YEAR 14, ISSUE 4 | APRIL 2017

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Verno's BEER BRIEF

THE WHOLESALE INDUSTRY'S LEADING BEST-PRACTICES PUBLICATION

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SALES REP COMPENSATION: LEARNINGS AND IDEAS

One of the top questions wholesalers ask us is, "*What is the best compensation system?*" The truth is there is no one, sure fire, best sales compensation system.

A few related questions wholesalers ask include:

- How many PFP goals can a rep handle?
- Should PFP goals be 30 days or 60 days?
- How much should a sales rep earn compared to his or her immediate supervisor?
- How do I keep all my suppliers happy relative to PFP goals?
- Should I do incentives on top of my PFP program?
- Should my sales supervisors be included in the PFP program?
- What is the right mix of commission, PFP, and salary?
- How do I handle seasonality and the impact on sales rep comp?

In this issue of ***Verno's Beer Brief*** we will share some of our learnings regarding sales rep compensation.

This will not be a road map to designing a new comp system - it will be a series of concepts you can use to evaluate and adjust your current sales rep compensation system.

SALES COMPENSATION LEARNINGS AND IDEAS

COMMISSIONS, PFP, AND INCENTIVES EACH HAVE DIFFERENT ROLES AND PURPOSES IN THE COMPENSATION MIX.

- **Commissions mainly push volume.** This means high volume packages. Commissions can have a small effect on the sales mix and selling high-end products but not as much of an effect as we all think.
- **The PFP portion of total sales comp drives short-term tactical execution.** Each period, new objectives can be developed to steer the sales reps in the direction determined by sales management and in alignment with the wholesaler's overall sales strategy.
- **Incentives are supplier generated short-term monetary rewards that are not completely controlled by wholesaler sales management.** The purpose of incentives is to drive execution that is not currently included in the PFP. In many cases, if incentives aren't managed correctly, they can steer the sales reps in a direction that is not aligned with the wholesaler's overall direction and strategy. Incentives do placate suppliers and are often an attempt by suppliers to get more attention than their brands warrant.

COMPENSATION MIX DEPENDS ON YOUR STRATEGY.

Based on the definitions we discussed in the above section, how you design your sales comp mix will have an impact on what behaviors you will get from your sales reps. Your answers to the following questions will help decide on the appropriate sales compensation mix:

- **What is the role of the sales rep in each channel?**
  - Selling machine, replenishment clerk, merchandiser, other?
- **While every wholesaler wants more volume, what is the overall strategy to grow profits?**
  Examples may include:
  - Continue to grow volume ahead of other priorities
  - Plan and work towards a more favorable and profitable sales mix
  - Be the most attractive wholesaler to new suppliers
  - Be risk oriented looking for the next Red Bull, Mike's, NYFRB, etc.
- **What does your supplier portfolio look like?**
  - How many suppliers do you have?
  - What level is each supplier?
  - How many supplier annual PFP opportunities do you need to make available in order to follow your overall strategy and keep suppliers happy?

HOW MUCH DOES THE REP IN EACH SALES CHANNEL INFLUENCE SALES VOLUME?

The rule of thumb here is the less the sales rep controls or influences his or her volume in their assigned accounts, the less the sales comp should be based on commission. Instead, the portion of sales comp tied to execution and achievement of wholesaler retail standards should be greater. Sales reps in different channels most likely will require different compensation packages.

COMMISSION PER CASE VERSUS % OF SALES COMMISSION

Today more wholesalers talk in terms of sales revenue and profit growth rather than just cases. It makes sense to get the sales reps thinking about sales revenue rather than just cases. While margin dollars per case can vary, margin percent doesn't usually vary as much. So getting your sales reps focused on sales dollars is really impacting gross profit dollars. Sales reps' commissions should be based on sales dollars and not cents per case.

Yes, the sales reps will get earnings increases every time there is a price increase. If you do the math on net price increase after discounts, you will see that over four or five years the real dollar increase in sales compensation resulting from the impact price increases have on commission earning per rep doesn't add up to a whole lot of money.

If you are worried about the impact price increases have on sales rep earnings and your math says the reps' earnings are growing too fast, adjust your sales commission percentage every 3 or 4 years.

DON'T LET INCENTIVES OFFSET THE INTENTIONS OF YOUR PFP.

We mentioned this earlier in this ***Brief***, in many cases incentives on top of normal monthly PFP objectives circumvent the purpose of the PFP. For example, a small supplier has an incentive that pays $10 per new placement. The sales reps think they can make $100 by getting 10 new placements. Will they chase the $100 in incentives harder than they chase one or more of their PFP goals? Do you want your sales reps spending that much time getting new placements for the new brand at the expense of other company priorities?

In most cases the answers to both of these questions should be NO. If the new product placements were that important, they should have been included in the PFP objectives. In many cases, incentive dollars compete with PFP dollars for the sales rep's attention and focus.

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SEASONAL VOLUME IMPACT ON COMPENSATION CAN BE A REAL ISSUE.

If you are in a highly seasonal market, your sales reps' incomes can be impacted by the large swings in seasonal volume. The more seasonal the route, the lower the percentage of total comp that should be tied to commission. If there is a high commission component of sales comp, then the swings in volume will have a big impact on sales rep earnings.

In seasonal markets, the sales comp mix should be skewed more towards salary and execution based PFP. If you still want to pay commissions then consider a low season subsidy on seasonal routes. This gets the sales rep in the total earnings range but doesn't disincentivize them during the larger volume months because there is no subsidy during the higher volume months. In most seasonal markets there are only two or three low volume months.

DON'T ROUTE BASED ON COMPENSATION.

Some wholesalers overly influence their sales routing based on getting the sales reps to a targeted earnings level. When wholesalers do this, they sacrifice pure logistics and make the sales rep less efficient. Every minute the sales rep spends in unnecessary travel time or calling on the wrong type of account is one less minute they can spend growing the business.

The funny thing is once a wholesaler breaks down the integrity of their sales routes in order to hit sale rep comp targets, over time more and more accounts will need to be shifted amongst sales reps and the result will be overlapping routes, geographically inefficient routes, and sales reps without enough time-to-sell.

Always route based on yours strategy (e.g. channel segmentation, required time-to-sell, etc.) and sales route logistical efficiency. Then adjust the compensation (use very small base salaries) to get reps into the target range.

HOW CAN YOU KEEP ALL OF YOUR SUPPLIERS HAPPY RELATIVE TO PFP PARTICIPATION AND OPPORTUNITIES?

Short answer: *You can't keep all your suppliers happy relative to PFP participation.*

For example: If you have 15 PFP objectives per month that is 180 objectives per rep per year. If you have 40 suppliers, that is only an average of 4.5 PFP objectives per supplier per year. You know your tier one suppliers will take two or three PFP slots every month. Your tier two suppliers will take one PFP slot per month or one PFP slot every other month, and you need to leave room for new brands you might pick up.

The way you keep the most suppliers happy is to manage the PFP participation and discriminate. Some suppliers will be included in the PFP every month, some suppliers every other month or once a quarter, while other suppliers may never be included or included only once a year.

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Also, segmenting your sales force increases the different types of PFP goals you can have each period and can help include more suppliers in the monthly PFP. For example, a supplier may be included in this month's on-premise PFP but not in the off-premise PFP.

HOW MANY PFP GOALS ARE TOO MANY?

We don't know the "perfect" number, but from our experience we recommend 10 to 15 monthly PFP goals per sales rep. If you have too many PFP goals, then the sales rep picks and chooses which PFP goals he or she will go after and which they won't even try to achieve. Too many PFP objectives generally reduces the amount of pay at risk associated with each PFP goal. Too few PFP goals and there aren't enough PFP slots to satisfy your suppliers who look to use PFP goals to drive their brand's volume and execution.

If there are too few monthly PFP incentives, then the dollar value of each goal may be too high. This increases the burden on brand and sales management to make sure the goals are realistic. If there are a small number of PFP goals, each with a high dollar value, then missing a goal or two may mean the sales rep is not able to pay his or her monthly bills.

THERE NEEDS TO BE ENOUGH MONEY TIED TO THE ACHIEVEMENT OF EACH PFP GOAL.

The number of PFP goals you have per period are somewhat dependent on the number of PFP dollars available. Too many PFP goals means the value of each goal is less. Not enough PFP dollars available each period means the value per PFP goal will be too low.

If your reps' PFP earnings are based on the percent of their assigned PFP goals achieved, then there is a good chance you are making each goal equal in value and importance. If this is happening, it's not good.

USING BOTH COMMISSION AND VOLUME GOAL BONUSES IS DOUBLE DIPPING, ESSENTIALLY PAYING TWICE FOR THE SAME VOLUME.

If you are paying a commission and a volume bonus, then you are paying twice for the same volume. When commissions are designed correctly they should be enough to motivate the sales reps to sell more volume. In most cases, if you pay a commission and a volume bonus, you often don't have enough comp money dedicated to PFP execution, or your commission is so low it doesn't push sales.

Over-emphasizing volume can cause some negative results: increased out of code, less emphasis on execution, over-emphasis on high volume packs at the expense of the right mix of higher-end products, etc.

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COMMISSION CAN CONTRIBUTE TO OUT-OF-CODE PROBLEMS.

In a flat or slightly declining market, commission encourages reps to oversell the account in order to maintain their same earnings levels as in the previous year. Commission can be a good tool and appropriate for many wholesalers, but you need to make sure commissions are not encouraging bad results.

ACCEPTABLE PFP ATTAINMENT RATES ARE BETWEEN 65% AND 85%.

Below 65%: If the total sales department is below 65%, then the goals are unrealistic (too hard). If an individual rep is consistently below 65% you may need to consider a career adjustment for that rep.

Above 85%: If the total sales department PFP attainment rate is consistently above 85%, the PFP goals may be too easy. If 10% or 20% of the sales reps are consistently above 85% then these reps should be your best performers.

USING ACCOUNT AUDIT SCORES AS A FACTOR IN COMPENSATION IS AN ADVANCED COMP MODEL CONCEPT.

Using account audit scores as one of the factors in the sales reps' compensation plans helps drive total account execution rather than reps just executing on this month's PFP.

With some of our clients, the account audits are done for each sales rep but the audits aren't factored into the sales rep's compensation. Instead, they use the account audit scores as a factor in the sales supervisor's compensation plans. When you base a portion of the sales supervisor's pay on account audit scores, you are strongly encouraging the sales supervisors to train and manage their sales reps to do the complete job at retail. This is the best way to leverage the skills and effort of the total sales force rather than having the supervisors be hired guns who accomplish short term goals. Meanwhile, the company never achieves the benefit of enhancing and leveraging the sales rep's skills and effort.

With account audits, a typical sales supervisor who is really a "super sales rep" (spending all of his or her time selling over the top of reps in order to help reps hit their monthly PFP goals) will have to learn how to train and manage his or her reps. Otherwise, the sales supervisor will fail to earn the account audit portion of his or her compensation and may even lose their sales supervisor job.

IF THE SALES REPS CAN'T EXPLAIN THEIR COMPENSATION PROGRAM, THE PROGRAM IS NOT GOING TO MOTIVATE THE REPS IN THE WAYS THAT MANAGEMENT INTENDS.

This is pretty straightforward. If a rep doesn't understand the comp plan, the comp plan won't motivate the rep as intended by management. This is a good test that any wholesaler exec can do.

Sit down one-on-one with 4 or 5 sales reps. Ask each rep to explain his or her comp plan. If the rep can't explain the comp plan, then either: a) the rep doesn't understand it; b) the rep just doesn't care to understand it; c) the plan was never thoroughly explained to the rep; and/or d) the comp plan is too complicated and can't be understood. If the reps cannot explain the sales comp plan, simplify the plan and thoroughly explain the plan to the reps. In 60 days, go back and ask 4 or 5 reps if they can explain their sales comp plan. If the reps can't explain the new comp plan, then go back to step one and start over.

WATCH OUT FOR RUNAWAY PAY. WHOLESALERS NEED COMP RANGES OR "BANDS" FOR EACH TYPE OF SALES REP.

In many wholesalers, it's common to find a few sales reps with earnings way above the targeted comp range for the sales rep position. This "over-paying" typically occurs because a rep has been given a big, high volume account or accounts that should be house accounts and over the years the rep's compensation hasn't been adjusted to factor in these circumstances.

Another contributing factor to reps being over paid is when the wholesaler buys or is awarded a substantial brand and the reps get a huge compensation windfall. For establishing ranges, consider the following points:

- Wholesalers need to establish compensation ranges for all positions, including sales reps.
- Make sure some reps aren't slowly getting into this "runaway" pay zone where they will eventually be way above the predetermined sales rep compensation range. Catch and fix a runaway pay problem early.
- Some wholesalers are successfully giving pay cuts to employees who are either getting demoted or have compensation way above the targeted compensation range.
- In many cases, pay cuts create a negative attitude and if the employee is unchecked, he or she can become a cancer in the organization. Wholesalers who plan to give selected employees pay cuts really need to assess how the employee will respond and whether or not the outcome will be acceptable to the company.
- In some cases, it's better to over pay the employee or to terminate the employee (if just cause can be established), rather than to give an employee a large pay cut.

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FOR EVERY GOOD BEHAVIOR DRIVEN BY COMPENSATION, THERE CAN ALSO BE A NEGATIVE BEHAVIOR OR RESULT THAT WAS NEVER INTENDED.

Consider the following examples:

- Comp plans with too much money tied to pure volume can stimulate sales but can also stimulate out-of-code product.
- Give each sales rep 20 monthly PFP goals. This may make more of your suppliers happy because they are in this month's PFP program. The sales reps know they can't accomplish all 20 goals so on day one of the PFP period the reps decide which PFP goals they will try to achieve and which they will not even attempt to achieve. When this happens, many suppliers will be unhappy with the results.
- Make the PFP goals really attainable so that the sales reps earnings are in the targeted comp range. At the same time, this can create an entitlement culture.
- Use supplier incentive monies to offset your total payroll cost and also create more earnings opportunities for reps. Unmanaged, supplier incentives can detract from the wholesaler's key short-term priorities and overall sales strategy.

COMPENSATION IS NOT A SUBSTITUTE FOR EFFECTIVE SUPERVISION.

Compensation is a tool. Compensation does not replace sales supervision, and it does not overcome poor sales supervision. Sales supervisors are the most important people in the company when it comes to impacting sales. Before you redesign your whole sales compensation plan, first ask yourself if your sales supervisors are performing at a high level. Are they true supervisors who leverage their sales team, or are they super sales people who just sell over the top of their reps?

We always say, "We can grow sales faster and better if we have a sales team that is paid 100% salary and has great sales supervision, rather than a sales team with a great sales comp plan and substandard sales supervision."

GREAT SALES SUPERVISION
COMBINED WITH EFFECTIVE SALES
COMP PLANS WILL MAXIMIZE SALES
EXECUTION AND OVERALL SALES RESULTS.

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KEY OPERATING INDICATORS

Key Operating Indicators (KOIs) are tools that can help alert management that there may be a sales compensation problem. Any one KOI may not tell management exactly what the problem is or the solution, but the KOIs will tell management that they need to look into the compensation program. Wholesalers don't need to get carried away and have too many KOIs as they relate to sales compensation. Each wholesaler should choose the best KOIs for his or her own company from the following list.

SALES COMPENSATION KOIs

- # of sales reps by channel that:
  - Have total earnings within the targeted sales comp range
  - With total earning less than last year
- Actual sales PFP $ paid out as a percentage of total PFP $ available for total department and by different sales channel teams
- % of supplier PFP goals attained compared to % of PFP $ paid out
- Ranking of sales people's effectiveness (best to worse) compared to annualized earnings for each rep

CONCLUSION

Sales compensation systems are a major tool in sales management's arsenal for managing and directing the sales force. We encourage every wholesaler to conduct focus groups with selected sales reps that represent a cross section of the entire sales force. These sales rep focus groups should be kept to a manageable number of participants to help ensure the group is managed and stays on topic. During the focus groups management will learn some of the real problems that exist in the sales department that need to be addressed. Sales management will also learn some of the perceived problems as seen by the sales reps. While these perceived problems may not really exist, the sales reps' perception of these problems will still need to be addressed by management.

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