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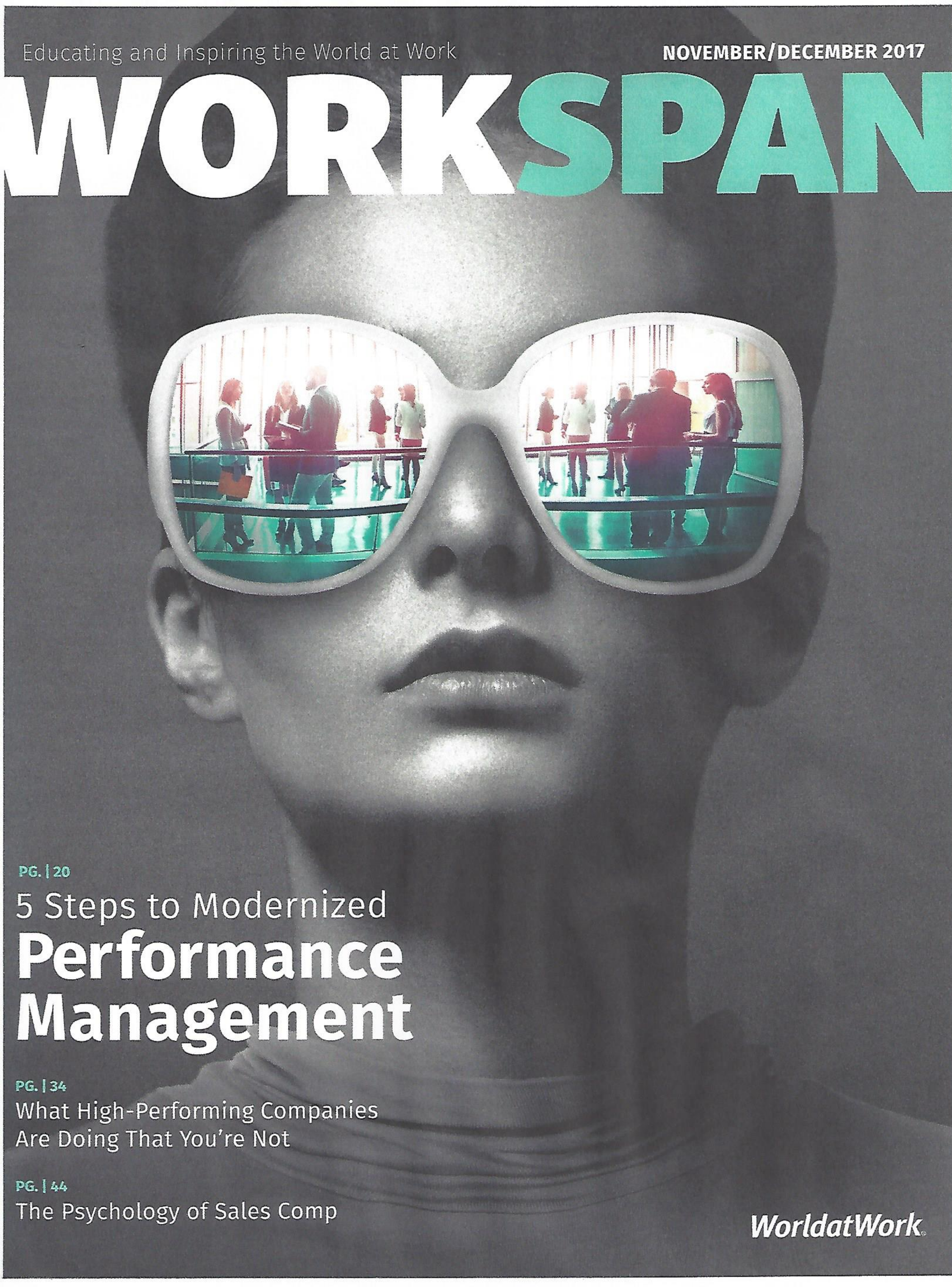

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The Psychology of Sales Comp

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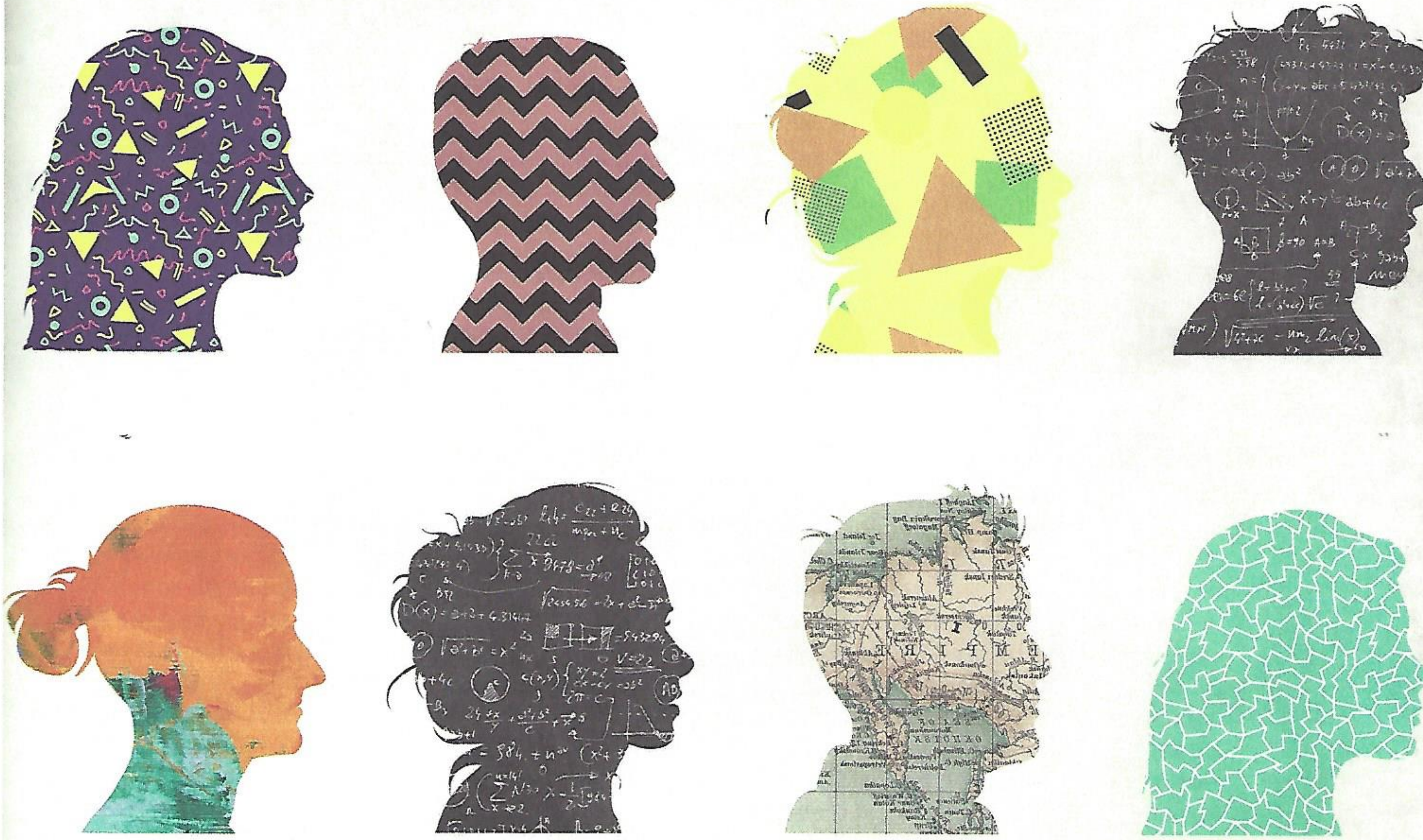
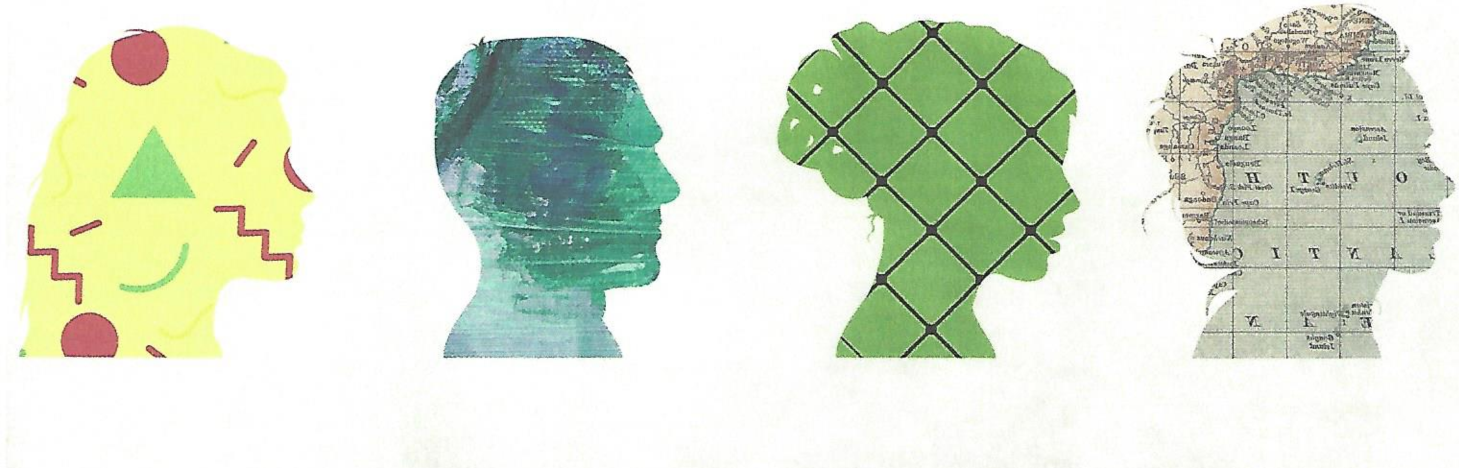


The Psychology of Sales Comp

There's a time in sales compensation when you have to put away the calculator, look away from the numbers and focus on the mental aspects.

By Josh Miller, OnTarget Incentives



The Psychology of Sales Comp

ANY PRACTITIONER WILL TELL YOU: Sales compensation involves a lot of math. Whether it's plans with multiple commission rates, tiers, multipliers, quotas, compensation targets and so on, there are many variables and formulas that test the limits of our algebraic skills. But even if you understand the math and can perfectly design the equations, doing so without considering the psychology will result in failure.

Realize it or not, accept it or not, psychology is a required component for success in sales compensation design, strategy and administration. In fact, the combination of the two disciplines of mathematics and psychology make sales compensation unique, particularly because of the ability to quantify the success or failure of decisions made. There are five areas of sales compensation — all with easily identifiable psychological implications — that sales compensation professionals must consider when making decisions.

Consideration 1: Quota Setting

Quotas that are set too low give a psychological feeling of relief to a salesperson: Moderate effort allows them to meet and exceed previous earnings amounts, and the pressure to perform is lessened. Conversely, quotas that are set too high have a different psychological effect. A quota or target that feels unattainable leads to a decrease in confidence and motivation. Or, perhaps it leads to a moderated level of effort as the salesperson feels resigned to failure. Maybe he/she starts looking for a job elsewhere. Accurately setting quotas requires research and data, including historical performance. But this research and use of data is all in the context of creating the desired psychological effect of maximizing the salesperson's motivation.

Consideration 2: Acceleration / Deceleration

Acceleration is intended to inspire greater levels of performance. It also provides a sense of momentum and accomplishment, which are particularly important in annual plans. And a continued sense of accomplishment helps fuel solid performance. Similarly, deceleration needs to be used to moderate for risk but employed carefully to mitigate the negative psychological effect of salespeople feeling like they've provided strong performance but have moved backward in earnings. The data and research that drive modeling are still required to properly set the tiers or gates for acceleration with the goal being balance. Too many gates or tiers, or gates and tiers that occur too early or too late, can complicate matters and water down the sense of progression.

Consideration 3: Penalty vs. Reward / Carrot vs. Stick

Consider a sales strategy intended to place greater emphasis on cross-selling ancillary products in a role. Cross-selling could be additive within the compensation plan, or penalties could be built in for not cross-selling. There is no single best practice that applies to all scenarios, but there are several considerations, including the frequency with which cross-selling opportunities occur. Penalties almost certainly will have a negative psychological effect on

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the salesperson, hindering motivation and excitement unless substantial upside is built in, too. Cuts and penalties must be used carefully with data that supports the frequency of opportunity so it doesn't negatively affect the salesperson. Communication is an important psychological facet in how penalties and rewards are explained and emphasized.

Consideration 4: Compensation Plan Complexity and Component Weighting

A successful compensation plan design needs to clearly communicate how compensation aligns with desired sales behaviors. If a plan includes 10 different components that signal 10 different behaviors to incent, the salesperson walks away confused. Components and metrics must be carefully vetted and prioritized to include only the most important measurable metrics in the plan. Component weights directly communicate prioritization. A plan with eight different components with equal weights of 12.5% gives very little indication of where the salesperson should focus. A plan with two components weighted at 45% and a third component weighted at 10% sends a signal to not apply much focus to that third component. Even within a reasonably weighted metric, too many different rates or tiers can lead to confusion — certainly not a desired state for our salespeople.

Consideration 5: Compensation Administration Policy Setting

Consider your windfall and cap policies. A payout cap policy can communicate that, regardless of how much revenue a salesperson brings in, his/her own reward has a limit. There's little motivation to increase the size of a deal if he/she has one that has the potential to meet and exceed the amount in a windfall or cap policy. This is true whether applied to a single transaction or across cumulative performance in a performance period. Once you've reached the performance that triggers the cap, why push further? These policies do have a time and place for risk-mitigation purposes, or if the salesperson's role in a transaction is unclear. But they should be used carefully, with full awareness of the psychological effect they carry.

Reviewing Considerations + Avoiding Heuristics = A Winning Formula

Given the considerations we must weigh and the heuristics we must acknowledge, we as sales compensation practitioners should carefully consider multiple facets of psychology to help us avoid errors in our decisions and judgments. Psychology has an important place in our field, and we'd be wise not to underestimate its effect on the success or failure of what we do. **WS**

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Heuristics in Practice

There are other reasons for sales compensation practitioners to be familiar with psychology, for example, the psychology of decision making and the common cognitive errors made. As sales compensation practitioners we regularly make decisions and judgments that have substantial effects on our organizations, and these decisions often are made in environments of uncertainty.

Psychologists Amos Tversky and Daniel Kahneman pioneered the field of study into common human errors in these environments. They called three of these common mistakes heuristic, or an approach to problem solving that uses a practical method that isn't guaranteed to work, but is good enough for now.

Representativeness Heuristic

This is a common error made when judging the probability of something based on how similar it is to something else without accounting for other factors. For example, a question like "What is the probability that object A belongs to class B?" frequently arises in sales compensation. Scenarios may be proposed or exceptions requested to compensation policies that are then reviewed for reasonableness. It is important to dig into data that supports (or doesn't support) the request before deciding, rather than overreacting to anecdotal evidence.

Availability Heuristic

Trying to relate something we are deciding or judging to prior experience results in this heuristic. Readily available memories tend to cloud or distort decision making. Sometimes we assess the likelihood of an event by the ease with which we can think of similar instances. Biases occur because certain types of instances are more memorable than others, even though the less-memorable instances may be greater in likelihood. In sales compensation, this heuristic can lead to errors when judging the likelihood of different scenarios and erroneously leaning on memory that selectively recalls certain types of events over others.

Adjustment and Anchoring Heuristic

This heuristic causes frequent errors in estimating — an important component of sales compensation plan modeling. In sales compensation, the implications of this heuristic affect both modeling (not letting randomness affect estimations) and communication. How we communicate the mechanics of a plan and the order of items we communicate can greatly affect the salesperson.