
<td>5</td>
<td>Health care and wellness benefits</td>
<td>Ability to manage work-related stress</td>
<td>Performance Review</td>
</tr>
</tbody>
</table>

Source: WTW 2016 Global Workforce Study - North America/Sales Roles
2: Diversify (Cont.)

“Our sales managers are the critical lynchpin for sustainable engagement and talent management”

Most organizations report that they have under-invested in this role but that they are turning much greater attention to it.
“We want to balance consistency with flexibility”

Global Consistency
- Transparent
- Culturally neutral
- Facilitates mobility and communication

BUT ...
- HQ-centric
- Not market responsive
- Some programs may be ineffective

Local Market Design
- Market responsive
- Aligned with local deployment
- Strong sense of ownership

BUT ...
- Less transparent
- Communication and mobility challenges
- More labour intensive design/administration

“Find the balance”
### Step 3: Guide (Cont.)

“We want to save ourselves from reinventing the wheel”

<table>
<thead>
<tr>
<th>Level of Governance &amp; Consistency of Plan Design</th>
<th>Local Plans</th>
<th>Guidelines/Principles only</th>
<th>Guidelines/Principles with Governance</th>
<th>Incentive Framework</th>
<th>Global Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low/No</td>
<td>● No global governance&lt;br&gt;● Plans are designed at the local level</td>
<td>● Provide high-level guidelines/principles, grounded in best practice, to assist in the design of any sales incentive plan across the enterprise&lt;br&gt;● Allows for potentially significant different local plan designs, but establishes some guidance for best principle design practices&lt;br&gt;● “Voluntary” adherence to guidelines</td>
<td>● Provide high-level but specific guidelines/principles to underpin the design of any sales incentive plan across the enterprise&lt;br&gt;● Allows for potentially significant different local plan designs, but establishes some guidance for where things should and should not be different&lt;br&gt;● Plans must be approved by a “central” governing body to ensure adherence to guideline</td>
<td>● Fully detailed plan designs for ‘generic’ sales roles that can be applied globally&lt;br&gt;● Provides actual plan designs to local countries, for them to install locally with some modification and adaptation, as required</td>
<td>● Sales incentive plans are global with little/no local modification and adaptation (typically only to adhere with local regulations)</td>
</tr>
</tbody>
</table>
4: Communicate in a world of information overload

I don’t care/this isn’t a priority

I don’t understand

There are too many places to go

Only 1 out of 4 companies sustain gains over the long term. Because only 1 out of 3 frontline employees are in the know.

About half (55%) of change initiatives meet their initial objectives.

Good communication is a critical element of incentive plan implementation … especially when the impact of the change is significant.
4: Take a marketing approach

“Rewards communication doesn’t have to be boring”

Text-heavy emails
Letters in non-descript envelopes
Printed Plan Guides
Long animated PPTs

KEEP IT SHORT!

Videos – less than 2 minutes
Examples and calculators
Emails – 200 words (or just pictures)
Streamlining the planning process

Leading contemporary trends

New accounting challenges
What are these?

Financial Accounting Standards Board (FASB)

Accounting Standards Codification (ASC 606)

"Revenue from Contracts with Customers"

International Accounting Standards Board (IASB)

International Financial Reporting Standards (IFRS 15)

This could potentially create upheaval in sales compensation design.
So how does this affect sales compensation?

<table>
<thead>
<tr>
<th>The W’s</th>
<th>The Highlights</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Why do this?</strong></td>
<td>▪ Under GAAP, industries had their own rules-based standards</td>
</tr>
<tr>
<td></td>
<td>▪ Standardize the way revenue is recognized</td>
</tr>
<tr>
<td></td>
<td>▪ Make financial results more transparent and comparable</td>
</tr>
<tr>
<td><strong>Who is impacted and when?</strong></td>
<td>▪ Issued in 2014, effective for annual reporting periods after 12/15/15 for public and non-public entities, but deferred...</td>
</tr>
<tr>
<td></td>
<td>▪ Now effective for annual reporting periods:</td>
</tr>
<tr>
<td></td>
<td>▪ After 12/15/17 for some companies (public, certain NFP)</td>
</tr>
<tr>
<td></td>
<td>▪ After 12/15/18 for others</td>
</tr>
<tr>
<td><strong>What does it mean?</strong></td>
<td>▪ Revenue is recognized when the goods/services are delivered</td>
</tr>
<tr>
<td></td>
<td>▪ Revenue and expenses must be allocated over time</td>
</tr>
<tr>
<td><strong>So what?</strong></td>
<td>▪ Complicates accounting – changes how revenue is calculated</td>
</tr>
<tr>
<td></td>
<td>▪ Impacts compensation plans based on revenue metrics</td>
</tr>
<tr>
<td></td>
<td>▪ Especially with recurring revenue or subscription business model</td>
</tr>
</tbody>
</table>

Not yet on the radar of most sales compensation teams
### Understanding some common terms

<table>
<thead>
<tr>
<th>Type</th>
<th>Meaning</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bookings</td>
<td>A customer commitment to spend</td>
<td>Measures impact and growth of your sales from orders/contracts</td>
</tr>
<tr>
<td>Billings</td>
<td>Invoice sent to customer for payment</td>
<td>Request for payment but not aligned with RecRev unless product is already delivered</td>
</tr>
<tr>
<td>Recurring Revenue</td>
<td>Contract amortized into subscription revenue</td>
<td>Tracks your momentum as a subscription business</td>
</tr>
<tr>
<td>Recognized Revenue *</td>
<td>Revenue accrued for product/services delivered</td>
<td>Allows you to make accurate predictions regarding cash flow and manage financial health of your business</td>
</tr>
<tr>
<td>Deferred Revenue *</td>
<td>Revenue not yet earned for product/services still owed</td>
<td>Same as above but a liability</td>
</tr>
<tr>
<td>Cash Collections</td>
<td>Actual cash collected from customer</td>
<td>Knowing how much you can spend</td>
</tr>
</tbody>
</table>

*RecRev and DefRev are new accounting standards per FASB and IASB*
An illustration

<table>
<thead>
<tr>
<th>Type</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>...</th>
<th>Jan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Booking</td>
<td>$36,000^1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Billings</td>
<td>$12,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$12,000</td>
</tr>
<tr>
<td>MRR^2</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td></td>
<td>$1,000</td>
</tr>
<tr>
<td>RecRev</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td></td>
<td>$1,000</td>
</tr>
<tr>
<td>DefRev</td>
<td>$11,000</td>
<td>$10,000</td>
<td>$9,000</td>
<td>$8,000</td>
<td></td>
<td>$10,000</td>
</tr>
<tr>
<td>Cash</td>
<td>$12,000^3</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$12,000^3</td>
</tr>
</tbody>
</table>

1: Assume 3 year contract
2: MRR = Monthly Recurring Revenue
3: Assume 1 year pre-payment

Do not mistake cash collections with revenue; pre-payment is good, but revenue is not recognized until services are delivered; until then, the revenue is still a liability
Be aware of the “Rule of 78”

### Year 1

<table>
<thead>
<tr>
<th>Deal</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>...</th>
<th>Full Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$10,000</td>
<td></td>
<td>$120,000</td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>$10,000</td>
<td>$10,000</td>
<td></td>
<td>$110,000</td>
</tr>
<tr>
<td>3</td>
<td></td>
<td></td>
<td>$10,000</td>
<td></td>
<td>$100,000</td>
</tr>
<tr>
<td>12</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$780,000</td>
</tr>
</tbody>
</table>

- Actual portfolio of deals is unlikely to be “smooth and consistent” like this but a portfolio of diverse contracts acquired at uneven intervals throughout the year
- **Sales can be measured 4 ways:**
  - $4.32m of bookings (assume avg. 3 year term = TCV)
  - $1.44m of ARR (=ACV)
  - $120,000 of MRR
  - $780,000 of RecRev (same as in-year revenue or IYR)

### Year 2

<table>
<thead>
<tr>
<th>Deal</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>...</th>
<th>Full Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$10,000</td>
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<td>$120,000</td>
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<td>2</td>
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<td>$10,000</td>
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<td>$110,000</td>
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<td>3</td>
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<td></td>
<td>$10,000</td>
<td></td>
<td>$100,000</td>
</tr>
<tr>
<td>12</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$780,000</td>
</tr>
</tbody>
</table>

- Prior year sales will deliver year two revenue of $1.44m, assuming all retained
- Plus year two new RecRev of another $780,000
- Total year two RecRev = $2.22m

### Year 3

<table>
<thead>
<tr>
<th>Deal</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>...</th>
<th>Full Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$10,000</td>
<td></td>
<td>$120,000</td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>$10,000</td>
<td>$10,000</td>
<td></td>
<td>$110,000</td>
</tr>
<tr>
<td>3</td>
<td></td>
<td></td>
<td>$10,000</td>
<td></td>
<td>$100,000</td>
</tr>
<tr>
<td>12</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$780,000</td>
</tr>
</tbody>
</table>

- Prior two years’ sales will deliver year three revenue of $2.22m, assuming all retained
- Plus year three new RecRev of another $780,000
- Total year three RecRev = $3.0m

**In a subscription model, selling $10,000/mth of new MRR = $780,000 of RecRev**
# Must the sales rep wait for RecRev?

<table>
<thead>
<tr>
<th>Current Year</th>
<th>Basis for Sales Person Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>Deals sold in 2015 generate commissions paid in 2015 but none in 2016 or 2017</td>
</tr>
<tr>
<td>2016</td>
<td>Deals sold in 2016 generate commissions paid in 2016, but none in 2017 or 2018</td>
</tr>
<tr>
<td>2017</td>
<td>Deals sold in 2017 generate commission paid in 2017, but none in 2018 or 2019</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bookings</th>
<th>RecRev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deals sold in 2015 generate commissions paid in 2015 but none in 2016 or 2017</td>
<td>Commissions are paid in the year that revenue is recognized, regardless of when it was booked</td>
</tr>
</tbody>
</table>

### Compensation Cost of Revenue

- **Disconnect**
- **Aligned***

### Reward the Compensable Event

- **Aligned***
- **Disconnect**

* Depends on the desired responsibilities of the role (in terms of account acquisition / retention / renewal / growth)
Accounting regulations apply to RecRev, NOT to how or when sales people get paid

The compensation team will need to balance potentially competing needs
Questions?