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Increasing Sales Performance Levels by Means of Value-based Remuneration From Sales Hunter to Customer Value Manager

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Management Summary

Sales is the decisive driving force behind success in the company. The launching of new products or a process of international expansion are doomed to fail without efficient Sales. The traditional management of Sales stands in marked contrast to the actual meaning. Although sales bonuses etc. cause massive mismanagement and frequently only lead to product values being destroyed, people still have great faith in these mechanisms.

The prerequisite for a power sales department is a remuneration system that provides the right incentives. The solution is to be found in the development of a value-based remuneration system which takes account of the correcting variables and which is directly linked to an increase in value within the company.

Sales resources are all too frequently wasted in activities that do not add value. It is necessary to identify the profitable customers from an overall company perspective. This helps to ensure sales resources are not directed at customers that do not offer value potential and Sales focuses on gaining and securing profitable customers.

Wrong Sales Incentives

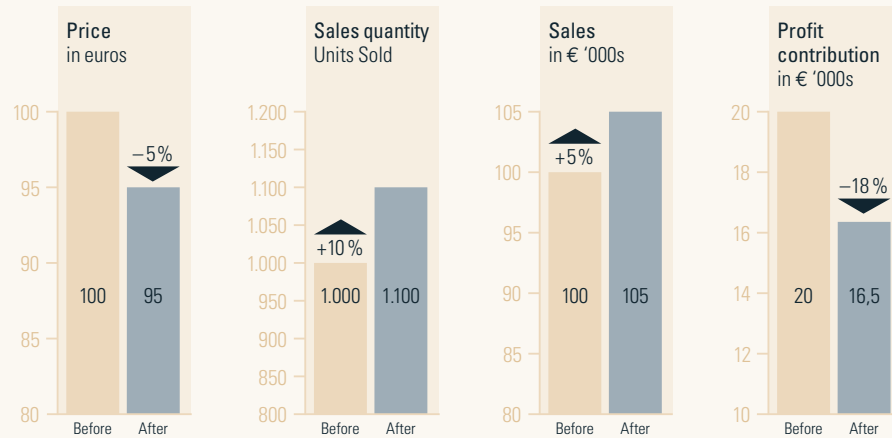
The modern structuring of remuneration systems in Sales is being debated in a lot of companies. The remuneration systems are too often based on classic sales commission. The sales figure, either per employee or per product, is the most frequently used target value at more than 50 percent in the sales field services of German companies.

Sales-based remuneration systems set the wrong incentives or just short-term incentives.

In the short term the overall sales levels are indeed generally ok, but in the long term the results as well as the product and customer structure do not develop satisfactorily. Sales concentrates on established products and customers whilst new products that require an intensive amount of consultancy, which offer higher margins, are not marketed sufficiently. The case example of a sales manager in the food industry whose bonus was solely based on increases in sales demonstrates what this mismanagement can lead to in an individual case. The sales manager managed to greatly increase the levels of market share in the very competitive German food retail trade and was highly rewarded for doing so. However, the price the company paid for the high levels of growth was high. Unprofitable orders were not recognized due to a lack of transparency and in the end the company had to be sold due to its massive liquidity problems.

The example of a 5 percent price reduction clearly demonstrates that vast values were destroyed despite increasing turnover by 10 percent and sales by 5 percent: In the case of a profit contribution of 20 percent the profit contribution would fall by 18 percent. The price reductions had not paid off from the company's perspective. Even if sales representatives do not make any price-related decisions other "expensive" levers are operated to induce the customer to buy. The consumer goods industry is an example of this where the sales departments offer discounts for large batch sizes and simultaneously offer the customers several smaller deliveries on the quiet and thus cause higher logistics costs.

Example of an operating results loss due to sales-based commission systems:



Contrary effect: A reduction of price of 5 percent does indeed lead to increases in sales and turnover but the profit contribution collapses.

Define the Right Basis of Performance for Sales

Basic principle:
Direct participation in
company's success

An effective remuneration system in Sales motivates staff to act in an entrepreneurial manner. A successful example of this is franchising: Companies like McDonald's or Obi are based on the adoption of an existing business model by an independent entrepreneur. He very frequently manages the company to above average levels of growth and profitability. Obviously this business model cannot be transferred to every company. However, the basic principle of direct participation in the company's success can be applied in all industries: An ideal remuneration system turns the sales staff into joint entrepreneurs.

The decisive thing is that corporate success is specifically defined for Sales. Value drivers must be to the fore which can directly influence Sales and which are simultaneously directly linked to the enterprise value. The integration of yield components such as a profit contribution or operating results and of asset components that can be influenced such as accounts receivables or inventories is a must in this process. Ideally these components will contribute towards added value (e.g. EVA®) of the company or the business division combined. In this way Sales thinks in a company value-based manner and products are not primarily sold on the basis of the price. Unprofitable sales are terminated and the lever of terms of payment will also be taken into account more.

Specific definition of company success for the sales section

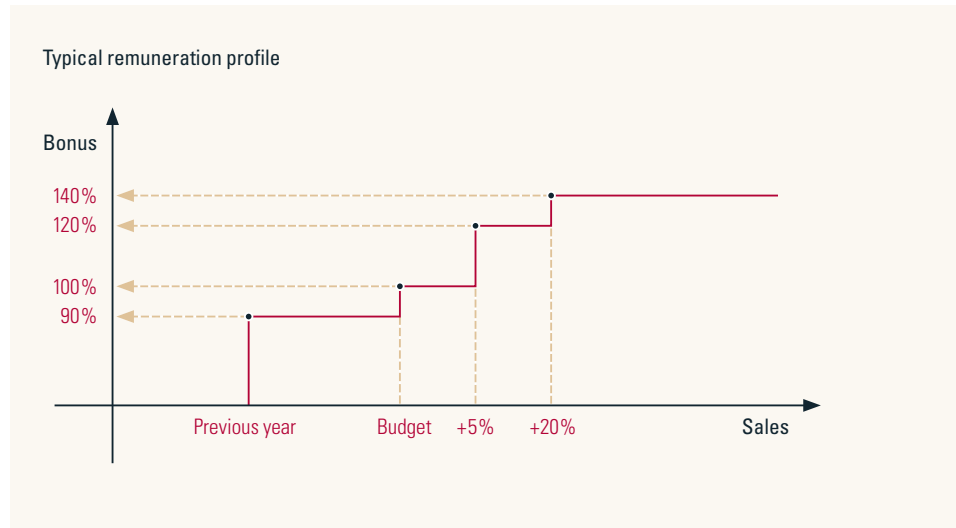
Gross sales – Sales reduction (discount) = Net sales – Costs of materials – Manufacturing costs = Profit contribution I – Costs that can be directly allocated • Sales costs (Wages, expenses, communication) • ... = Profit contribution II	Asset items that can be directly allocated Accounts receivables + Inventories = Invested capital Profit contribution II – Capital costs (Invested capital + cost of capital rate) = Value-added / EVA®
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Superordinated division and company goals can be integrated within the basis of performance by means of a combination of goals. As regards the additional personal goals individual focal points can be set in order to secure the company's future success in particular. Examples of this are customer satisfaction or the sale of new high-yield products to improve the customer focus and the product customer mix and secure future successes.

Set ambitious Goals

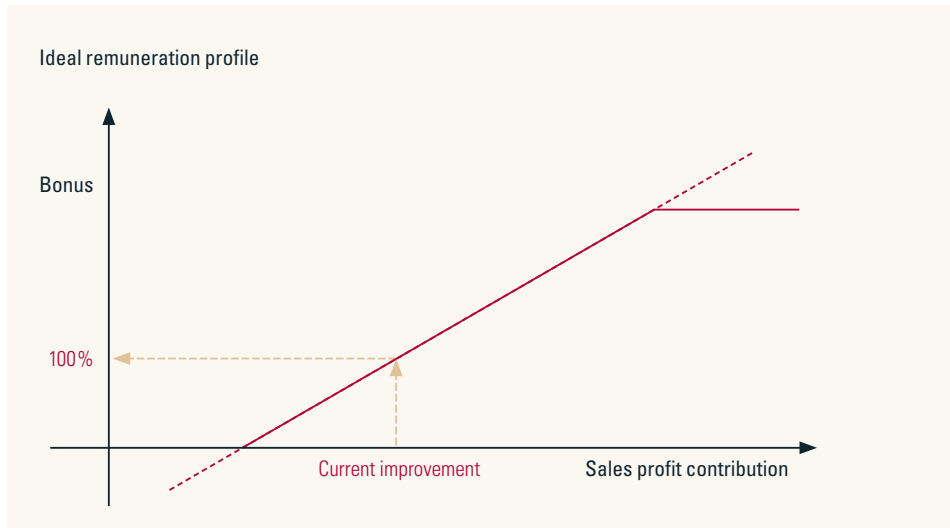
In addition to the correct basis of performance ambitious goals are decisive to ensure the success of the remuneration system. Commission, whereby the amount of the bonus is directly related to the basis of performance, is widespread because it is very simple to implement. The sales representative receives a percentage X of the profit contribution or value-added as a commission fee. The bonus amount the representative receives is directly dependent upon his performance and the market and competitive situation. The target bonus is reached differently if all the targets of the target bonus are reached in the case of a bonus system/target bonus system. The advantage of the bonus system compared to the commission model is that specific target specifications are laid down and different types of targets can be combined with one another. This applies especially to the personal targets which the sales representatives cannot directly participate in such as customer satisfaction or the number of new customers.

Promote the Company Incentive Effects



Massive mismanagement due to traditional bonus systems

The assessment of the target achievement in the case of the bonus system can be based on the linear, progressive, declining or step by step course of the bonus line. The latter has the disadvantage that marked disincentives can arise at the cut off points. In the example shown 90 percent of the bonus is paid if the sales levels of the previous year are reached. No bonus is paid if this goal is not reached. That's why the sale representative will try to generate additional sales at "any price". The price for this is generous discounts or terms of payment and thus frequently unprofitable sales. At the subsequent steps sales will be held back if the next step no longer seems feasible. For instance the marketing department of a garden appliance manufacture in a sales region greatly reduced their sales from October until December once the annual targets had already been reached. The steps in the remuneration profile thus lead to marked mismanagement.



A value-based remuneration profile does not use steps in the bonus line and an upward or downward limit. All the plausible target achievement factors are calculated using the bonus column function. The essential benefit is that additional business is generated even if the target is surpassed because Sales has a participating interest in the additional operating profits. In the case of demanding targets the bonus line should progress very steeply whilst they should be flatter in the case of targets that are easier to achieve- If the capping of the system is desired this should be employed too early on.

Value-based remuneration promotes entrepreneurship

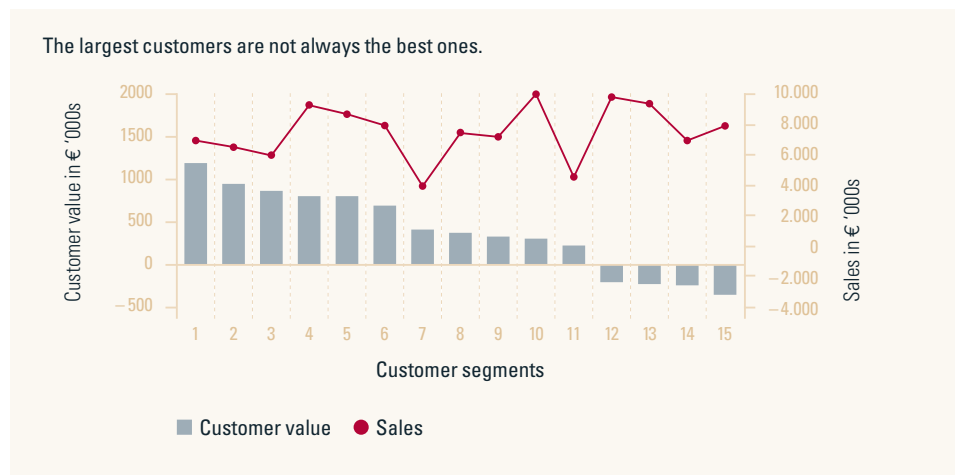
In addition it is possible to combine long-term remuneration with virtual bonus pots or a bonus bank. In this case portions of the bonus calculated are initially retained and only paid out for instance in the following periods if the targets are attained in a sustained manner. Bonus banks are used especially when bonuses are already paid during the year and the annual levels of profit are not yet certain. This procedure ensures that short-term successes do not jeopardize the company's long term success.

It is essential that the remuneration is actually variable to ensure a successful remuneration system. In this case part payments and guarantees stand in marked contrast to the corporate incentive system.

Placing Customer Value before Sales

Focusing of
Sales activities

The most faithful customers are not automatically the best customers. If the sales are based on the frequency they visit there will be spreading losses in terms of sales' employment of resources. That is why the necessary information must be available to ensure the right targets are set. The starting point to this end is a powerful Sales Controlling which helps to identify those customers which create the greatest value for the company. With the aid of a customer profile a targeted decision can be made as to with which customer segments and categories the company can achieve its value-added target in the future.

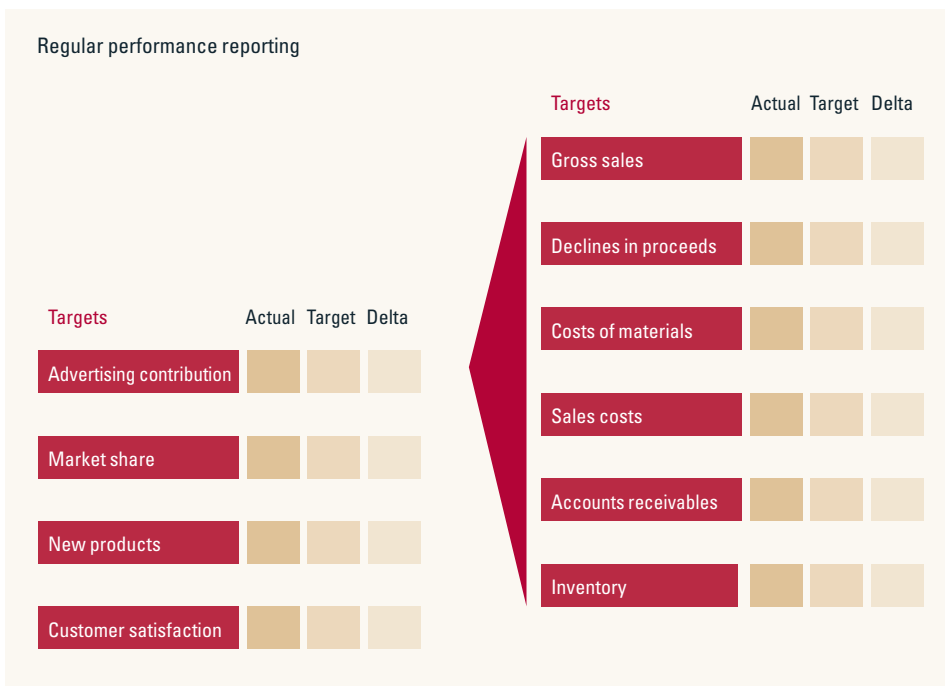


Attractive customer segments are characterized by the fact that the company can also realize the customer value in this case – and are thus ideal conditions for a growth strategy. Important actions comprise the use of areas of cross-selling potential, increasing levels of customer loyalty and extending the offer, e.g. by means of after-sales offers. Customer relations with a fundamentally low level potential value should only form a part of the target portfolio if the competence is so marked to ensure an improvement vis-à-vis the competition that customer profit contributions can be generated despite the difficult market environment. Customer relations that are unprofitable in the long term should be consistently dispensed with. Instead the Sales resources can be focused on customer relations with greater potential.

Reporting and Communication secure Success

The essential requirements for the acceptance of a new remuneration system are high levels of transparency and its low levels of complexity. Sales Controlling must be able to regularly inform Sales about the extent to which the goals have been attained.

The performance-based remuneration should be recorded in as timely a manner as possible. The frequency of the settlement dates differs depending on the industry ranging from monthly to quarterly to annual settlement. In the event of a monthly settlement the volatility of the payments, due for instance to seasonal fluctuations, should be taken into account in the development of the company's business. In this case a bonus bank can function as a compensation account: In this process only a partial amount is immediately paid out from the monthly bonus and the rest is paid in the following months.



The precise representation and explanation of the system to sales staff is decisive with regard to the acceptance and thus the success of the new system. Above all the executives in Sales should be trained to enable them to apply the new control tool. Using simple calculation models the sales representative can simulate what influence the new remuneration system has upon his personal income situation and what individual steps are necessary to increase his income.

Sufficient communication is decisive to ensure success.

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