Sales Compensation Automation
Opportunity to Increase Sales and Profits

Makana Solutions White Paper

November 17, 2008

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Table of Contents

Executive Summary

Management often recognizes that sales compensation is one of the most powerful levers they can use to drive corporate strategy. Yet most companies struggle to take full advantage of its potential due to the lack of proper tools, expertise, and visibility. Instead, they are bogged down in Excel spreadsheets and Word documents trying to build effective plans. The result is often misalignment between plans and corporate goals, delays in payment and reporting, unclear plan documentation, inaccurate or incomplete calculations, and too much overhead. Paying on these ineffective plans often leads to cost exposures, overpayment, and other unintended consequences. In the end, everyone involved in the sales cycle can become de-motivated, while productivity is drained and sales opportunities are missed.

The answer is to automate with a solution specifically for plan design, payment calculation, reporting, and feedback. Small and medium-sized businesses in particular have much to gain by automating the design and payout of incentive compensation plans. Using the right tool helps bolster efficiency, accuracy, and consistency, and – more importantly – can result in higher and more profitable sales.

Makana Solutions provides small and medium-sized businesses with the first and only solution that helps organizations design the best plans, while freeing those who design and manage incentive compensation from the mundane aspects of plan creation, modeling, and administration. By offering a self-service, web-based solution, Makana enables small and midsized organizations to easily automate a cumbersome, time-consuming, and error-prone process and quickly realize better results.

Introduction

Sales compensation is becoming increasingly strategic – especially for small- and medium-sized organizations. In a recent Makana survey, 56% of respondents indicated that they are looking to further optimize sales productivity as a way to adjust to current business conditions. When modeled and executed effectively, compensation plans help motivate profitable sales behavior and enable companies to hire and retain top talent. And since incentive compensation is typically an organization's second highest variable expense (after salaries), its strategic nature becomes even more apparent.

Unfortunately, designing and managing sales compensation plans is increasingly complex as organizations add more job functions, products, and incentives, or as market conditions change. This complexity is complicated by the fact that – according to the Aberdeen Group – "a majority of companies are using spreadsheets to support their commission process."[1] This leads to a number of issues, including overpayment, incentive cost exposure, inconsistencies, and the inability to audit. However, the problems don't end there. Companies that rely on plans designed and managed in spreadsheets struggle to make payouts in a timely and accurate manner – a problem that dilutes the effectiveness of incentive compensation to motivate repeat behavior.

The Pitfalls of Spreadsheet-based Planning

While spreadsheets help organize and manipulate data, they are cumbersome, time-consuming, and error-prone as a means for creating and administering compensation plans (figure 1). Spreadsheets fall short for a number of reasons:

> • **No compensation planning guidance**
>
> • **Hard to detect potential cost exposures**
>
> • **Lead to conflicting priorities**

fig.1

Compensation summary by assignment

Assignment	Leverage	Accelerator 100-120-120+	Quarterly Skew Incentive
Distribution Manager	60/40/125	1%/$800/$1200	$3500 per quarter
Territory Manager	60/40/125	1%/$800/$1200	$3500 per quarter
Major Account Manager	60/40/125	1%/$800/$1200	$3500 per quarter
Network Integrator	90/20/110	$400 per contract over goal	N/A
ABU/SBU/NS Manager	70/60/120	1%/$800/$1200	$3500 per quarter
Systems Engineer	Salary plus 15% bonus	90%= $2000 100%= $2500 110%= $3000 120%= $3500	N/A
Level 1 Manager	70/30/120	1%/$1000/$1500	$4000 per quarter
Regional Manager	70/30/120	1%/$2000/$2500	$5000 per quarter

page 14

1   *Sales Compensation Management: Coin-Operated Productivity, Aberdeen Group, December 2007*

No Compensation Planning Guidance

The job of compensation planning involves five key tasks:

- **Definition of the plan metrics, rates, and calculations**

- **Quota allocation and definition**

- **Modeling of costs at various levels of attainment**

- **Comparing modeled payouts to history**

- **Documentation of terms and conditions**

While spreadsheets are powerful tools for analyzing and sharing data, they were not designed for the development and management of compensation plans. Instead, when used for sales compensation, spreadsheets present sets of data in nested pages, based on complicated formulas that require fairly sophisticated knowledge to craft and modify.

Using spreadsheets, key compensation planning tasks must be handled using low-level cells and formulas. It's like choosing to build a house with LEGO instead of brick. To complicate matters, spreadsheets provide no guidance or best practices for building an ideal plan, leaving important decisions in the hands of those who might not have the necessary expertise. As a result, organizations that use spreadsheets as the basis for their compensation plans must retain someone in-house with enough spreadsheet and compensation plan expertise.

Because spreadsheets also lack support for workflow, planners struggle to take advantage of input from others within the organization. In addition, when numerous people exchange and edit spreadsheet formulas, the potential for error is compounded.

Hard to Detect Potential Cost Exposures

Failure to model incentive costs at varying levels of attainment can result in unintended financial consequences that severely impact the bottom line. Yet identifying and addressing plan anomalies or potential distortions to commission rates are nearly impossible to do in a spreadsheet-based plan. That's because organizations lose sight of the key elements of the plan when they're bogged down in rows, columns, cells, and formulas.

For example, one business owner decided to pay 4% on sales of a certain product with an accelerating scale. In other words, the commission percentage rose as sales reps went beyond 100% attainment. Unfortunately, the organization's spreadsheet-based compensation plan made it difficult to determine what such an incentive might ultimately cost the business. When a sales rep closed a really big deal that was not anticipated (i.e., a "windfall"), the company paid the rep a $20,000 commission – an amount not commensurate with the salesperson's efforts.

Lead to Conflicting Priorities

Unless the planner is very schooled in using spreadsheets to build models, it's difficult to compare multiple plans side by side to understand the implications. The complexity can be so overwhelming that many departments create their own compensation plans (for example, sales creates one plan while professional services creates a separate plan). Building plans in silos leads to inconsistencies, and more often than not the plans that get created work against one another, causing inter-team conflict. Because each organization focuses on its own goals, the plans lack alignment around corporate goal and performance measurements and often fail to support company objectives.

A classic example of this issue is a traditional software company comprising both sales reps and a professional services organization. The sales reps are usually incented to sell services at a much lower commission rate than they are for software sales. In some cases, they are not incented to sell services at all. At the same time, the professional services consultants are compensated partly on number of billable hours. To close the deal, sales reps may heavily discount or throw in a professional services engagement, leaving the professional services organization undercompensated.

In another common example, a direct salesperson and channel partner may end up competing for the same deal. Rather than support collaboration, their respective compensation plans unintentionally motivate them to compete. Only by comparing plans side-by-side can organizations identify unintended consequences such as these.

Fail to Produce Desired Outcome

Incentive compensation plans are critical to driving the sales team's priorities. But they fail to produce the desired outcome when they're not aligned with company goals – often the case when they're designed in a spreadsheet.

Because design is so difficult using spreadsheets – and those tasked with creating plans are often juggling multiple responsibilities – many organizations resort to modifying existing plans. Whether last year's plan or one brought over from a previous company, these rarely turn out to be the most effective option – especially when they originated in another company.

In addition, many plans are overly complex, making it difficult for sales reps and others to quickly grasp the key motivators and understand where to focus their efforts. As a result, the sales team is focused on calculating its compensation instead of drumming up new business. Instead of collaborating to close a deal, employees and partners are focused on conflicting priorities. In addition, companies frequently either over- or under-compensate employees based on ineffective, spreadsheet-based plans. To top it off, organizations dedicate far too much time managing their sales compensation plans. The result? No time to ensure that the plan is driving the desired behavior and results.

Spreadsheets Fall Short for Payout

Not only do spreadsheets leave much to be desired when it comes to designing compensation plans, they also fall short when it comes to payouts. Specifically, they lead to:

- **Inaccurate and late payments**

- **High administration costs**

- **Poor audit trails**

- **Limited reporting**

"Plan administrators divide their attention among performing commission calculations, searching for errors, researching questions, providing answers, and even counseling."

— Aberdeen: Sales Compensation Management

Inaccurate and Late Payments

Because spreadsheet-based plans tend to be too complex for anyone other than the plan administrator to understand – and do not assist with compensation-related tasks – fraud and errors are harder to identify and address. Consider the pay out of commissions and bonuses. Organizations relying upon spreadsheets must handle these manually. This often involves consolidation of separate spreadsheets and creation of new formulas to calculate totals across the board. In such cases, there tends to be a lag between end-of-month closing and payout. Because of this gap between the sales activity and the reward, the compensation is less effective as a motivator for repeat behavior.

Salespeople have good reason to question the accuracy of their compensation – research shows that 91% of spreadsheets contain errors,[2] leading to incorrect payments.

In addition, without proper documentation, without trust in the system, sales reps often conduct shadow accounting and question how commissions are determined. Not only is this a de-motivating exercise for reps, they are distracted from selling. Disputes must be dealt with manually, as sales compensation analysts and sales managers dig back through spreadsheet formulas, rows, and columns to determine how the compensation was calculated. Furthermore, because salespeople typically only report instances when they feel they were undercompensated, all the errors that lead to overpayment are rarely caught.

> **Types of spreadsheet errors**
> - Accidental
> - Omissions
> - Duplications
> - Alterations
> - Formula
> - Syntax

High Administration Costs

The exhaustive exercise of manually managing and administering spreadsheet-based payment plans leads to excessive operational costs. Not only is it time-consuming to manually calculate payments every month, it can be an even more time-consuming and draining exercise to handle disputes and resolutions. For example, consider the common occurrence of an order being cancelled after a commission was paid out. The plan administrator must determine who received the commission and for how much, and then reverse it – no simple task when relying on a spreadsheet that is disconnected from other key systems.

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2 *Spreadsheets and Sarbanes–Oxley: Regulations, Risks, and Control Frameworks, Dr. Raymond R. Panko, a professor of IT management in the College of Business Administration at the University of Hawaii, June 2006 research paper*

"I have spent up to five days on one prior-period adjustment."

— **Sales Operations Manager**

Poor Audit Trails

Regardless of whether or not a company needs to concern itself with regulations such as the Sarbanes-Oxley Act, good business practices dictate that a company track all steps in its key processes. Unfortunately, spreadsheets lack the support for security, consistency, and reporting that are needed for auditing efforts. As a result, most organizations that rely on spreadsheet-based plans do not even conduct formal audits, depriving them of a key opportunity to identify potential areas for improvement.

Limited Reporting

When organizations rely upon spreadsheets as the basis for their compensation plans, the onus is on them to create and generate all compensation-related reports. Because spreadsheets do not include robust support for reports, the company is limited in the types of reports it can create. In addition, generating reports on a frequent basis can be extremely time-consuming. At the same time, the organization must always worry about the accuracy of the reports. After all, if the formula used to generate the report is incorrect, the results will also be inaccurate. In the end, limited reporting impacts the visibility of everyone throughout the organization, leading to ineffective decision-making.

"Static spreadsheet reports are limited in the level of detail they can provide the sales force to illustrate how and why they were paid."

—**Aberdeen: Sales Compensation Management**

How Automated Planning-to-Payment Can Drive Success
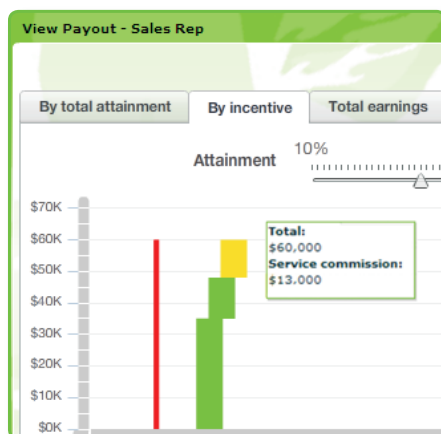
fig. 2

Businesses today have reaped tremendous benefits by automating key business processes, such as enterprise resource planning, customer relationship management, and accounting. Now organizations also have the opportunity to automate compensation planning and payment. Automation of the cumbersome, time-consuming, and error-prone process – from planning to payment – provides significant business benefits and opportunity for competitive advantage.

fig. 3
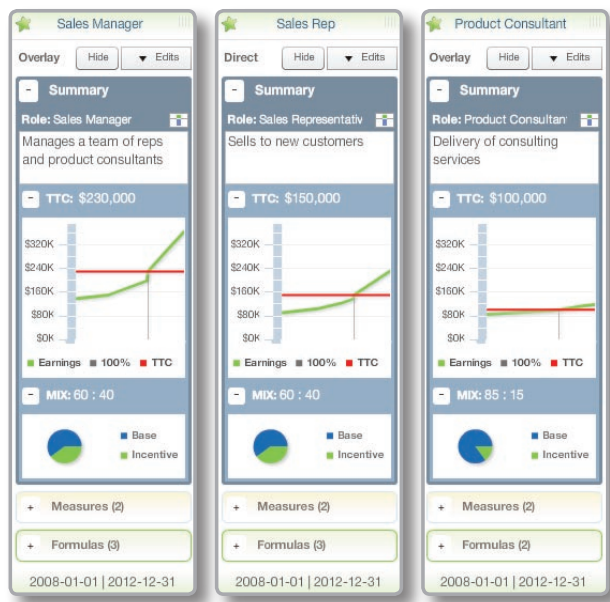
Benefits of Automated Planning

When companies automate plan creation, they realize more than just efficiency and accuracy gains. Such an approach results in the design of more effective plans that can lead to an increase in company revenue or profits by motivating the right behavior. It also enables organizations to quickly design and deploy high-quality plans, leading to faster realization of these benefits.

Powerful, easy-to-use modeling tools (figure 2) enable organizations to properly anticipate all costs, helping to avoid issues such as overpayment and cost exposure. By using a solution built specifically to design and manage sales compensation plans, organizations can easily compare plans (figure 3). This enables them to eliminate the silo effect and build intelligent plans that encourage teamwork, align with overall strategy, and help avoid unintended consequences.
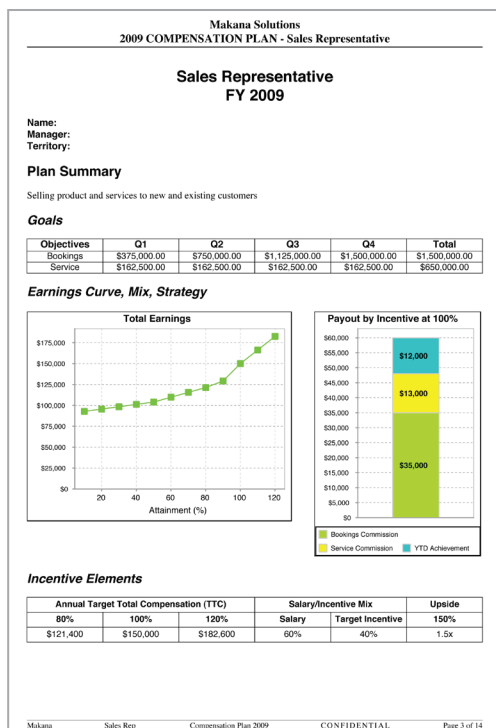
By automating the generation of plan documents, organizations can quickly and easily individualize the documents with motivating graphs (figure 4) showing earnings and payout components. With access to clear and timely plans, sales reps rapidly grasp their goals and understand the rewards for achieving them – leaving more time for selling. Based on clear guidance, everyone involved in selling will be confident they are working toward the right goals.

At the same time, centralized plan terms and conditions enforce consistency of policies and procedures. That's because centralization eliminates the use of unique terms and conditions for each department. It also ensures that changes are reflected in all plans automatically. As a result, each plan is aligned with overall strategy, and the compensation model is applied consistently across all salespeople.

"Many use stand-alone spreadsheets, which are the single biggest obstacle to making planning…a more useful management tool. Replacing them with software dedicated to the task can make the process much more efficient and remove barriers to transforming planning…."[3]

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3   *Planning and Budgeting Remains Immature, Ventana Research,* http://www.intelligententerprise.com/showArticle.jhtml?articleID=188100925

fig. 4

Makana Solutions
2009 COMPENSATION PLAN - Sales Representative

Sales Representative
FY 2009

Name:
Manager:
Territory:

Plan Summary

Selling product and services to new and existing customers

Goals

Objectives	Q1	Q2	Q3	Q4	Total
Bookings	$375,000.00	$750,000.00	$1,125,000.00	$1,500,000.00	$1,500,000.00
Service	$162,500.00	$162,500.00	$162,500.00	$162,500.00	$650,000.00

Earnings Curve, Mix, Strategy

Total Earnings — Attainment (%)

Payout by Incentive at 100%
$12,000
$13,000
$35,000

Bookings Commission
Service Commission   YTD Achievement

Incentive Elements

Annual Target Total Compensation (TTC)			Salary/Incentive Mix		Upside
80%	100%	120%	Salary	Target Incentive	150%
$121,400	$150,000	$182,600	60%	40%	1.5x

Makana   Sales Rep   Compensation Plan 2009   CONFIDENTIAL   Page 3 of 14

Benefits of Automated Payment

Organizations can boost benefits by also automating the payment process. Payout accuracy improves when using a system that automatically handles formulas and calculations, leading to higher satisfaction of sales reps and others who receive incentives. In addition, plan administrators and managers are freed from the time-consuming task of calculating payments, manually creating commission statements, and resolving issues related to compensation errors and disputes. Automated payment also enables organizations to apply the best practice of rewarding people close to the point of influence for positive reinforcement. When payment happens automatically, sales reps receive timely commission payments.

A Planning-to-Payment Solution for Today's Business

Designed specifically to meet the needs of small- and medium-sized businesses, Makana Motivator Pro automates planning, payment calculation, and statement and report generation. Offering rich features in an easy-to-use interface, Motivator Pro enables organizations to quickly design effective incentive plans and ensure accurate and timely compensation.

Harness Best Practices and Step-by-Step Guidance


fig. 5

Makana Mix Matrix
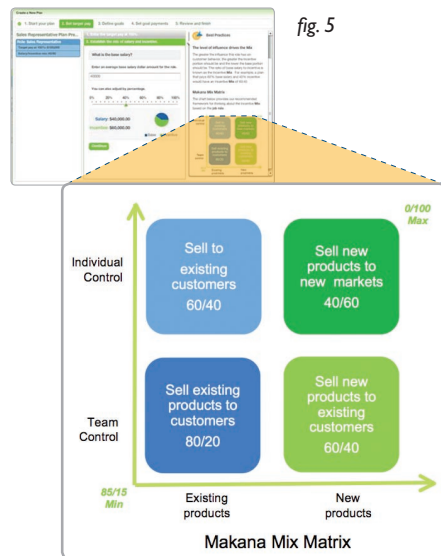
Motivator Pro provides step-by-step guidance and visual feedback through the entire planning process, advising on best practices (figure 5) along the way. By empowering end users, the solution enables people without domain knowledge to design effective plans. By offering guidelines from sales compensation experts on key compensation issues, for example, Motivator Pro allows organizations to ensure the proper incentive mix or leverage, the target total compensation, and the right number of goals.

Anticipate Incentive Costs with Easy Modeling

Because Motivator Pro makes effective cost modeling easy and accessible by (figure 6) using historical and projected attainment information, users can avoid getting bogged down in the detail of individual orders and transactions or complicated error-prone spreadsheets. Organizations can use this historical data to create "what-if" cost scenarios and test plan outcomes based on performance and quotas. They can also verify that plans meet budget requirements before they get rolled out to the sales force. Accurate cost modeling ensures that incentive costs can be anticipated at higher levels of attainment, avoiding overpayment. It also allows management to model and adjust globally – by group or individual – and even by measure or goal.

fig. 6
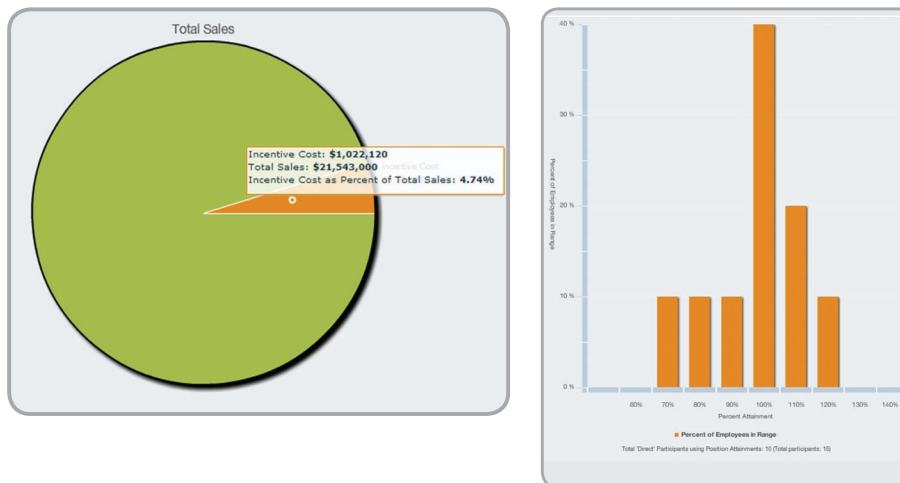
Move Seamlessly from Planning to Production

All too often, once plan designs are agreed upon, organizations must undertake a completely separate effort to build new spreadsheets to calculate payments on these plans. With Motivator Pro, designed plans are moved into production for calculation, administration, and payment with a single click. With seamless integration between plan design and payment, all rules and formulas from the plan are automatically applied to all orders to calculate payments. That means crediting of transactions to the appropriate sales rep or sales team is completely automatic, saving organizations a tremendous amount of time.

Access Real-time Reports and Feedback

With Motivator Pro, organizations can share up-to-date graphical commission statements and management reports through email or online. (figure 7). Access to detailed commission statements builds trust among the sales force, allowing them to easily see how their incentives are calculated. As a result, they stop maintaining their own compensation spreadsheets and focus more on selling. Up-to-date management reports enable sales reps to instantly understand how they are performing against quota and where they can focus future efforts for the biggest reward. They also enable sales management to clearly understand how each member of the sales team is doing – at any point in time.

fig. 7
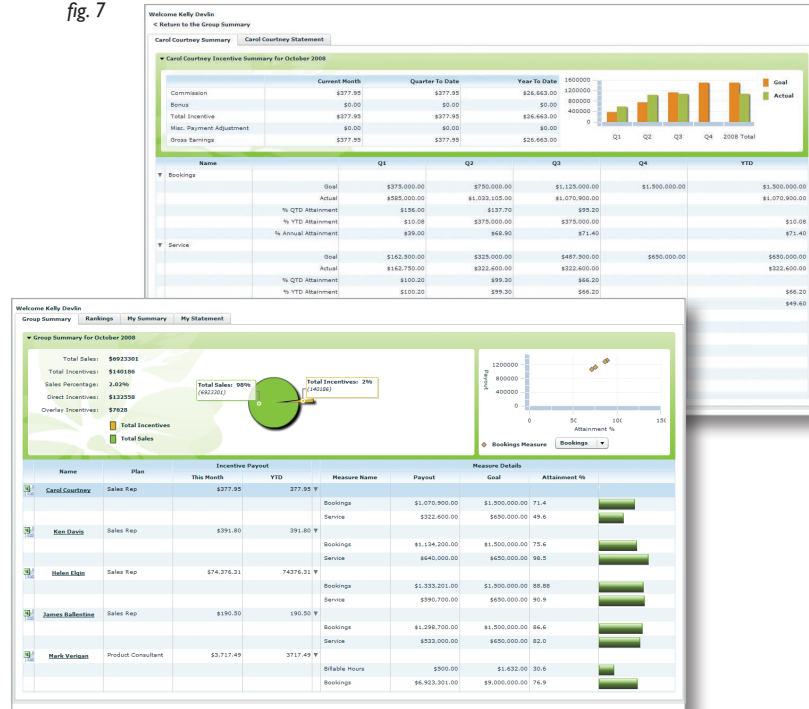
> *"Without this tie [between compensation management and CRM], it is difficult if not impossible to build commission scenarios as sales reps need to be able to translate the opportunities in their pipeline into money in their pockets based on their compensation plan."*
>
> — **Aberdeen: Sales Compensation Management**

Extend Value through CRM Integration

Integration with CRM systems such as salesforce.com provides real-time plan visibility and feedback in the most accessible, familiar place for the sales team. Often this visibility is what ultimately motivates the sales team to fully adopt CRM.

Take Advantage of a Self-Service Model

Because Makana Motivator Pro is a web-based, self-service solution, organizations can get up and running in no time and easily work with colleagues – anytime, anywhere. No upfront capital investments, implementation, or IT support is required, and upgrades happen automatically – a real plus for small- and medium-sized businesses.

Improve Business Results

While the breadth and depth of the Makana Motivator Pro features set it apart, nothing speaks louder than the experience of Makana's customers.

Wilson Tile and Stone

Wilson Tile and Stone is a leading residential and commercial provider in the Ohio, Michigan, and Indiana tri-state area. Facing a significant market change with the slowdown of the construction market, it turned to Makana Motivator to help adapt its sales activities. After quickly getting up and running, Wilson Tile was able to design plans that drove a new strategy. Specifically, it was able to quickly put in effect two major changes: First the incentive mix was changed from high base/low commission to lower base/higher commission to increase sales productivity. The sales team was not de-motivated by the change as the rich graphs in the new plan documents clearly illustrated the new earnings potential, Second, it aligned incentive payout with profitability for each product in its mix. These changes resulted in increases in revenue and profitability in a declining market.

"With the clear communication that Makana provides, we were able to focus our sales team's attention on the opportunity to increase their income with a greater mix of incentive pay focusing on our more profitable products. Our numbers were up 15 percent in just one month. I think the second quarter will show an even greater increase."

— Tom Wilson, General Manager, Wilson Tile and Stone

DSG Canada

Another Makana customer used the Makana solution to avoid compensation errors and increase its gross margins. DSG Canada – a leader in diesel engine performance services and engineering – was unable to correctly anticipate what its spreadsheet-based plans would pay out at higher levels of attainment. Using the Makana solution, DSG Canada was able to fully understand the ramifications of its compensation strategy and built measures into the plan that rewarded more profitable deals. The result? Higher gross margins.

"I was unhappy with my spreadsheet results. Then I found Makana online and was able get started right away and design my own plans in a matter of hours. I addressed my overpayment issues and realized additional benefits including a 2% increase in gross margin."

— Percy Hoff, President and CEO, DSG Canada

Summary

The accepted way of designing and managing incentive compensation is inefficient and ultimately hurts organizations. While spreadsheets are useful versatile tools, organizations that use them to support compensation are unable to reap the full benefit of this valuable business lever. In fact, reliance on spreadsheet-based compensation plans can cost organizations in several ways. Not only do spreadsheets fail in the design of effective plans, they are an inefficient and inaccurate way to pay incentives. Small- and medium-sized organizations in particular cannot afford the lost productivity, errors, and de-motivation that often result from such plans – never mind the inability to align plans with company strategy. Simply put, spreadsheet-based plans are inadequate for today's compensation requirements.

Fortunately organizations can now automate plan design, payout, and administration to enjoy the types of benefits reaped by automating other business processes. Automation enables organizations to realize two key benefits: 1) higher revenue and profits from more effective plans and 2) higher productivity at lower cost. Specifically, through automation, organizations can:

- **Simplify design and management**

- **Ensure tight alignment between compensation and company strategy**

- **Motivate employees to focus on behavior most beneficial to the business.**

Why should an organization automate its sales compensation planning and payment? The answer is that it can't afford not to. After all, the amount invested in incentive compensation – and the opportunity to drive strategy – is too great to waste. Automated planning and payment may make the greatest impact on a company's revenue and profits.

To learn more about how Makana Solutions can help you get better business results from your sales compensation, visit us at www.makanasolutions.com or contact us at 877-881-0001.

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