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July 2016

Sales Compensation is Rising, but Performance is Tracking Lower. What's Going On?

Following a hiring frenzy in 2015, many technology companies are now focusing on sales staff productivity, hoping that their big investments in talent will deliver on ambitious growth goals.

One of our recent engagements with a San Francisco Bay Area technology firm resulted in creative approaches to dealing with a common problem: undertaking a mid-year redesign of a sales compensation plan to be more cost-effective without crushing team morale. In this case, our client knew they had to make meaningful changes after missing revenue goals and exceeding expense targets, and so, the company's sales operation managers developed a new plan to raise quotas and decrease commission accelerators. While everyone agreed on the need to cut costs, sales leaders were rightly worried about employee engagement. An alternative approach was needed— one that would strike the right balance between cost containment and sales team motivation.

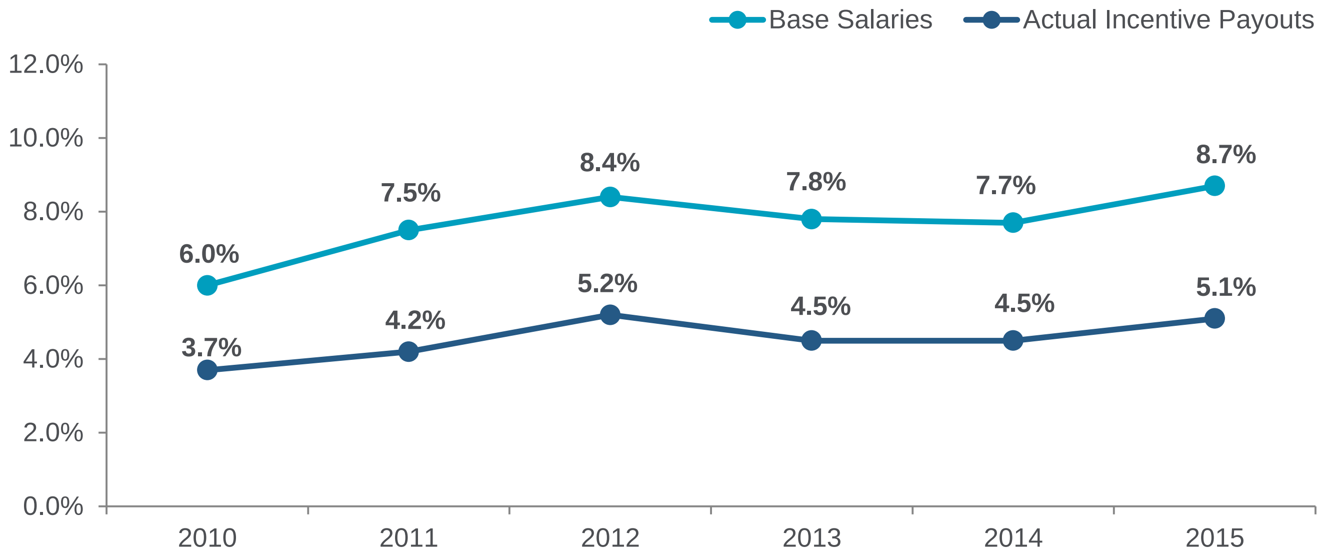
Importantly, new data from the **Radford Global Sales Survey** shows that this dilemma is not unique in the market. Sales compensation costs are rising consistently from year-to-year, while quota achievement levels continue to drop. So what exactly is going on, and what can be done to reverse the trend?

High Turnover Rates Influence Pay

According to new data from the Radford Global Workforce Trends Report, median voluntary turnover for sales employees at software companies is currently trending at an annual rate of 14%. This compares to 13% a year ago. High turnover drives costs because new sales employees take time to reach full productivity. During this ramp-up the company could be paying outsized base salaries and sometimes for resources that deliver the training and onboarding for new employees. If the company does not address high turnover, it can self-perpetuate as partial-year sales employees tend to be less productive per time worked than full-year employees.

To illustrate "cost of sales" trends, the following chart displays sales compensation spend, including base salaries and actual incentive payouts, as a percent of revenue at global software companies since 2010. As you'll see, the aggregate cost of base salaries and actual incentives has grown from 9.7% of revenue in 2010 to 13.8% of revenue in 2015. Additionally, while it appears that the market successfully attempted to tamp down rising costs in 2013 and 2014, cost jumped upward considerably in 2015.

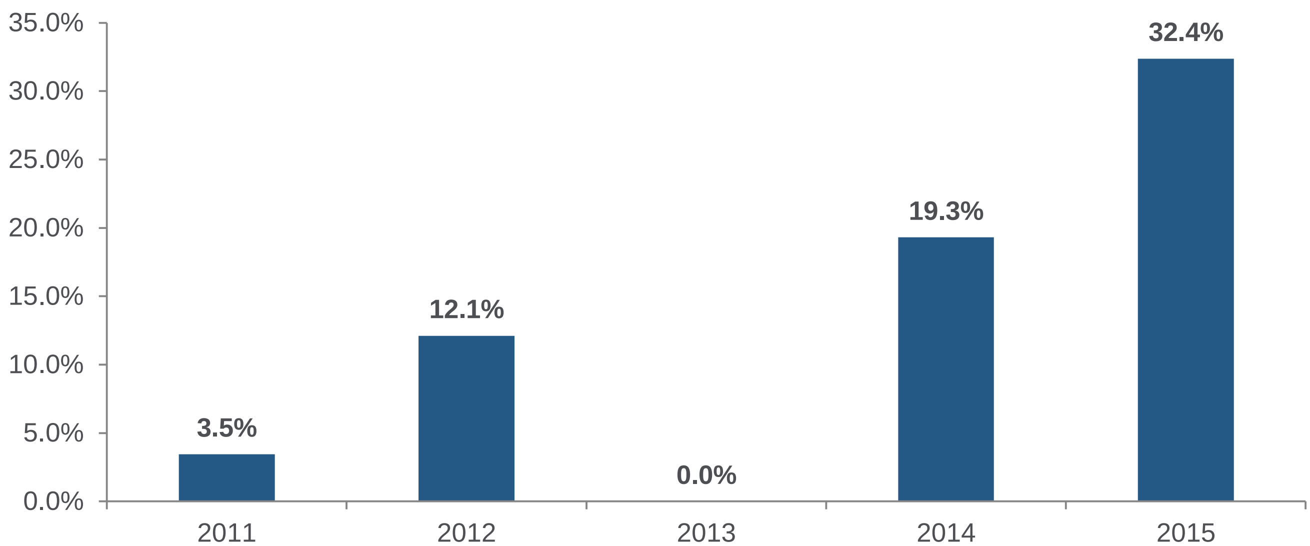
Sales Compensation Spend as a Percent of Revenue at Global Software Firms



Source: Radford Global Sales Survey Practices Reports, 2010-2015

Beyond cash compensation, equity award values are also on the rise. In fact, new-hire grants have skyrocketed for many sales positions since 2010. As an example, the chart below illustrates the year-over-year change in new-hire equity grants for a mid-career Sales Account Manager focused on new accounts (Radford job level 4).

Year-over-Year Increase in Median New-Hire Equity Grants at Global Software Firms



Source: Radford Global Sales Survey Compensation Totals for M4 Sales Account Manager - New Accounts, 2011- 2016 January Results

Once again, we observe what looks like an attempt by the market to control costs in 2013, followed by an even more aggressive uptick in compensation levels in subsequent years. While it's hard to imagine that sales compensation levels will continue to climb at such high rates, no matter how fast pay moves going forward, the frothiness of the last several years will have lingering effect on profitability.

Declining Quota Achievement Rates Don't Help

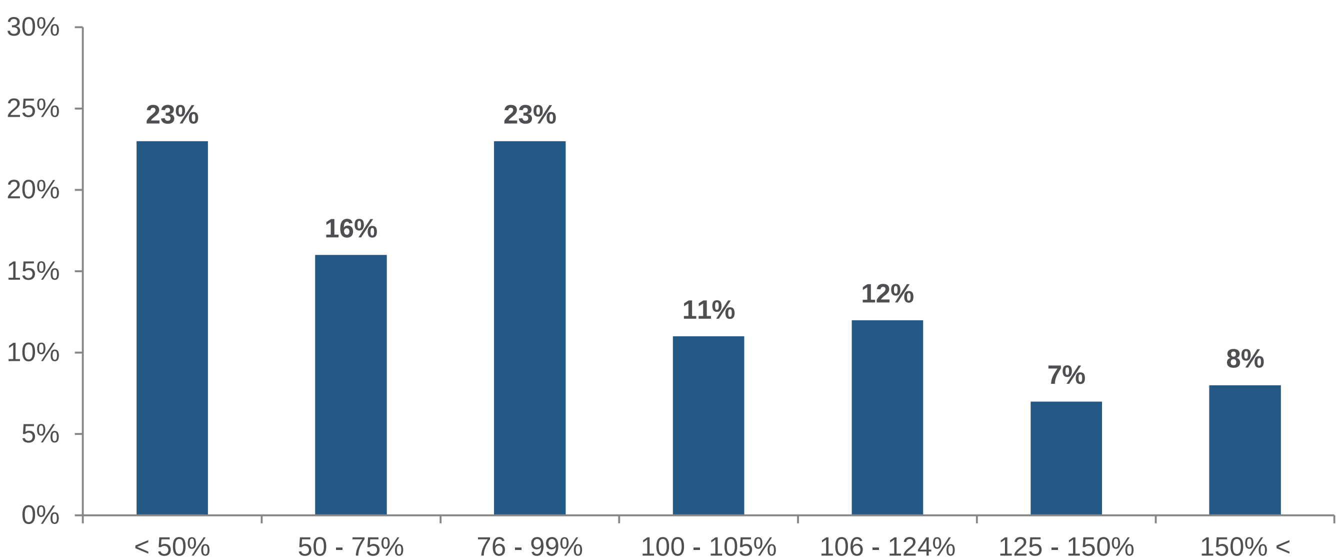
Another reason sales compensation costs continue to outpacing revenue growth is that a growing number of sales reps aren't meeting their quota targets. While this may seem counterintuitive at first glance, given the fact that incentive payouts decline when performance is poor, sales costs include base salaries and equity awards, which as we noted above, continue to rise. This makes the return on average and weak performers even lower.

Additionally, economic headwinds, market volatility and a looming Presidential election all play a role in sales performance. It's a very hard to tell at this specific moment in history, but if last month's jobs report was any indication, the US economy appears to be in a cautious, wait-and-see mode. This makes closing deals hard.

Yet, disturbingly, in an effort to justify the rising cost of sales compensation, many companies have responded by raising quotas even higher. Like so many others, this was the first instinct of our client. However, this only serves to reduce quota attainment levels, leading to reduced morale and even wider gaps between expected and actual performance levels. Ultimately, the overall perception of the sales function suffers.

As an example, the following chart displays the quota achievement distribution for field sales representatives at global software firms. Currently, more than 60% of field sales reps fall below 100% quota attainment.

Quota Achievement Distribution for Field Sales Reps at Global Software Firms



Source: Radford Global Sales Survey Practices Report, January 2016

Pushing quotas higher in the face of rising costs, especially when macro forces may be conspiring against sales, does little to address the fundamental challenges companies face. To truly shift the cost vs. performance equation in the right direction, companies will first need to address rising base salaries, skyrocketing new-hire equity awards and continue to focus more energy on sales enablement and productivity. Adjusting the structure of incentive payouts, reducing accelerators and increasing quotas can play role, but are less likely to drive meaningful change.

Moving Forward

In our view, companies should undertake a five step audit to address any concerns they might have over the effectiveness of their sales compensation plan. A comprehensive audit across all five areas should help companies come closer to striking the right balance between setting realistic, but challenging performance goals aligned to a cost-effective rewards model. Our five audit steps include:

- **Assessing the Competitiveness of Cash Compensation**: What is our competitive position to the market for each element of cash compensation, including base salaries, target incentives, target total cash, and actual total cash?
- **Reviewing Plan Component Performance**: What elements of our sales compensation plan currently provide the best return on investment (e.g., commissions and quotas, strategic components or SPIFs)?
- **Examining Quota Achievement Distributions**: How do our quota achievement levels, over a multi-year period compare to the market and impact our costs and employee motivation?
- **Aligning Pay and Performance Relationships**: Are our highest-paid sales team members also our highest performers? Are we overpaying low performers?
- **Acting on Sales Employee Engagement**: What is the engagement level of our sales people? Why do they stay or leave? What's our experience trying to recruit people into these jobs? What impact does compensation have on employee engagement vs. other factors (e.g., career development)?

To learn more and discover how your organization can create a cost-effective and engaging sales compensation plan, please contact our team.

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