

In the Spring of 2007, the NPTA Alliance surveyed its members on a variety of perceptions associated with outside sales compensation. Responses represent the diverse demographics of the NPTA Alliance distribution membership because in most cases there were more questions raised than common answers. It was also difficult to find common compensation practices across specific types of merchants or distributors. For example, companies in the printing/imaging business did not universally use salary/bonus programs versus straight commission; companies in the packaging business were not uniformly satisfied with their current compensation programs; all dual merchants were not considering a radical change to matrix plans.

For this reason, this article was written to help the reader understand what the current plans and programs are that are in place; which potential changes were identified by respondents, and to determine what are the most important considerations when analyzing current compensation plans, regardless of whether changes are made.

Know What Drives Your Profitability Before Making Compensation Changes

Current Plans or Programs Being Utilized

Since this article is not a statistical compilation of the survey results, I have chosen to highlight specific responses from various survey returns that reflect the variety of plans or programs currently in place.

- Our matrix pays a larger percentage the higher the trading margin and trading margin percentage in the order. Effective rate for paper is probably 20-22% and packaging is 25-30%
- Salespeople are all commissioned per order by a sliding scale based on gross profit percentage per order not per item. The scale is different for a "warehouse" order versus a "direct" order. For warehouse orders a 35% commission is paid on the Gross Profit \$ for orders of 25% GTM or higher, 25% commission is paid on the Gross Profit \$ for orders between 15.00%-24.99% GTM. 20% commission is paid on the Gross Profit \$ for orders 14.99% and under. For direct orders the same 35/25/20 commission structure exists except the thresholds are 20% or higher, 10.00%-19.99% and 9.99% below to receive the corresponding commission.
- Matrix is built on Margin % and Margin Dollars; \$30 min. For example, an order at 5.8% min. margin = 14% commission rate to \$750 + G.M. at 54% and over = 34% commission rate.
- GTM \$, GTM % Bogey against last year's results.
- We pay 1% on all new business total revenue, in addition to salary and bonus.
- Based on an annual customer stratification process, customers are ranked into four classes; there is also a "tax supported" class. The ranking is derived using the average gross profit dollars per order (all orders in calculation except for backorders). The "A" group is paid at 25%, the "B" group at 23%, the "C" group at 20%, the "D" group at 17% and "tax supported" (schools, etc.) at 15%.
- For "commissionable" orders (those that meet a minimum GP\$ of \$160 and 23% GP% up to 50% for 2007) the GP% is multiplied times the GP \$. For example, if an order is at 30%, the commission is 30% of the gross profit dollars generated. The combination salary/commission reps get a pro-rated % of the same formula. Direct shipments get an additional 5% commission.
- 75% of our sales force is on salary + a variable bonus based on achieving plan for sales, margin, and three other specific sales targets (house brand, equipment, packaging)

Potential Changes in Compensation Structure

The responses to this question provide some sense of merchant/distributor thinking. However, the real challenge is sorting through these responses in order to identify certain patterns or themes. Then, using this

By Jeff Grover

understanding to assess your company's strategies and tactics related to compensation.

Here are some verbatim comments related to changes being considered:

- We need to tie compensation to the profitability of the order
- Would like to tailor compensation to the company's strategic goals
- We need incentives for growth in sales, penalties for A/R losses
- Would like to compensate based on profitability of product categories.
- Need help in getting the senior reps to go after new business
- Would like to pay more for *new* business
- Our program rewards small order writing and not growing sales to existing customers
- Comfort level with comp level or targeted comp level sometimes gets precedent over company objectives
- We would like to go to percentage of profit on gross : 20-22% after load.

- Salary and bonus for reaching objectives
- Matrix that kicks in after the gross margin covers the cost to serve
- Greater salary/less commission. Salary based on past sales performance. Bonus based on strategic goals.
- We are exploring a salary plus model that would offer the salesperson a more consistent form of income while allowing the company to reduce the effective commission rate.
- Pay based on cost to serve as entry
- We do not have a target rate at this point. The goal is not to lower the sales commission rates but to facilitate sales reps encouraging customers to purchase larger orders in an effort to improve profitability at the operational level.
- Implementation of minimum gross margin per invoice requirement and bonus for achievement of specified higher average gross margin %'s
- Too many different pay plans and not

enough consideration of minimums or minimum profit. We are looking at going to a matrix system to cure these problems.

- We are aiming toward paying no more than 5% of sales for sales compensation.
- Possible matrix model to provide incentives for higher margin sales
- Alter commission on items that are more profitable for the company.
- Variable % paid based on a combination of \$profit/order, and % of profit/order

Considerations When Analyzing Compensation Plans

This third question asks members what should be considered when analyzing compensation plans and how to prevent yourself from jumping to a "quick fix" that doesn't address your company's overall strategy for building profit and shareholder value?

First, my sense from the responses is that many members do not have a clear under-



Today more than ever, consumers want to know, "Is this paper from an endangered forest?"

Printers, publishers and corporations are frequently asked this question. At NewPage, a leading producer of coated paper in North America, we would like to help you with the answer.

When you select NewPage coated paper products, we can tell you where the wood fiber comes from that we use to produce our paper. You will be proud to share this information with your customers because we only obtain our wood fiber from areas identified and designated for harvesting with increasing amounts of third-party certified wood fiber. We follow our own high standards in using natural resources wisely. Contact your NewPage sales representative for information to help you discuss tough questions about paper sourcing. Or request or view a copy online by going to www.wheredoesyourpapercomefrom.com.

At NewPage, we have **solid answers** to **tough questions**.



www.newpagecorp.com © 2007 NewPage Corporation

standing of what drives their particular firm's profitability. If this is not clearly understood and ingrained in the company's mentality, then pricing strategies, inventory and receivables policies, etc. are not built on a driving and sustainable logic. If it is important to have a clear and shared understanding of profitability, then assume that compensation plans for outside sales representatives should be built on the following premise:

- a. Individual transactions
- b. Individual customers
- c. Individual territories

Next, managers and sales representatives need to have tools to focus on creating profitable transactions, or making decisions on profitability when pricing and/or accepting orders. Companies should do whatever they can to streamline overhead, so that "g and a" is reasonable, understandable, and at the lowest denominator before allocations to individual transactions. Companies should also enable outside reps to understand the direct costs they control that impact order profitability positively or negatively.

Customer profitability needs to be assessed on an ongoing, as well as an excep-

tion basis.

Activity based costing that is "user friendly" must be available for managers and reps to objectively assess a customer's profitability.

The process enables conversations on how to improve a customer situation, if the customer is an existing client; or how to start off on the correct foot if cultivating a new client.

The impact of raising margin percentage, decreasing DSO, improving special or dedicated inventory turns, raising minimum gross margin, can be more easily seen utilizing user-friendly tools. (There are many available.)

Second, my sense from the responses is that many managers are considering "band-aid" solutions that appear to be worthwhile, but may not address the most significant opportunities. Let's consider the following:

1. A manager is considering raising minimum order size for commission. What impact would this have on the rep's transaction, customer and territory profitability? How would you—as a manager—determine the correct minimum order size, for example?
2. A manager is concerned about existing reps generating new business. What impact would changing an existing rep's focus from

maintaining and growing current customers (who are profitable), to calling on new customers, have on his territory profitability? Are there other options that a manager might use in accessing new business, in addition to trying to get veteran reps to change behaviors based upon changing commission percentages for doing so?

3. A manager feels that his outside reps are being paid too much of a shrinking margin. He wants to reduce outside sales expense as a percentage of overall company expense. Is the motive to arbitrarily cut sales cost or to enable the outside reps to understand and engage in behaviors that enhance profitability, thereby supporting their compensation models?

Third, my sense is that many managers are not equipped to support the behaviors that will be required due to compensation plan changes. Let's consider the following:

1. Sales managers are not always sophisticated in finance. If a sales manager, or person acting in this capacity, is not able to understand *why* and *how* profitability is impacted through pricing, inventory, receivables, and other variables, then it is impossi-

(Continued on page 52)

Please visit our suites to learn more about SMART Papers and our well-known brands of premium coated and uncoated papers.

Kromekote Collection

Knightkote Matte

Carnival

SMART Brights

Genesis

Magna Carta

Outback

SMART Digital

Passport

Pegasus

Synergy



PAPERS

www.smartpapers.com

stop by:

Swissôtel Chicago | 323 East Wacker Drive | Chicago, IL 60601-9722
312.565.0565

SMART Papers' NPTA attendees include: Mark Grillo, Tom Kleimeyer, Peter Magnuson, Dan Maheu, Tim Needham, Paul Simpson and Ian Vincent

What Drives Your Profitability

(Continued from page 26)

ble for any compensation and/or associated behavioral change to occur in a meaningful and consistently planned way.

2. That being said, if a manager and rep are on the same page in regard to the need for compensation policy change, perhaps driven by raising prices or order margin to impact transaction/customer profitability, then the manager must be able to help coach the rep in how to create a “win-win” for the customer.

3. Managers need to be able to consistently guide and reinforce strategies and tactics, based upon the compensation plans that are in place, or modified from time to time. Exceptions for “favorite” or “veteran” reps are not acceptable.

4. Managers (and reps) need to have their performance expectations and behaviors related to ensuring profitability part of their consistent job reviews. This should be as important as “generating new customers,” or “increasing top line sales,” and other general goals.

Fourth, there are inherent challenges to making substantive and meaningful compensation changes. Here are a few:

1. As mentioned, companies need to first understand what drives their specific profitability.

2. Many companies do not have non-compete agreements. Changing compensation plans may trigger rep departures. In some cases, this may actually be desirable.

3. Communication on policy change needs to be driven from the top, regardless of company size. Corporate merchants may have inherent challenges communicating and “selling” compensation policy and/or customer pricing and policy changes to branch locations, managers, employees and clients.

In Summary

Ensure that your company understands and has targets for what drives its shareholder value. This may be stated as “return on investment,” “EBITDA,” or specific measurements. Regardless, if a company understands what it expects, year to year, then it can reasonably assess and craft a compensation program that defines and reinforces appropriate behaviors that managers and outside reps understand, act upon, and are measured upon.

Watch out for slapping “band-aids” on corporate bleeding. Arbitrary choices are perceived that way, are often considered punitive, and don’t address systemic issues or problems. They are hard to internalize, sell, and ultimately don’t provide results that are driven from a clearly understood corporate ROI objective.

Realize that existing managers, at all levels, may not be equipped to drive change. Resist assuming that managers “get it.” Educate them so that they are better business people and provide them with the tools they need to implement and reinforce changes that are driven by profitability enhancement. These include the implementation of new compensation plans and associated behavioral changes.

Consider specific challenges within your company. If you have uniform non-competition agreements, it may be easier to make compensation changes than if your firm has no non-competition agreements, or has different plans for different outside reps. Further, recognize your own inherent strengths and weaknesses. Some managers, (whether in corporate entities of small private single location businesses), are not able to assess situations, identify potential changes, and/or implement effectively. Failure to assess, identify changes, and implement spells disaster.

Finally, insanity has been defined as “doing the same thing twice or more and expecting a different result.” I might point

out that any compensation plan will have room for improvement, and members recognize the need for change based upon the reality of market changes, competitive pricing, different economies of scale, etc. However, simply recognizing the need for change and making a cosmetic compensation plan modification is not enough. It will simply make a minor adjustment, positively or negatively. Without first understanding what drives your company’s profitability, in balance with what investment return your shareholders have in place, insanity (at least in regard to outside representative and overall sales compensation) will prevail. •

Jeffrey Grover is president of Grover Group LLC. He was a co-owner/partner with his brother, Brent Grover, in National Paper and Packaging before it was sold to SupplyONE in 1999. Jeff Grover has been on the Board and Executive Committee of the NPTA Alliance and chaired the Young Leaders Division during his tenure. He has been a frequent contributor to the NPTA Alliance's SAPI web site, authoring dozens of articles on topics related to sales management and sales and marketing. (Archived articles may be found on Grover Group LLC's web site at www.grovergroupllc.com.) In addition, he is involved in theater and film, both as an actor and a producer. He is currently working on a short form documentary, "Luminaries," profiling individuals who made domestic and international impact in industry, medicine, social justice and the arts.

Coming Next Issue

- **3rd Annual Services Directory**
- **Role of Converting in Manufacturing & Distribution**
- **NPTA Convention Wrap-up**
- **DistriPakUSA Show Coverage**

**Advertiser Bonus:
Signet Ad Performance Study**