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Effective incentive compensation for sales employees during tough economic times

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Sales employees are important contributors to the financial performance of many business organizations. Consequently, sales and human resource managers invest financial and other resources to effectively motivate and manage their sales workforce. A common mechanism managers use to bolster salespeople performance is incentive compensation programs. These programs provide sales employees with the opportunity to earn rewards based on sales performance. Incentive compensation programs also build a mutually beneficial relationship between the company and the salespeople because incentives align the organization's goals with the salespeople's goals.

Although sales incentive compensation programs are ubiquitous among organizations, the design and implementation of these programs differs along several dimensions, such as the type of rewards (e.g., cash or non-cash), the variability of the incentive (e.g., flat or tiered), the performance measures used to administer the rewards (e.g., customer service or sales), and the flexibility of the reward scheme (e.g., standard or customized). Therefore, it can be a challenge to implement an effective sales incentive program.

In times of economic recession, the importance and the complexity of managing incentive programs are exacerbated. A recession is characterized by a slowdown of economic activity translating into a reduction of demand for goods and services. During periods of market contraction, businesses sometimes tend to shift focus from sales growth and expansion to cost reduction and savings. This situation complicates decisions regarding incentive compensation programs. On the one hand, incentive compensation becomes more important because the company needs sales employees to sell more; on the other hand, budget cuts jeopardize the viability of incentive systems. Therefore, it becomes increasingly important to understand which types of incentive programs are most effective so that they can be justified and perhaps modified to improve their effectiveness even during difficult economic conditions.

We reviewed and summarized academic and practitioner articles on sales incentive compensation that were published in the last 40 years in order to identify a concise but comprehensive list of recommendations for the design and management of sales incentive compensation programs during tough economic times.

OUR ANALYSIS

We conducted a literature review that started with an electronic search of potentially relevant literature related to the topic of incentive compensation for sales employees. We performed computerized literature searches on Business Source Complete, PsychInfo, and PsychARTICLES using keywords such as sales compensation, incentive plans, and motivation and reward of salespeople. In addition, we searched the ProQuest dissertation database for unpublished doctoral dissertations using the same keywords. Our search yielded over 2000 documents including articles, books, and dissertations.

Based on the abstracts, we identified the documents that appeared to be related to incentive compensation for sales employees. Cross-referencing was also used to identify additional relevant articles and books by looking at the literature cited in the reference lists of chosen articles. The result was the identification of 90 research articles, 15 practitioner articles, and 27 books. Finally, we used a modified Delphi technique by having a group of experts discuss and identify recommendations of managerial interest regarding the management of incentive compensation programs for sales employees under times of economic recession.

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We organized our review and analysis of the sales incentives literature in terms of five areas of recommendations relevant to the design and management of sales incentive programs in times of recession. For each area, we evaluated the advantages and disadvantages of various types of sales incentive compensation programs. To the extent possible, we drew conclusions and recommendations that have implications for organizations and managers of sales personnel.

RECOMMENDATIONS FOR SALES WORKER INCENTIVE PROGRAMS

Use sales incentive programs

In times of economic austerity, human resources and sales managers are pressured to implement budget cuts that impact compensation programs (e.g., salary freezes and incentive reductions). For example, in 2009, Watson Wyatt Worldwide (currently Towers Watson) surveyed human resource and sales executives at 91 U.S.-based companies regarding company measures to confront the economic downturn. It was found that 51 percent of the companies responded by reducing salesforce headcount, adjusting rewards and incentive programs, realigning sales territory, and balancing sales goals.

In our review we found that despite the economic pressure, managers should continue to commit to sales incentive programs. A robust body of empirical findings across diverse industries indicates a strong positive relationship between sales incentives and sales worker productivity. Although this relationship is somewhat stronger for manufacturing than service settings, on average, sales incentives increase sales workers' performance by 17 percent. Thus, managers should strive to maintain and reinforce these incentive programs in times of recession because salespeople's performance translates into revenue that is a necessary component of business survival.

Maintaining sales incentive programs also reduces the risk of losing top sales performers. Research suggests that top sales performers are valuable both for their financial and non-financial contributions to the organization. Successful sales agents not only sell more, they also inspire and educate their peers, and develop strong networks of relationships between the company and customers. When there are reductions in incentive compensation programs, top sales performers are the most affected because incentives can be a substantial part of their income. The reduction or elimination of such incentives can drive top sales performers to look for job opportunities elsewhere. Therefore, management's commitment to sales incentive programs is critical in retaining top sales employees.

Use cash incentives

Incentives can include cash and non-cash rewards. Cash incentives include salaries, commissions, and bonuses. A salary is a fixed amount of pay that is not dependent on sales. Commissions are calculated as a percentage sharing of the revenue from each unit of sales. Bonuses are calculated as a percentage of pay or set dollar amount for attaining specific results (or goals). Managers can offer any of these cash incentives or combinations of them.

Studies show that cash incentives are extrinsic aspects of the job that positively influence salespeople's performance and retention. Monetary rewards are effective incentives for at least two reasons. First, cash incentives help salespeople maximize their self-interest. According to agency theory, the goals of the owners of the organization and sales employees differ. The owners seek to maximize long-term profits while reducing cost. Salespeople seek to maximize their income. Thus, cash incentives are effective motivators of sales employees' behaviors. Second, cash incentives are flexible in that they can be used to satisfy diverse material and/or psychological needs and achieve specific personal goals. Consequently, cash incentives increase employees' feelings of satisfaction, achievement, status, control, and power.

Hence, human resources and sales managers should consider cash incentives. Moreover, research shows that these incentives are more effective when one or more of the following conditions exist: a company is highly dependent on their salespeople's expertise, salespeople's intrinsic motivation is low, salespeople are experts, salespeople are risk takers, and expected sales volumes are variable.

Consider salary plus commission

In times of economic recession, a greater emphasis on salary plans rather than increasing commissions or bonuses may be a better option to spur salespeople's performance.

A common measure that sales managers undertake during economic hardship is to revamp commission programs. The rationale for this choice is that sales commissions are likely to motivate employees to work harder while maximizing the company's resources. However, our review shows that under challenging economic environments, base salaries should not be decreased. A stable base salary can be more effective in motivating salespeople than increases in commissions and bonuses, because economic downturns increase the level of market uncertainty. Under this condition, sales employees feel less confident about reaching their sales goals and, consequently, less confident about their future income. A greater incentive to base ratio provides sales employees with certainty and stability about the future and provides a sentiment of company's commitment to their employee. Social exchange theory suggests that when employees feel that the company cares for them, they tend to reciprocate by becoming loyal and engaged.

Set achievable goals

When companies opt for a combination of base salary and commissions or bonuses based on sales performance, managers should assess the appropriateness of employees' sales goals. Based on expectancy theory, vast research shows that salespeople's motivation for a specific course of action is determined by the expectancy that effort will lead to performance, the instrumentality that performance will lead to various outcomes, and the valence or value they place on the outcomes. That is, commissions or bonuses based on sales performance are effective when salespeople estimate that their efforts will result in enough sales to obtain a valuable reward. In addition, goal setting theory would suggest that commissions or bonuses based on sales work best when sales goals are clear and moderately difficult. Moreover, offering high commissions and bonuses in volatile markets can backfire to the organization. Research shows that offering high commissions and bonuses for achieving high goals increases salespeople's stress and discourages salespeople from attempting to reach the goals. Although moderate levels of stress can motivate salespeople, high levels of stress do not increase salespeople's performance.

In short, managers should align commissions and bonuses with realistic and attainable sales goals that reflect the current economic environment. For example, a study by Deloitte — one of the Big Four professional services firms — shows that in 2009 companies in the pharmaceutical and technology sectors had to reduce their sales quotas because the economic crisis made it difficult for sales teams to meet their sales goals.

Choose the mix of flat versus tiered plans

Managers should also evaluate whether to offer flat or tiered cash incentives. Flat incentives (linear plans) are constant incentive rates paid for all levels of sales. These plans are easier to implement, require less monitoring, and need less record keeping. Flat incentives, however, are not necessarily effective in motivating salespeople to exceed their sales goals. Flat incentives are more effective when the setting of sales goals is difficult, and market conditions are uncertain (e.g., start-ups, high volatility).

Tiered incentives (non-linear plans) are ramped with progressive and/or regressive rates that vary depending on the levels of sales. With a progressive tiered incentive, the rate of compensation increases with higher levels of sales. This plan motivates high levels of sales volume. However, this plan may encourage salespeople to engage in heavy discounting by offering low prices for large volumes at the expense of profit margins to meet product quotas. Progressively tiered incentives are more effective in predictable markets, well-developed businesses, and high sales volume contexts.

Regressively tiered incentives involve rates that decrease with higher levels of sales. These plans protect the company from overpaying salespeople. However, this plan is not as effective in motivating the sales force. Regressively tiered incentives are implemented when sales personnel have little influence over order size or profits and when large sales are common.

Combination plans include a rate that increases with the first number of sales and then decreases at higher levels of sales. These plans motivate salespeople to engage new customers and protect the company from overpayment. On the other hand, they are complex and require increased monitoring. Nevertheless, they are effective when salespeople are influential in closing a deal and future orders are expected to be large and steady over a period of time.

We suggest that, in times of economic hardship, businesses should implement flat rather than tiered incentive compensation programs. Tiered incentives increase high sales performance under stable and predictable market conditions. The uncertainty of a downward market decreases sales worker confidence in achieving higher sales performance, increases stress, and increases the likelihood of suboptimal (and unethical) sales practices to reach high sales volume.

In sum, cash incentives positively influence sales performance. Moreover, in times of recession, managers should not deemphasize fixed cash incentives (e.g., salary plans) in favor of variable cash incentives (e.g., commissions and bonuses). Furthermore, when commissions and bonuses are offered, these cash incentives should be aligned with clear and realistic goals, and should offer flat rather than tiered compensation rates.

Offer non-cash incentives

There is empirical research evidence that non-cash incentives such as non-monetary awards, performance feedback, recognition, and employee privileges, if well-managed, can be even more effective than cash-incentives. For instance, in the mid 1990s, Goodyear Tire & Rubber Company implemented non-cash incentives to reach 46 percent more in sales compared with cash incentives. Recently, the relevance of non-cash incentives is highlighted in a study of 291 companies conducted by Aberdeen Group in 2011. The results showed that companies that used non-cash rewards and recognition programs for their salespeople reported a 9.6 percent increase in revenue compared with a 3 percent increase reported by companies who did not use non-cash rewards. In the same survey, although 91 percent of the sales professionals indicated to be motivated by cash-incentives, 61 percent said that internal recognition for positive performance is also an important incentive.

Although a recent analysis by the Incentive Research Foundation shows that non-monetary awards such as travel, restaurant gift cards, and merchandize have a positive influence on sales, decreased waste, and reduced absenteeism, these awards can be costly. Hence, we focus our recommendations on less costly and highly effective options for non-cash incentives such as performance feedback, recognition, and employee privileges.

Provide performance feedback

Research shows that salespeople's performance increases when they receive constant feedback regarding their performance relative to other salespeople, as competition motivates them to reach higher goals. In fact, a research study indicated that performance feedback increased performance almost twice as much as a cash incentive (i.e., pay). In addition, the cost of providing feedback is much less compared with cash incentives. Thus, businesses should provide information about the performance of colleagues so that sales employees can be motivated by comparisons to their peers. Feedback sessions can also help sales employees to feel more appreciated and improve company performance, because salespeople can provide input about the company's products, services, and operations. Although some studies suggest that the time, source, and form of the feedback influences its effectiveness as a motivator, in general, performance feedback is a viable alternative to cash-incentives.

Recognize salespeople's accomplishments

Employee recognition is an effective non-cash incentive. Research shows that recognition is a powerful motivator of salespeople, able to increase performance as much as 24 percent. In fact, several studies demonstrate that salespeople consider instant personalized recognition as the most important reward. Furthermore, studies show that lack of recognition is the number one reason for salespeople seeking to leave a company. Hence, during hard economic times, managers should revamp their formal recognition systems to increase salespeople's performance as an alternative to cash-incentives.

Management can recognize salespeople's accomplishments in private or in public. Private recognition includes one-on-one acknowledgements of achievement. This type of recognition provides employees a feeling of accomplishment and self-realization. Public recognition involves acknowledgements of achievement that are displayed in public venues such as internal newsletters, plaques, recognition events, among others. Public recognition enhances the recipient's sense of prestige and status among their peers.

Grant employee privileges

Recognition can be combined with the granting of work-related privileges. Privileges are special permissions, arrangements, or benefits granted to employees who meet certain expectations. Research shows that many salespeople appreciate privileges such as flexible work hours or other work arrangements, job autonomy, and job variety. In fact, a study conducted by the Center for Talent Innovation in 2012 shows that young educated professionals value flexible work arrangements as the number one criterion for job choice. This finding extends to emerging markets such as Brazil, China, and India, where commuting time is a constant issue. For example, in 2008, HSBC bank implemented a flexible work arrangement program in India. After two years, the company saw productivity increase by 88 percent among employees who participated.

Effectively manage non-cash incentives

The implementation of non-cash incentive programs, however, is not a trivial task. Managers should remember that the value of non-cash incentives is often idiosyncratic to each sales worker. Not all salespeople value the same rewards, and not all salespeople value one reward to the same extent. For instance, research studies show that non-cash incentives are more effective for salespeople who are intrinsically motivated for the job and for salespeople at the start or at the end of their career, when productivity is not at its maximum potential, and other non-cash outcomes are more highly valued than in mid-career when financial needs are greatest (e.g., often due to family responsibilities). Thus, managers should carefully match non-cash incentives to the specific personal needs of salespeople.

In times of financial constraints, non-cash incentive programs are a feasible option to reward salespeople. To be successful, these programs should be customized. The effectiveness of non-cash incentives depends on management's ability to match these incentives with sales employees' characteristics, situations, and preferences. Customizing the non-cash incentive mix for employees, however, demands the allocation of more resources (i.e., time and personnel) to the management of incentive programs. At first glance, the implementation of non-cash incentives can appear to be burdensome. However, World at Work (formerly American Compensation Association) reported that effectively implemented non-cash incentive programs can achieve a return on investment three times higher than cash incentive programs.

Measure and monitor outcomes and behaviors

Sales incentive programs are tied to sales worker's performance. Sales worker's performance can be measured in two dimensions: outcomes (outputs) and behaviors (inputs). Outcome measures of performance include the number of products sold, the sales volume achieved in dollars, and the profit margin achieved. Behavioral measures of performance consist of monitoring sales process activities aimed to attract, keep, or retain customers. Behavioral measures attempt to control the process of selling (as opposed to just the outcomes) and to reward effort as well as results.

Outcome measures are common because the behavior of salespeople is often hard or costly to monitor directly, as salespeople usually control their own work and often work away from company premises. However, managers must decide whether the performance of salespeople is measured based exclusively on their output or whether their behavior is also factored in to some extent. Thus, managers should consider the advantages and disadvantages of each type of measure.

For instance, outcome measures are easier to monitor, provide a more objective basis for rewards, and motivate high performers. However, outcome measures do not always reflect effort, superior customer service, or long-term relationship building. Also, outcome measures may lead to undesirable salespersons' behaviors, such as selling low profit items or prioritizing sales over customer service. Nevertheless, outcome measures are often more useful when salespeople cannot be supervised, salespeople are experienced, profit margins are similar across products, and products do not differ in the time and effort required to sell.

Behavioral measures also have pros and cons. Studies show that behavioral measures give managers more control over the sales process, reward effort as well as results, reward less tangible aspects of performance, and direct people to adopt behaviors without having to convince them of their profitability. The negative side of behavioral measures is that they are not as closely linked to observable financial performance, are difficult to monitor, increase the managerial burden, increase subjectivity in evaluations, can create perceptions of unfairness and favoritism, reduce salespeople's autonomy, and may limit salespeople's creativity regarding the sales process. Behavioral measures are more effective when salespeople are new to the organization and there are monitoring systems (i.e., records) in place to monitor salespeople's behaviors objectively.

Several studies provide mixed results regarding which type of performance measure leads to higher salespersons' performance. Some studies favor behavioral measures by showing that behavioral measures will eventually translate into outcomes, while other studies show that outcome measures are preferred because behavioral measures are too expensive to monitor.

We recommend that in tough economic times, there should be a combination of outcome and behavioral performance measures attached to incentive programs, with a greater emphasis on behavioral measures. In bad economic times, salespeople may perceive it to be harder to meet outcome measures of performance and may reduce their attempts to reach outcome-related goals. In addition, when outcome measures of performance are emphasized, salespeople tend to develop a short-term mindset, focusing less on customer service, organizational image, and long-term relationships. In fact, Deloitte reports that in 2009, to face the adverse economic environment, pharmaceutical companies re-aligned their sales people's incentives and tied them to customer relationship management instead of transactional volume. This change was aimed at gaining customer loyalty that could potentially translate into sales growth once the economy recovers. The inclusion of behavioral measures as part of incentive programs motivates salespeople to perform behaviors that otherwise may seem unfruitful.

Behavioral measures should include monitoring activities that are directly associated with performance outcomes. Some authors call these activities "points of persuasion," which refer to the point during the sales process where the customer makes the commitment to buy. For example, in buying a new cable package over the phone, a customer may be more likely to commit to a purchase after signing up for a free trial. Therefore, the number of customers who sign up for a free trial should be monitored and rewarded rather than just the number of phone calls a salesperson makes during the day. The key to success of incentive programs based on behavioral measures is monitoring the right set of behaviors. Managers should monitor and reward behaviors that are directly conducive to profitable sales.

However, relying only on behavioral measures blurs the link between behaviors and outcomes. Thus, outcome measures should also be included as part of incentive programs. The preferred outcome measure to monitor incentive programs should be profit margins rather than sales volume, because sales volume does not always translate into high profits and may encourage bad selling practices (e.g., heavy discounting).

Individual versus group incentives

In addition to choosing performance measures, managers must decide whether to attach incentives to individual or team performance. Individual performance assesses whether an individual salesperson has met her/his individual objectives. Research shows that rewarding individual performance is most appropriate when salespeople do not depend on a team to complete the sale and salespeople have little interaction with team members. Team performance assesses whether a team of salespeople has met their team objectives. Individuals are rewarded based on the aggregate level of performance by the group. Studies suggest that team-based compensation works when sales are a group effort, job tasks are designed to be done in teams, and the company is in a growth stage.

Based on our review, we suggest that in times of economic downturn, sales incentives should be based on individual rather than team performance. The reason for our recommendation is that individual performance can be tied to personalized goals that take into account the salesperson's input, career stage, sales region, and past performance. More personalized goals, in turn, reduce uncertainty and increase commitment. In addition, rewarding individual rather than team performance increases the likelihood to retain high performers.

Sales contests can be effective

Sales contests monitor and reward an individual's performance relative to his or her peer's performance. These rewards can reduce the budget allocated to rewards while motivating higher performers, because not everyone gets rewarded even though many will try to compete. In fact, a 2009 study report by Watson Wyatt regarding recession measures to manage sales force investments indicated that 42 percent of the companies that participated in the study introduced or expanded special incentives or contests to spur sales.

In tough economic times, we recommend the implementation of sales contests because research suggests that contests spur salesperson performance when the uncertainty of sales is high. In addition, based on our review, we recommend that sales contests should include a small number of winners, and the prize should be spread among them. However, if salespeople are risk averse, the number of winners should be increased. In addition, it is recommended that if salespeople differ in their degree of ability or opportunity to complete a sale, a handicapping structure should be implemented to allow everyone to compete equally.

In summary, we identified several suggestions regarding how to measure and monitor performance for incentive compensation programs in times of economic downturn. Managers should use a combination of outcome and behavioral measures. Outcome measures should be related to profit rather than volume, behavioral measures should be directly related to points of persuasion, and sales contests should be introduced or expanded.

Sales incentives should be flexible

Like most people, salespeople differ in many ways, including the things that motivate them and their preferences for rewards. Experts suggest that salespeople should be given a choice of sales incentive compensation programs. Historically, these programs have been based on "normative" information, meaning the motivations and reward preferences of the norm or average or most typical salesperson. However, that view is being challenged. There is considerable research that shows effective incentives should match salespeople's preferences and needs. Salespeople differ in terms of risk preferences, career stage, skill differences, rewards preferences, and other factors. Therefore, several authors suggest that just as employers offer cafeteria benefit plans, perhaps they could also offer cafeteria sales incentive compensation programs.

In an effort to customize incentive programs, several companies are relying on new software programs and advanced data mining techniques. For instance, Globoforce, a company based in Southborough, MA, recently presented a new program called "Talent Maps" that tracks different types of employee performance data, including peer-to-peer recognition interactions throughout the company. Then, the program allows managers to match social recognition with performance appraisals to provide adequate rewards and other honors. This software won the 2012 American Business Award for Best Human Capital Management Solution. In a similar vein, companies are introducing new data mining solutions to better understand employee's preferences and customize non-cash rewards such as travel, restaurant gift cards, or merchandize.

Another way to increase the flexibility of sales incentives is by letting salespeople customize their own incentive plans. However, in some instances, letting salespeople choose an incentive plan may not be the best option. Research shows that individuals are not always certain about what they want. A research study demonstrates that when people are not sure about their preferences, letting these people choose increases stress and reduces satisfaction with their choices. Thus, salespeople may not be motivated to perform better if they feel as though they made the wrong choice regarding their incentive program. Hence, managers should be careful when letting salespeople customize their own incentive plan. Specifically, managers should make certain that the pool of incentives matches the salespeople's needs, and that salespeople can make changes to their customized plans in case they change their minds.

Although flexible incentive programs can increase salespeople's performance, these programs are more difficult and costly to manage, as additional personnel and technology are needed to implement them. A company under economic pressure may not have the resources (e.g., time and money) needed for the initial investment.

We recommend that in tough economic times, the flexibility of sales incentive compensation programs should be moderate. Programs that offer one type of incentive to all salespeople are unlikely to be effective, because salespeople are heterogeneous in their preferences and characteristics. Yet, programs that customize incentives at the individual level are complex, costly, and difficult to implement. Nevertheless, programs that are moderately flexible in their rewards can be designed by combining cash and non-cash incentives that are attractive to a wide range of salespeople.

CONCLUSION

In tough economic times, it may be difficult to find support for using sales incentive compensation programs because companies are implementing austerity measures. Moreover, these programs present a paradox for business. On the one hand, sales incentives can drain cash out of the business; on the other hand, incentives can motivate salespeople who are the principal agents of revenue generation. The resolution to this paradox is achieved when managers understand how to best design and administer their sales incentive compensation programs.

Our review of the literature on sales incentives proposes several recommendations on how to design and manage sales incentive compensation programs in times of economic hardship. During tough times, our review suggests that human resources and sales managers should maintain sales incentive programs. Furthermore, our article provides guidance on how to manage cash and non-cash incentives, how to measure and monitor salespeople performance, and how to design flexible incentive programs.

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