Sales and Distribution Management
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Lecture – 28
Sales Force Management: Compensation

[FL]. Today we will be discussing the next topic in Sales Force Management which is Compensation. So, this is lecture 28 which is the 3rd lecture in the 6th module of our course on Sales and Distribution Management. Compensation is something which is always an always a very important criteria by which you know people join companies and also something by which companies are able to retain their sales people.

Not only retain companies attract a lot of sales force, a lot of employees on the basis of the compensation packages that they offer, and they often retain them on by paying you know salaries and you know providing incentives, which are something very very attractive. So, that they can retain the sales force they can also motivate the salespeople and the sales force in their organization.

So, compensation is something which is a very very crucial you know decision which companies must take when they when they must attract and motivate and retain the employees in any of the departments. And, in the sales function it becomes even more important that a very sound compensation policy is adopted and we comes you know sound you know compensation packages are designed so, that companies can attract you know you know efficient sales people sales force. And they can you know they would be able to motivate them better, they would be able to retain them better and the organization would overall benefit from the performance of the motivated sales force.

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So, under this particular topic we shall be discussing first, what is compensation the meaning of compensation, then strategic policy decisions with respect to compensation, the motivating role of compensation the requirements of a good compensation plan, devising a good compensation plan and types of compensation plans. So, let us discuss first you know with what do we mean by compensation.

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Now, a compensation is what employees in an organization receive for the services that they provide to a company and it is a very very important source of motivation to an extent, you know the question which is often you know us is, is money and important motivating factor well.

Money has a limited motivating power as a motivating factor, yet it is perceived to be something is very very important and it is perceived as something very crucial you know when people you know this apply for jobs in an organization or you know get attracted towards joining an organization. And, you know not only you know joining even when it is to continue working for an organization and the compensation is in important factor that every employee keeps in mind. So, attracting talent retaining talent is something which every organization wants, and as I just said compensation is a very very vital tool to attract and retain you know talent in the company attract and retain efficient and effective sales for sales people in the company sales executives in the company.

Money is also very very more you know important motivating factor, because it helps employees built their career and ensures their relationship with the organization. People will be motivated not only to you know work hard and perform well, but also motivated to remain you know a part of the company, they would I want to remain a part of the organization for which they are working. Now the what are the objectives of a sales compensation plan? Of course, the first objective as I said is to attract and retain salespeople and the more important objective here becomes motivating them towards higher productivity levels, controlling their you know activities and their you know performance. So, as to be able to you know derive sales and profits for the organization.

So, if we ask you know if that is money and important motivating factor the truth is that money has a limited motivation power as a motivating factor, but yet it is perceived as something which is very very crucial you know which very crucial for not only for an organization, but for people who join the organization. Because when companies design compensation packages they must also keep in mind the sales that are generated the revenues the profits. So, and So, companies must be able to afford you know lucrative packages and you know compensation packages for their sales force, and that would again depend upon the performance of the sales force in the field.

So, it become more of a vicious circle companies would be able to pay only and only when you know people are performing well and to encourage people to perform well, again money is something which attracts people to work harder.

Because they feel that if they work harder they would get higher commissions and higher incentives. So, the very objective of designing a very good compensation plan for an organization is to attract and retain sales force motivate them control them and improve productivity levels.

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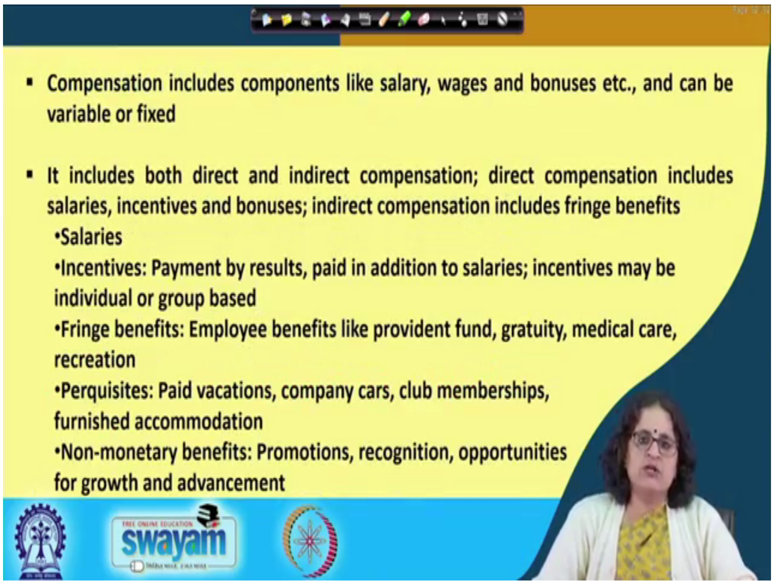

So, what does compensation include? Compensation basically includes components like the salary, the wages, the bonuses etcetera and can be a fixed or variable. Now we will be discussing the fixed and variable you know parts or components or elements of a salary structure a little later, and we should also be speaking about profit sharing and bonus and you know fringe benefits as we move our along, but when we talk about compensation it includes both direct and indirect compensation. Direct compensation including the salaries, the incentives, the commissions, the bonuses and internet compensation which comes in the form of fringe benefits.

So, if we if we actually break up salary package of a person, what we get is a salary, then we get incentives which are basically payments by results it is something which is paid in addition to salaries and again incentives are something which may be either individual based to keep an individual sales person motivated to make him feel rewarded. It could also be group based to make the entire sales team reward it and to keep them motivated at work at their workplaces.

Apart from that we have fringe benefits which are employee benefits like social security, schemes sometimes which are statutory and regulated by law, sometimes it is you know a you know a something which companies opt for out of their own will and so, you have a provident fund, you have gratuity or a medical care, you have recreational facilities a club membership facilities etcetera, which have become a part or fringe benefits.

You also have something which are parks or perquisites. Perquisites could include paid vacations, company cards again club memberships furnished accommodation. Now, in some cases the club memberships or furnished accommodation or you know paid vacations becomes again a part of the fringe benefit. In some cases it is you know they are put into two different heads one is a fringe benefit the other is a perquisite or a park. And then you have non monetary benefits which could be promotion, recognition, opportunities for growth and advancement.

So, you have these different elements or components in a salary, where you know in a salary package or in a compensation package which starts with salary which is more of a fixed element and then you have the variable elements in the form of incentives, further you have fringe benefits perquisites and non monetary benefits. We shall be discussing about some of these elements a little later

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Now there are certain strategic policy decisions which need to be made when we when companies decide on the compensation packages, first is the pay level policy. Now the pay level policy here refers to you know the organization pay level compare to those of it is competitors. So, it refers to how an organization is pay level compares to those of it is competitors. If this has an impact on the organizations ability to attract you know salespeople or you know it also has an ability to you know retain competencies people and companies here have an option to either match with the competitor or lead ahead of the competitor and pay more or lag behind the competitor and pay less.

The second you know in this you know important thing which we discuss here is the salary or the pay structure policy. Now the pay structure policy refers to the pay ranges, the minimum or the maximum you know in the range are based on the relative worth of the job. So, here comes in the importance of job evaluation which basically determines the relevant worth of jobs in comparison to other jobs in the organization.

We shall be speaking about job evaluation a little later, but here when we talk about job evaluation it is important to mention. The pay must be related to the relative worth of a job. A job which is extremely important and crucial for an organization necessarily means that you know the person who is placed on the job must be paid more or you know either in the form of salary or in the form of incentives or in the form of fringe benefits and perks. The second thing which we speak of in the pay structure policy is the internal and external equity. Now internal equity here means the similar jobs in an organization are paid similarly and the more demanding job positions and the better you know and the better qualified people, for those jobs are paid higher than the others.

So, similar jobs get similar pay and the more demanding job positions and better qualified people are paid higher than the others this is within the organization. External equity is when you know jobs are fairly compensated in comparison with similar jobs in the industry. So, it is its very important that you know a people feel that they are being equitably paid, whether it is within the organization or you know outside the organization and here if you recall it is Stacy Adams, equity theory is something which is very applicable and relevant here.

That each and every person desires equity and fairness in the kind of compensation on the kind of salaries, that they receive. The third thing which we discuss here is the types of rewards offered which could be extrinsic and intrinsic. Again we go back to Hertzberg theory, and where he spoke about you know certain elements in you know which are intrinsic to the job and threaten certain elements which are extrinsic to the job which can motivate that is one part.

But apart from that what we here specifically speak off is the you know whether we are talking of the monetary and the non monetary reward. So, you know the pay for example, becomes or sales salary for example, incentives bonuses they are all monetary rewards and they are you know extrinsic to the job, but when it comes to you know non monetary benefits, it could be you know if is you know the advancement recognition you know career development facilities, opportunities for growth and development which become more of the intrinsic reward, which can act as strong motivators for an employee.

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So, going ahead again and again we come to the question about is money a motivator and we said yes, it has a limited motivation power and why and how because a good you know well designed compensation planed.

There is three important motivational roles. One it offers living the edges to it is employees. So, employees are assured of you know salary coming to them every month, specially if it is a fixed component and employees are paid on a monthly basis you know or on a you know generally we speak off as in terms of the sales role it is going to be more of a monthly basis.

So, it offers living wages to the employees of course, for certain kinds of jobs where people are paid you know middle of the month or they are paid you know every 15 days, in those cases of course, even their it money becomes important because it assures the employee or the worker that yes he is going to be paid every 15 days or every month.

And so, it offers to him living wages, when pay scales get adjusted to performance or we would refer to this as payment by results, they encourage employees towards higher performance and productivity. So, what we are talking of here is more of a variable component, which comes as a part of incentives and commissions and gain sharing profit sharing as bonuses.

Also a money acts as a means for achieving the congruence between individual goals and company goals, we all know that you know the company strives for attaining sales, profits, revenues, market shares you know and individuals also need you know you know salaries, for their bare sustenance, for their you know day to day expenses.

So, the reward system has to be such designed that the individual goals can be met and the company goals also go hand in glove and they both as and when individual goals are being met company goals are being met as well and vice versa.

So, again here if you remember we can relate these two rooms expectancy theory, where it is important that the reward system or the compensation package is designed in such a manner that it is lucrative it is attractive it is something which is of value to the person, who is going to be placed on a particular job position at a particular salary structure.

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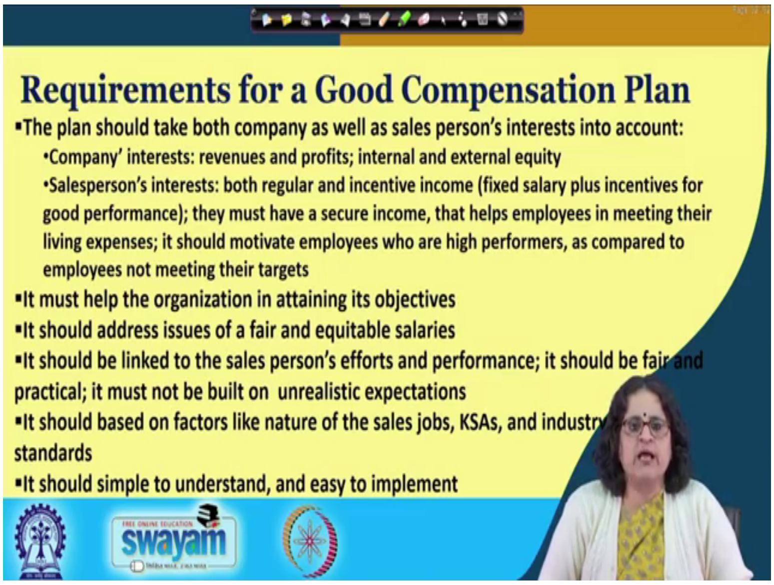

So, what are the requirements of a good compensation plan? So, it should take into account you know both company as well as sales persons interests, I just said that the company interests lie in revenues profits. And it is very important that companies are sure you know that sure such compensation plans and they design such compensation plans they assure their workforce with such compensation plans which can be perceived as equitable.

So, issues of internal and external equity become important. With reference to sales persons interests, sale persons are always and always would be keen on both a regular you know income as well as an incentive income. So, a sales person interests lie in a steady flow of income every month as a fixed component something which is very regularly paid monthly basis and an incentive income which is something which is paid on the you know based on their productivity and performance levels. So, what we are speaking off is a fixed salary plus incentive for good performance.

And the sales persons must feels that he has a secure income that would help him meet his living expenses, it should also motivate employees who are high performers as compared to employer employees who are not meeting their target. So, here when we are talking about sales persons in interest and the incentive, it is important that he you know feels that yes because, he is doing good work he has to be rewarded and he must be rewarded and the company is rewarding him with commissions, bonuses, incentives etcetera which is being paid to him and not to others because the others are not performing well.

Of course, the bonus is something which is generally paid to everybody in the organization if the organization earns profits, but components like incentives and commissions are something which should be paid to high performers and you know it through motivate employees who are on high end performance as compared to employees not meeting their targets.

So, so this is again. So, here what we are talking off is that the plan should take care of both the sales persons interests as well as the company's interest. Company's interest in terms of sales and profits and then a company has to take into account that it you know can assure perceived internal and external equity for the sales force.

And the sales persons interest here lies in both a regular flow of income as well as a variable component in the form of incentives and commissions, which will keep him motivated you know and we will feel that yes because he is a high performer he is paid more as compared to employees who are not meeting their targets. Also good compensation plan must be something which helps attain objectives of the organization. As I said it should address issues of fair and equitable salaries, it should be linked to the sales persons efforts and performance very it should be fair practical it should not be built on unrealistic expectations

Again based on the nature of the job and the knowledge skills and abilities required as well as the industry standards, you know the compensation package must be designed. So, it should be based on factors like the nature of the sales job, the knowledge skills and abilities required as well as the industry standard. So, industry standards were again here imply the you know perceived external equity for the salesperson. Also the compensation plan should be such which is simple to understand and very very easy to implement.

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Now, how do you go about devising a good compensation plan? We have these various steps which we will be discussing. So, we start with how do you first define the sales job, study the company's general compensation structure, study the compensation patterns in the community and the industry, determine the compensation level provide for the compensation mix and the elements.

And make provisions keeping in mind the unusual needs and problems face faced by the company, consult the existing sales force, I prepared the tentative plan pretest date, revise the plan if required and implement the plan and follow up. So, these are the various stages which would help develop a good compensation plan let us discuss these stages one by one

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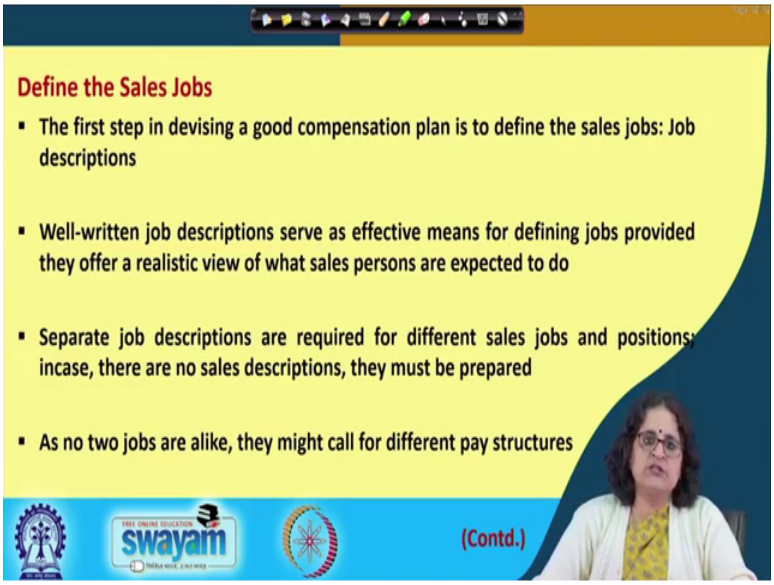

The first important thing here is to define the sales job. So, you know here when we define the sales job what we are typically speaking off is the job description. A well written job description serves as an effect effective means for defining jobs, provided they offer a realistic view of what the sales person is supposed to be doing. Separate job descriptions must be prepared for different sales jobs and positions and in case there are no sales descriptions, the first thing that the company must do is to prepare you know job description.

As no two job roles are alike they make name they will call for different pay structures and its so, it is essential that a job description is you know is done and it may also have to be followed by you know job evaluation, when it would come to determining the relevant worth of a job so, that the pay structures can be you know con decided accordingly. This is because no two sales jobs are alike. So, they would have to this would have this would mean different pay structures and different pay structures again would mean an exercise on job description and job evaluation.

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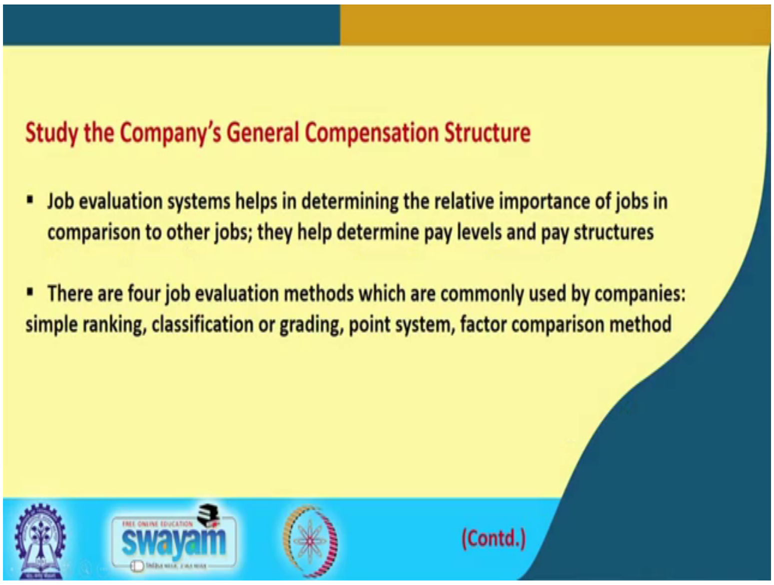

The second is a study the company's general compensation structure now, we all know that you know people in the sales force or in the marketing in sales team are you know you know paid differently then what other people in the organization are paid now. While, this fixed component may not vary that much what varies is in terms of the incentives the commissions, the perks and they are the kind of fringe benefits that the sales team enjoys.

So, the broad compensation structure being offered to all the employees in the organization irrespective of departments across the organization; has to be kept in mind else you know the people in other departments may feel antagonized. Yet provisions have to be made for the marketing in sales team and so, first what we start with is the company's general compensation structure and then we move on to make special provisions for the marketing and sales force.

So, the job evaluation system here helps in determining the relative worth of the job in comparison to other jobs, they would help in determine the pay level and the pay structures and there are four different kinds of methods which may be used for job evaluation. Simple ranking classification or grading point system and the factor comparison method.

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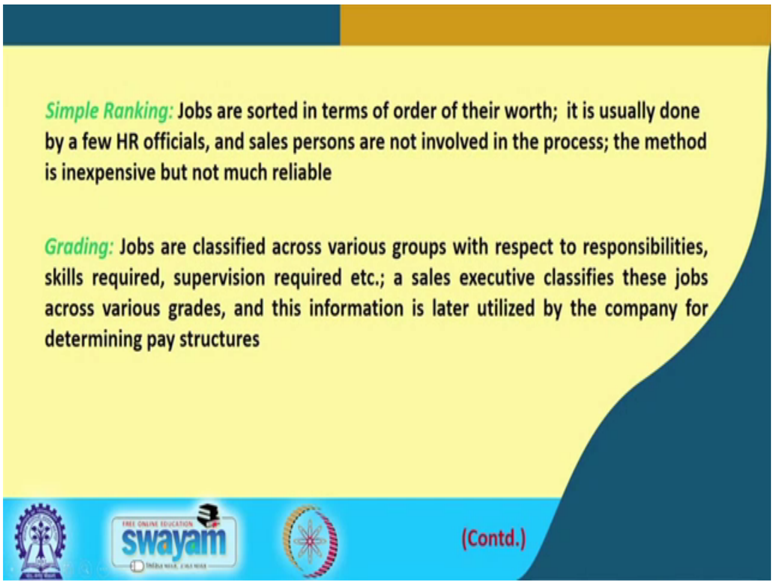

So, we first have the simple ranking where jobs are sorted in terms of you know their worth and it is usually done by a few HR people and sales persons are generally not involved in the process at all. The method is inexpensive it is you know it is something which would be done quicker and with lesser costs, but it is not much reliable.

The second method which can be followed to for job evaluation is grading where jobs are classified across various groups with respect to the you know responsibilities that one would have to you know in you know take the skills required the supervision required etcetera and so, the sales executive here would classify these jobs across various grades. And this information would be later used by the company for determining the pay structure.

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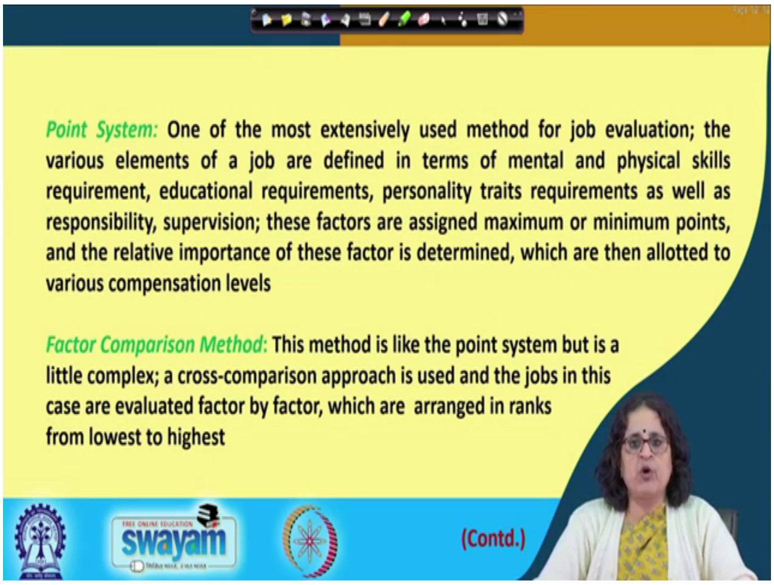

The third is a point system, one of the most extensively used methods for job evaluation, the various elements in a job are defined in terms of the physical skills required, the mental skills required, the abilities the educational requirements, personality trait requirements etcetera and as well as the responsibility supervision. And all these factors are assigned minimum or maximum points and the relative importance of these factors is determined which are then allotted to various compensation levels.

So, the various you know elements are graded and points are given to them and the relative worth of a job is determined. And then we have the factor comparison method where it is like a point system, but it is more complex across comparison approach is used and the jobs in this case are evaluated factor by factor and these are arranged in ranks from the lowest to the highest. So, these are four different methods which may be used to assess the relative importance of the job or the relative worth of the job or what we refer to as job evaluation

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Thereafter companies must study the compensation pattern in the industry. Now the compensation for salesperson is never decided in isolation it is always affected by you know the supply and demand of my trained manpower or the you know the kind of manpower which would fit into the job role in the in the industry.

So, the compensation level is affected by the supply and demand of you know trained manpower or manpower with necessary cases to fill those job requirements in the industry. he supply and demand here would determine whether you need to pay more or you can be something you know you can manage with paying just in the you know as the average levels.

So, the management of the company must analyze as to the kind of compensation systems that prevail in the industry, and the average compensation for similar jobs being offered by the companies in the industry and they must then take another decision to match to lead or to lag. And of course, they must also take into account the advantages and disadvantages of each of them you know whether you match with the competitors in the industry or you lead and pay more than other companies in the industry or you know you know lag and pay less than other people in the industry.

So, you know you have to basically see whether you will match or you will lead or you will lag. Now, in case there is an inequity in the pay scale offered by the competitors, they would be a higher probability of attrition by the sales force would then you know leave your organization and go and in join the competitors are organization especially the computer is paying more.

So, it is very very essential that the compensation pattern in the industry is analyzed one to two to assess the demand and supply of manpower in the industry and accordingly determined you know whether you must pay more to attract the scarce manpower the scarce trained manpower or the scarce manpower with the cases required cases or you need to pee you know you could you can afford to pay the average what is being paid.

And of course, then you must also keep in mind above and decide on whether what the competitors in the industry are paying and whether you would want to match with them or lead and pay more or lag and pay less.

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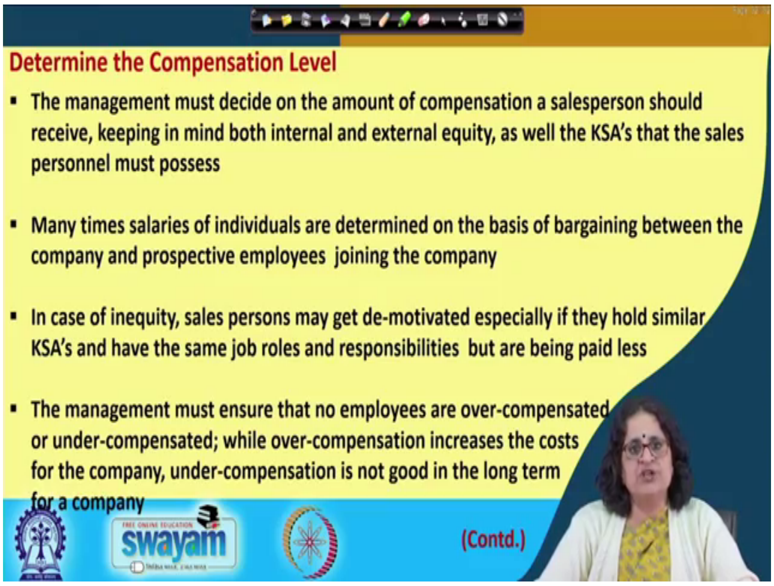

Now, thereafter you determine the compensation levels the management must decide on the amount of compensation a sales person will receive, keeping in mind both the internal and external equity as well as the knowledge skills and abilities that a sales person must possess. Several times there is always a bargaining or a negotiation that takes place between companies and the prospective employees, but it is to be noted here that in case of inequity sales people may get de motivated and especially their old similar cases and have the same job and responsibilities, but are being paid less.

So, issues of internal and external equity need to be taken care of and management must always ensure that no employees are over compensated or under compensated. If they are over compensated it would mean increase in the cost for the company and if they under compensated it is again not good in the for the company in the long run, because some people the attrition rate will be very very high and people will sooner or later leave the organization for greener pastures.

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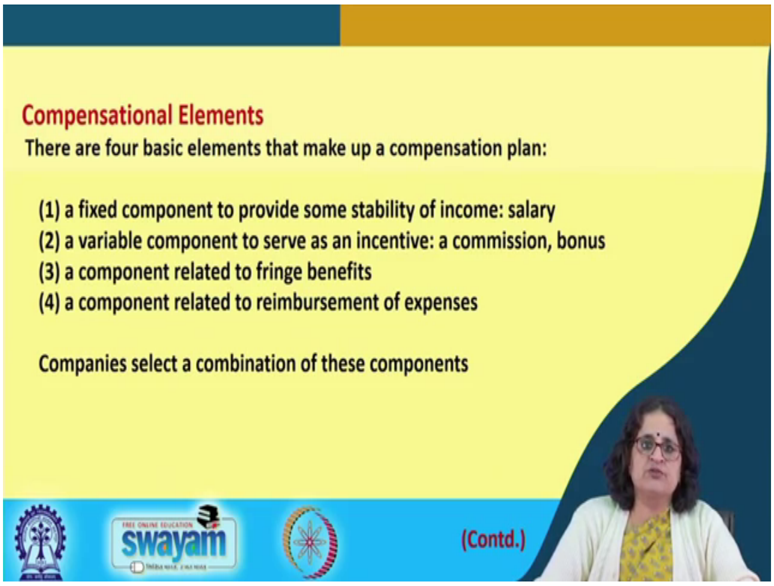

Thereafter you know the company has to decide on the compensational elements, there are four basic elements that make up a composition plan the fixed component which provides some stability of income every month which is a salary, the variable component which serves as an incentive which could be a commission or a bonus or in the another component which is related to fringe benefits and a component which is related to reimbursement of expenses. So, companies have to select a combination of these components, when they design their compensation package or the compensation structure.

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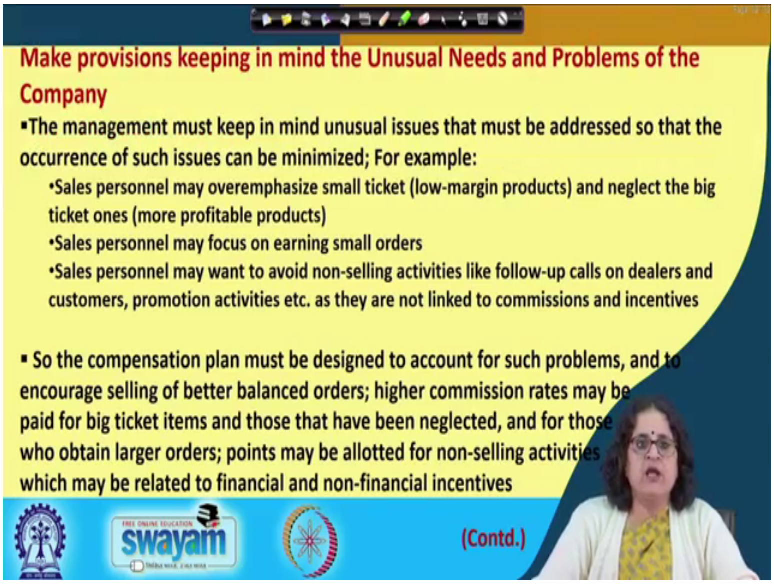

Of course a companies also have to keep in mind the unusual needs and problems of the company, you know and accordingly they must adjust you know the pay structures. For example, they you know one commonly faced problems by organizations is the sales persons may overemphasize you know upon selling, small ticket items and may ignore the big ticket ones now.

The small ticket items are easier to sell because they are you know inexpensive compared to the big ticket items, but small ticket items also a low margin products which would mean that high margin high margin products may get neglected. And, this may you know be at an it for this may be something which can which competitive with the competitor companies can take advantage of. So, this is one problem which companies often face another problem which companies face is that sales people prefer earning small orders.

Now the small orders in case of several small orders you know by several salespeople this would mean that the transaction costs increase and are very very high. So, this is something which again is a problem that instead of seeking higher orders or large orders they earn small orders. Now, why difference in high and low high and small orders is because small orders are easier to obtain as compared to large orders or higher orders, but they come, but the transaction cost you know associated with small orders are you know is something which is very very high as compared to you know high orders or large orders.

Another problem which is persons you know which companies face is that the sales persons want to concentrate only on selling activities and to do not and they want to avoid non selling functions. So, or non-selling activities because the selling activity is lead to you know commissions and incentives and non selling activities may not give them that opportunity. So, they would want to avoid non-selling activities like follow up calls or dealers and customers or promotional activities etcetera as they are not linked to the compensation plan.

So, the compensation plan must be designed in such a manner. So, as to account for such problems and to encourage selling of better balanced orders, high commission rates may be paid for big ticket items and those that have been neglected. And, for those you know who obtain larger orders you know more points may be given higher commissions may be given. Points may be allotted for non selling activities again to encourage people to come to concentrate on both selling and on selling activities, and these points may be later you know converted into financial and non-financial incentives.

So, these are things which people which the sales executives and the hr team must a to take into account while, they are designing a compensation package for a for us for a sales executive and for the sales team.

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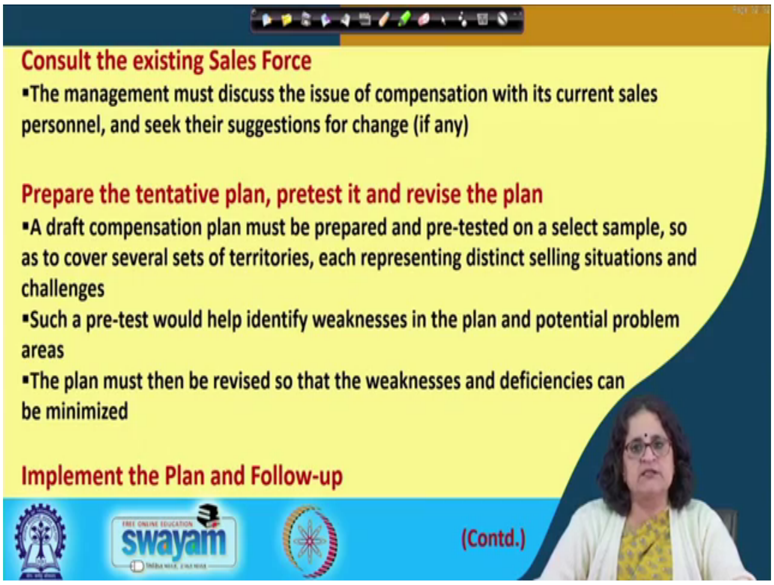

Thereafter a company's consult the existing sales force, they discuss the plan with them, seek suggestions with respect to changes that should be brought about in the compensation plan. They prepare the tentative plan they pretest it and they revise it in case you know there are problems of implementation. Now draft compensation plan must be prepared and pre tested in a small sample so, as to cover a very small set of territories each representing distinct selling situations and challenges.

And this such a pretest would help identify weaknesses in the plan and potential problem areas and these the plan must then be revised. So, that the weaknesses and the deficiencies can be minimized and then the company would implement the plan and follow up with it.

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Now, before we close we will discuss quickly the types of compensation plans, we have three different types of compensation plans one is a straight salary plan which is the simplest of all where the salesperson receives a fixed amount of money at regular intervals, and the entire salary is a fixed component it is not at all performance linked. So, you know the method is suitable for sales trainees were new to the job and I have not yet started you know performing well or giving good returns to the company.

So, in this case a fixed salary goes to them every month of course, as and when they grow you know they begin to you know perform and you know they begin to get on some experience, of course, at that time companies must revise and you know and they must also think of other incentives. But here in this particular case where the sales trainees have to be paid the simplest compensation plan which is the straight salary plan is something which is which is very very suitable.

Advantages are the method is easy to use understand, implement and it provides a secured income to the sales force and it is there is all there is there is you know freedom from any kind of financial uncertainties. But, the disadvantages are the people may prefer to be average performers, then being higher on productivity they have no motivation, they would have no motivation to work harder to earn more to so, that they can earn incentives. So, the method fails to also the method fails to reward outstanding performers or penalize people who are low on performance. So, high performance may sooner or later lose interest, high performers may lose interest and they may lose enthusiasm and motivation.

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The second is a say straight commission plan, which is based entirely and entirely on productivity and performance. So, the productivity of a salesperson is the only parameter which will determine his salary and determinant here is sales volume of profitability and the commission rate, will be a percentage of the sales or the gross profit. And the commission rates would vary with sales volume levels which are determined by the company, and these will again vary across products. So, commission systems are become very complex when they are different commissioner differential commission rates for different kinds of products or for different customers or for different territories or for different kinds of selling situations.

And the advantages of the method is it leads to huge amount of motivation among sales people and this would result in sales and profits, but the disadvantage is that people may ignore non selling activities because non selling activities generally do not get linked to incentives and to commissions. Now there are two formats here a straight commission which sales people managing their own selling expenses and a straight commission with the company paying the selling expenses.

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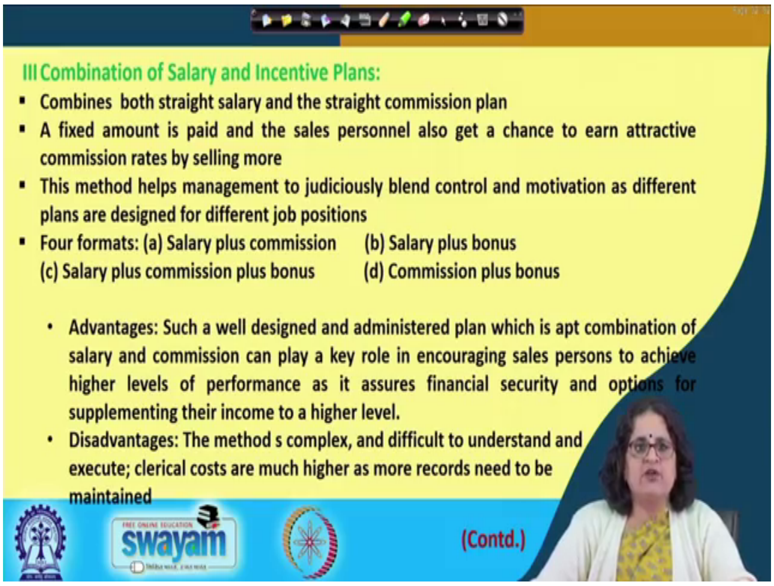

Then we have the combination of salary and incentive plan, which combines both and there are four formats here which is the salary plus commission, salary plus bonus, salary plus commission plus bonus and commission plus bonus. Now, bonus here is something which is you know given to employees as a group, as an employees in the organization, when they do something more than what has been desired from them. So, this particular method helps management to blend control and motivation as different plans are designed for different job positions.

A fixed amount is paid and the salespeople also get a chance to earn commissions by selling more. So, advantages are that it blends together the advantages of both the salary and the incentive plan and it shows financial security to the people, it also gives them an opportunity to earn commissions and which they can you know supplement their income to with. Disadvantages are that the method is highly complex and difficult, it will be difficult to understand and execute clerical costs also increased because lot of records have to be maintained.

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Finally we have the bonuses and the fringe benefits. The bonus here depicts an amount which is paid for completing a specific sales task an additional financial report which is paid by the company to it is employees for achieving or performing effectively performing tasks like reaching sales targets, earning new customers carrying out non selling activities etcetera, and such that the organ to of there is an overall benefit for the organization.

And fringe benefits are which benefits which companies use to attract and retain sales force which may be statutory and lower bound or they may be non statutory and these would include social security measures, paid holidays, club membership medical insurance, children's education etcetera. Of course, there is no direct relationship between the fringe benefits and job performance.

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So, with this we come to an end of this session, these are the references.

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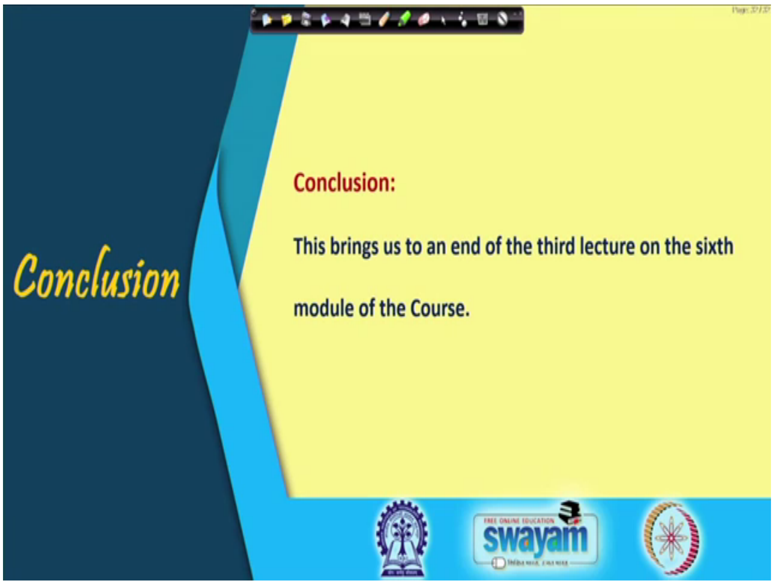

And so, we conclude with the third lecture on the sixth module of the course.

Thank you.