Xactly
Inspire Performance

HOW TO EFFECTIVELY MANAGE RISK

eBOOK

INTRODUCTION

Understanding and mitigating risk within business systems is a key aspect of a finance organization. CFOs, Controllers and FP&A managers have long understood this reality, but it is only recently that finance leaders are beginning to reduce risk in sales compensation programs. This is not simply an idea; it is a systematic process you can and should apply as you think about automating your sales compensation programs. In so doing you gain control over sales comp costs, eliminate material internal control weaknesses, and significantly improve your accrual and forecast accuracy.

You can answer the question of how to manage risk within your company when you understand the four components required to maximize the effectiveness of your sales compensation program:

1. Aligned, simple plan design
2. Fair, attainable quotas
3. Clear, timely, plan & goal communication
4. Effective, efficient sales compensation administration (see figure 1).

Quarterly quotas are significantly more effective for successfully managing sales compensation;. This is because most companies are not confident enough in their numbers to set a yearly target. According to our data, 67% or reps make greater than 80% of quota on a quarterly plan. However, if you have an annual quota plan, that drops down to only 60% of reps making greater than 80% of quota.

Why? Sales data proves that people slow down when they feel like they're already failing. Quarterly quotas give reps a restart button, if you will; morale isn't lost and reps are inspired to work more diligently and chase quota for the next quarter. Monthly and quarterly goals cause revenue to spike, since productivity always goes up when it's measured.

Fair and thoughtful target setting is also key to properly motivating the field and aligning with corporate objectives. Let's say reaching 125% of quota is a rock star performance at your company. You need to be aware that your top reps will chase the bonus and then stop selling.

FIGURE 1:

Maximizing Sales Compensation Effectiveness

Area	Leaders	Laggards
	Related Area Effective or Very Effective	
Design	75%	60%
Quotas	73%	39%
Communication	73%	61%

Clear, concise, and timely communication is the third tenet to a productive sales compensation program. Every industry is different and you have to formulate a plan that works for the one you're in, and the unique people you're employing. Know your people, and you'll find the best way to communicate with them. This involves leveraging multiple means of communication; use all that you have at your fingertips. Be it rallies, meetings, emails, or documents; clear communication ensures that reps understand the plan. Keep your people in the loop and you will win the hearts and minds of first line sales reps. Tracking through a tool like Xactly is very important when you remember that communication, transparency, and motivation lead to results.

INCENTIVE PAY LEVERAGE: A DOUBLE-EDGED SWORD

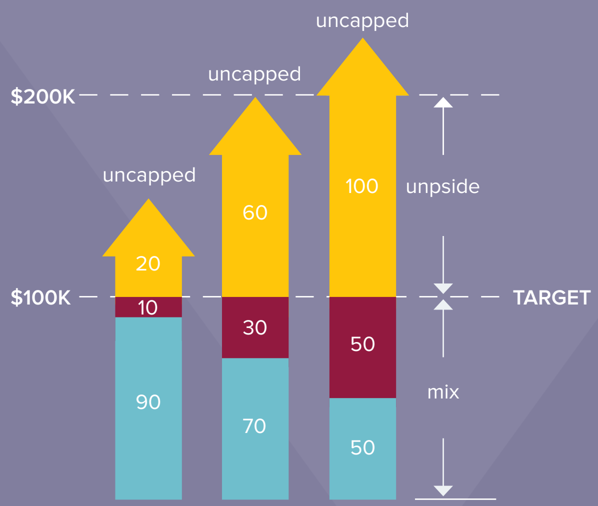
When you design your plan, it's imperative that incentive pay leverage is discussed. Leverage is an extremely powerful behavior driver, as it is the combination of mix and upside, which can maximize motivation. However, it also introduces the potential for increased risk. Incentive pay leverage is a raging debate in many industries like pharmaceuticals and manufacturing, and as public opinion becomes increasingly important companies need to watch out for the way their incentives look to customers. For example, is it acceptable for a pharmaceutical sales rep to be receiving consistently large bonuses when health care costs are through the roof?

MANAGING RISK: KEY PLAN DESIGN COMPONENTS

The plan components that motivate most are pay mix, upside, performance measures, and leverage. These also happen to be the plan components that invite the most risk from a cost perspective, as well as from the viewpoint of legal exposure. That being said, it's essential that they're designed carefully and within the context of risk and motivation reward. For example, a plan with strong upside and a significant pay at risk will attract hunters and motivate people to sell well beyond their targets (see figure #2 for an example of how the same Total Target Compensation (TTC) can pay $120K or $200K at the excellence point of performance). While this is powerful, it must be carefully considered from a behavioral perspective, especially for highly regulated industries like financial services and pharmaceuticals.

FIGURE 2:

Leverage Example for $100K TTC, with 3:1 upside



SALES CREDITING

In order to manage risk in your compensation plan, carefully examine your sales credit rules. Let's say you are handling a 10 million dollar deal. It's necessary to balance motivation with risk, which you can't do unless you thoroughly understand your team and the credit each member should receive. Questions to ask yourself might be: does the type of product change how much credit is given? Does the type of customer alter the amount of credit given? How much credit does each role receive?

When Xactly analyzed existing sales comp data we found as many as 160 commissions on one deal! This is a big problem. It costs too much, and if the company is still calculating compensation with excel, they likely don't realize what the true cost of the deal is. With the wrong plan you could be paying thirty people to drive just one deal, not to mention you might not be encouraging the best behavior. It's always important to be asking yourself, did I drive desired behavior with those payments?

MANAGING RISK: PLAN ROLL-OUT & SET-UP

Governance

Governance gets a bad rap in the field, and your staff may resist. However, if you're managing risk, and tightening your operation, governance has to have a part. It's a component of your company's process of maturing. "You don't fit into the pants you wore in fifth grade, and a growing company might find it's time for a new pair of pants." This new pair of pants is governance, and to implement it properly you must have multiple departments coming together and communicating with one another. Human resources, sales, finance, and legal all need to be invited to the party, and they need to learn to mingle. It's been said that "finance is from Venus, field is from Mars," one would claim they're paying too much; the other will say they're not getting paid enough. With governance, and with any luck an on-demand compensation solution, these communication issues are eliminated.

KEY AREAS FOR COMPENSATION GOVERNANCE:

1. Decisions, rights, and accountabilities-roles/responsibilities/approval & review.
2. Plan design guidelines-eligibility, pay levels, pay mix, performance measures, and crediting rules.
3. Policy terms and conditions-procedures for plan acceptance, quota, adjustments, and terminations embedded in in your plan.
4. Plan oversight-provides a check and balances as well as issue resolution to govern plan management throughout the year.

MANAGING RISK: ON-GOING OPERATIONS

Compensation Plan Effectiveness Metrics

A tool to look at the analytics of geography, position, business unit, performance distribution, and pay differentiation is imperative. This will give you rich information to discern what's working and what's not, and it also provides insight into the financial and behavioral risks your company could be facing. See figure #4 for a listing of key analytics to keep your eye on.

Figure #3: Key Compensation Effectiveness Analytics

ANALYSIS	KEY DATA CUTS	OBJECTIVE
Credit Revenue Ratio	• Geography • Position	How big of a variance exsits between actual and credited revenue? How does the ratio compare to industry standards How do the use of overlays and variances in crediting practices affect the ratio?
Pay for Performance	• Geography • Position	How big a variance is there in how plans pay for like levels of performance How effectively do the plans reward performance? How well are key objectives correlated to pay?
Pay Composition	• Geography • Position • Business Unit	How much more of a top performer's compensation is made up by incentive vs. bottom performers How strongly does the pay components drive performance? Do the plans incent for the right focus?

HOW TO SPOT WARNING SIGNS AND RED FLAGS

Do any of these scenarios sound familiar?

- Your company is making money but your reps are coming up short?
- Is quota attainment lagging?
- Is there an elevated rate of turnover?

These are all low-level problems that are indicators of stormy weather ahead. Specific signs like these indicate issues that you need to remedy, and the necessity to adjust your sales compensation plan.

Higher-level problems, or red flags, would include:

- Unhealthy levels of channel conflict
- Rising cost of sales
- Mis-management of turnover.

FINAL TAKEAWAYS

Do you have a reward system instead of an incentive system? How can you tell the difference? In an incentive system the way you compensate changes behavior. Sales reps will look at the plan and modify how they sell, where they sell, and who they sell to in order to be compensated accordingly.

Before crafting a plan, it's critical to figure out what your company is trying to achieve. Be it increased revenue, new products, or gaining more clients, zero in on your goals. Next determine out who is going to drive the action, and are you choosing the right people for your particular objectives.

Cost is a huge factor, so decide out how much you're willing to pay comprehensively. Then, figure out what you'll pay for each margin. Our data suggests that timely check writing matters. The faster you pay reps after a sale is made the better their quota attainment. There are many metrics to success, so knowing how your company individually measures it is extremely pertinent.

How will you know if you've made a mistake? Auditing your compensation plan quarterly allows you to change it frequently, in order to reflect the dynamic needs of your reps and your company. The market is moving constantly, and you need to be ready to change and make adjustments.

A well-managed comp plan is made up of three key puzzle pieces: objectives, how we incent them, and how we drive the right behavior. Managing risk is a team effort, and it takes the communication and engagement of HR, Finance, and Sales to do it effectively.

Want to learn more about how you can clearly communicate goals, use tracking tools for predictable budget management, and pay quickly when goals are met? Visit www.xactlycorp.com

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