



TECHNICAL UNIVERSITY - SOFIA  
FACULTY OF MANAGEMENT



UNIVERSITY OF VERSAILLES  
SAINT QUENTIN EN YVELINES – FRANCE  
GRADUATE SCHOOL OF MANAGEMENT



SCIENTIFIC AND TECHNICAL UNION  
OF MECHANICAL ENGINEERING

NATIONAL SCIENTIFIC AND TECHNICAL SOCIETY  
“MANAGEMENT AND ENGINEERING”

## CONFERENCE PROCEEDINGS Volume II

XIV INTERNATIONAL  
SCIENTIFIC CONFERENCE  
“MANAGEMENT AND ENGINEERING’ 16”

DAYS OF SCIENCE AT TU-SOFIA

JUNE 19-23, 2016  
Sozopol, Bulgaria



# SCIENTIFIC PROCEEDINGS

*SCIENTIFIC-TECHNICAL UNION OF MECHANICAL ENGINEERING*  
*Year XXIV 13/199* *June, 2016*

# XIV International Scientific Conference

MANAGEMENT AND ENGINEERING '16

ISSN 1310-3946  
ISSN 1314-6327

DAYS OF SCIENCE AT TU-SOFIA, 2016

JUNE 19-23, 2016  
Sozopol, Bulgaria

# FINANCIAL LITERACY FOR BUSINESS: REMUNERATION SYSTEM FOR SALES STAFF IN THE CONDITIONS OF UNCERTAINTY

**Nadezda Koleda**

*Faculty of Engineering Economics and Management,  
Riga Technical University, Latvia,  
E-mail:nadezda.koleda@rtu.lv*

**Abstract.** Sales staff remuneration system is one of the basic tools to increase income of a company. Approaches to remuneration systems are very variable and depend on business specific and branch the company is operating in. Determining the appropriate system is crucial for motivation of sales staff, as well as profit assurance. The issue is a complex, difficult and time consuming process for the majority of company as targets and interests between sales staff and owners of the company differ. The aim of this paper is to present an approach to determining the optimal remunerations system for sales staff by sharing experience in the development and implementation of it for a start-up Latvian company, which operates in uncertainty conditions.

**Keywords:** sales staff, remuneration system, conditions of uncertainty.

## **1. Introduction**

The appropriate remuneration system for sales staff is one of the basic tools to increase profitability of a company. If company is operating under uncertainty conditions it might become a multidimensional problem to solve which is caused by the crucial difference between the targets of companies' and their sales staff. It can cost around 40 per cent of gross income to run an office and determining the commission that is suitable for sales staff. Between 31 and 40 per cent of sales is spent on salaries [1]. There are many guidelines, regulations and standards related to fix salary and the amount of incentive pays for sales staff, but their applicability in the conditions of uncertainty is limited, risky or demotivating. The nature of sales means that remuneration system has traditionally been more results driven for sales staff than for other types of employees [2]. Meanwhile researches show that 50% of sales staff are not satisfied by their income. In some specific branches like estate industry their share from total staff might achieve 43% in average. Demotivation negatively impacts the level of sales representatives' turnover in company. Three years after registering, less than 50% of sales representatives may still be working in the industry [1]. According to a September 2008 survey conducted by Deloitte only 41% of business owners are satisfied with their sales compensation plans, and fewer than half say the plans do enough to encourage the right selling behaviour [3].

Determining the appropriate remuneration system is crucial for motivation of sales staff, as well as profit assurance. This issue is complex, difficult and a time

consuming process for most companies due to targets and interests between sales staff and stakeholders of the company differ.

The aim of this paper is to present the approach to determining the optimal remuneration system for sales staff by sharing experience in the development and implementation of it in a start-up Latvian company, which is operating in conditions of uncertainty.

## 2. Insights into existing remuneration systems for sales staff

The remuneration system for sales staff usually consist of two basic elements: salary and incentive pays. Salary is a fixed payment independent of current salesperson performance. Incentive pays are applied in the form of a commission or bonus. Commission is a percentage of some outcome measure; commonly, as a percentage of sales revenue or of profit or gross margin generated by the salesperson. Bonus pay is typically awarded as a lump sum and is contingent on reaching a goal set by management over some time horizon (e.g. monthly, quarterly, yearly), such as selling more than a pre-specified quota amount or reaching sales goals for a particular product. Team selling awards supposes either commission or bonus based on sales by a team of multiple salespersons [3].

There are 3 types of sales staff remuneration systems: 1) straight commission, 2) straight salary, 3) salary plus additional incentive. Under “straight commission” compensation arrangements, the salesperson receives a previously agreed-upon percentage of the selling price. The size of the percentage of the commission may vary from product to product. Business experts estimate that fewer than 15 per cent of firms apply a straight commission basis, although the majority of those companies that do choose this method of compensation indicate satisfaction with it. The remuneration system “straight salary” is based on eliminating employees' incentives. It is a fixed payment independent of current performance of sales person. “Salary plus additional incentives” is the most common one applied for compensation of sales force [4]. That system is applied by 66% per cent of companies which assume incentives linked to performance of salesperson stimulates his outcomes [5, 6].

The risks and advantages companies from applying the additional incentives are presented in the Table 1.

**Table 1.** Risks and advantages of additional incentives

Type of Incentive	Risks	Advantages
commission paid on sales (payment of X per cent of sales)	<ul style="list-style-type: none"> <li>• complexity of identification and selection process of the most appropriate commission rates</li> <li>• strong focus on economic self-interests of salesperson and conflict of interests between him and company</li> <li>• limited motivation opportunities</li> <li>• impossibility to identify valid commission rates in cases of uncertainty, when historical data regarding sales, costs and profit are not available and future prognosis have low probability,</li> </ul>	<ul style="list-style-type: none"> <li>• simple and clear for understanding by sales staff</li> <li>• easy and low time consuming calculation of commission volume for payment</li> </ul>

	<ul style="list-style-type: none"> <li>• high risk of losses in case sales force focuses on selling of low margin products, which can cause risk of non-covering total costs and expenses.</li> <li>• impossibility to set the focus on selling the highest-margin product</li> </ul>	
commission paid on gross margin (payment of X per cent of gross margin)	<ul style="list-style-type: none"> <li>• complexity of the identification and selection process of most appropriate commission rates</li> <li>• limited motivation opportunities</li> <li>• impossibility to identify valid commission rates in cases of uncertainty, when historical data regarding indirect costs are not available and future prognosis have low probability</li> </ul>	<ul style="list-style-type: none"> <li>• simple and clear for understanding by sales staff</li> <li>• easy and low time consuming calculation of commission volume for payment</li> <li>• focus on selling highest margin product that minimize the risks of losses</li> </ul>
Bonus paid individually for performance over quota, lump-sum payment for sales over minimum quota amount or bonus paid from fixed pool	<ul style="list-style-type: none"> <li>• complexity of identification the appropriate volume of bonus in cases of uncertainty, when historical data regarding indirect costs are not available and future prognosis of earnings and costs and expenses have low probability</li> </ul>	<ul style="list-style-type: none"> <li>• motivation for self-development</li> <li>• easier to identify the most appropriate amount of bonus if the expected net earnings are easy to be prognoses</li> <li>• easy for setting sales priorities</li> <li>• minimal risks of getting losses due to inappropriate incentive payments due to fixed size of maximal bonus</li> </ul>
Team Selling Award (Bonus or Commission)	<ul style="list-style-type: none"> <li>• complexity of identification and selection process of the most appropriate commission rates</li> <li>• limitation in efficient applicability for unstable teams with different levels of capacities of salespersons</li> </ul>	<ul style="list-style-type: none"> <li>• increase of team effort</li> </ul>

[created by author]

The efficient applicability of standard types of incentives is very limited in the conditions of uncertainty when company doesn't has access to historical data regarding sales, direct and indirect costs, or has limited information awareness regarding market, as well as unforeseeable changes in the future. That fact is crucial for companies, which launches innovative products or has start-up projects.

Identifying the most appropriate fixed payment amount and incentive pays type, their volume and proportion becomes an issue for that type of companies in uncertainty conditions. Researches show that the more uncertain companies' sales cycle is, the more a salesperson's pay should be based on a fixed salary; the less

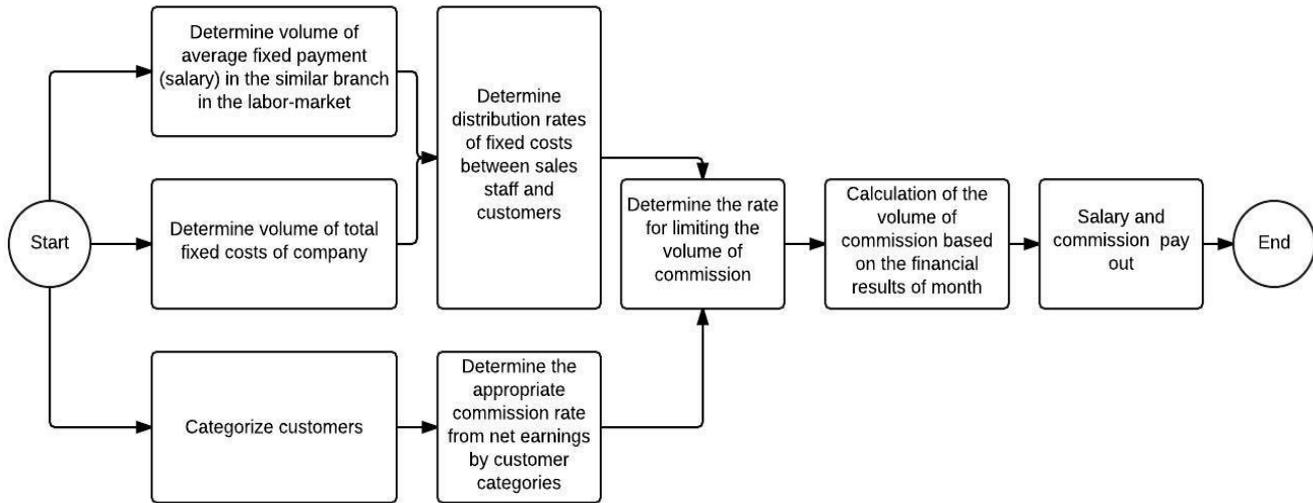
uncertain the cycle, the more pay should depend on commission [7], although that is impossible for start-up or innovative companies which need fast sales growth to support coming business activities. Under uncertainty conditions a start-up or innovative company has to implement remuneration system for sales force, which consider minimal financial risks and fast market growth.

### **3. Approach to optimal remuneration system for sales staff in uncertainty conditions**

The author of the paper suggests the approach to optimal remuneration system for sales force must take into account monthly financial results to eliminate the risks of financial losses due to unreasonable high employee costs, and also considers:

1. motivation of salesperson to sell high prioritized products;
2. motivation of salesperson to engage high prioritized clients;
3. motivation of salesperson to promote the product or services company provides;
4. motivation of salesperson to attract new clients and increase personal portfolio of clients;
5. motivation of salesperson to work in a team and to contribute indirectly into development of general portfolio of company;
6. minimization of attrition rate.

The algorithm of the above suggested approach consists of the stages presented in the flowchart below:



**Fig.1.** The algorithm for implementation of optimal remuneration system for companies which are operating in the conditions of uncertainty

The optimal remuneration system supposes the incentives calculated by formula 1:

$$C_j^{opt} = \begin{cases} C_j^{max} < C_j, & C_j \\ C_j < C_j^{max} & , C_j^{max} \end{cases} \quad (1)$$

where:

$C_j^{opt}$  - optimal volume of incentives payable to salesperson  $j$ ,  $j=[1, n]$ ;

$C_j$  - volume of incentives earned by salesperson  $j$ , taking into account financial outcomes of his activities,  $j=[1, n]$ ;

$C_j^{max}$  - maximal volume of incentives receivable by salesperson  $j$ , taking into account overall financial results of the company's activities,  $j=[1, n]$ .

The volume of incentives ( $C_j$ ) earned by specific sales person ( $j$ ) is identified taking into account gross profit ( $GP_j^i$ ), he generates from selling specific product or providing specific services ( $i$ ), volume of indirect costs distributed to this specific customer and related to this salesperson ( $VC_j^i$ ), the distribution rate of net earnings ( $NES_i^{CS}$ ) by customer categories ( $i$ ) taking into account the requirement to share of deals ( $CS_i$ ) with that customer into total number of deals completed by specific sales person (formula 2):

$$C_j = \sum_i^k ((GP_j^i - VC_j^i) * NES_i^{CS_i}), \quad (2)$$

where:

$i$ - customer,  $i=[1, k]$ ;

$j$  – salesperson,  $j=[1, n]$ ;

$CS_i^j$  - requirement to share of deals with customer  $i$  into total number of deals completed by sales person  $j$ ,  $CS=[0,1]$ ;

$NES_i^{CS}$  - the distribution rate of net earnings by customer categories ( $i$ ) taking into account the requirement to share of deals ( $CS_i$ ) with customer ( $i$ ) into total number of deals completed by sales person  $j$ ,  $NES=[0,1]$ ;

$GP_j^i$  - gross margin generated by sales person  $j$  from deals with customer  $i$ , EUR;

$VC_j^i$  - indirect costs distributed to customer  $i$  related to salesperson  $j$ , EUR;

Maximal volume of incentives receivable ( $C_j^{\max}$ ) by salesperson  $j$ , taking into account overall financial results of the company's activities are calculated using the formula 3:

$$C_j^{\max} = \frac{(GP_t - VC_t) * NES_t^{sf}}{n}, \quad (3)$$

$GP_t$  - total volume of gross profit of company received in accounting period, EUR;

$VC_t$  - total volume of indirect costs occurred in accounting period, EUR;

$NES_t^{sf}$  - share of net earning which can be spent for remuneration of sales staff [0, 1];

$n$  – number of salespersons, [1, r].

The limitation of volume of incentives receivable by specific salespersons minimize the risks of financial losses.

#### 4. Implementation of optimal remuneration system for sales staff in the conditions of uncertainty: case study from Latvia

The author of the paper has applied suggested approach and implemented the optimal remuneration system in a Latvian wholesale trade company, which sells construction materials. The optimal remuneration system for sales force of this company supposes next specifications:

- 1) customers of the company were categorized into 3 groups - new customers ( $i=1$ ) attracted directly by salesperson  $j$ , existing customers ( $i=2$ ), new customers attracted indirectly by salesperson  $j$ , ( $i=3$ ).
- 2) There was one requirement to minimal share of deals ( $CS_i^j$ ) with the customer  $i$  into total number of deals completed by sales person  $j$  are:  $CS_1^j=0.70$ .
- 3) The distribution rates ( $NES_i^{CS}$ ) of net earnings are:  $NES_1^{CS_i} = 0.30$ ;  $NES_2^{CS_i} = 0$ ;  
 $NES_3^{CS_i} = 0.10$

The results of efficiency analysis of developed optimal remuneration system in the current period compared against the beginning period of its implementation are presented in table 2.

**Table 2.** Outcomes of optimal remuneration system

Outcome	Improvement within half a year
Growth rate of number of deals	89%
Growth rate of net earnings	194%
Growth rate of number of new customer	200%

The suggested specifications of the remuneration system became key drivers to attract new customers and increase market share of company, as well as motivate sales people.

#### 4. Conclusions

Determining the appropriate remuneration system for sales staff is complex, difficult and a time consuming process for most of companies operating under uncertainty conditions. Presented optimal remuneration system supposes the elimination of such risks as financial losses and demotivation of sales staff, while assuring a strong improvement in growth market share and increase of net earnings. The applicability of this approach is unlimited. It can be adopted to specific companies as well as to sales staff requirements. It doesn't require strong software support and can be implemented by means of MS Excel, that makes it a fast, cost saving option and easy to implement tool.

#### Funding

This work was supported by the Latvian Council of Science [grant number 394/2012]

#### Reference

1. Sales staff Remuneration, Elite Agent Magazine, [Online], [Cited 26.08.2009]. Available from Internet: <http://eliteagent.com.au/>
2. ARMSTRONG, M., Employee reward, CIPD Publishing, 2002, 583 p.
3. COUGHLAN, A. T., JOSEPH, K., Sales force compensation: research insights and research potential, [Online], [Cited 18.11.2011], Available from Internet: [http://www.kellogg.northwestern.edu/faculty/coughlan/htm/personalpage\\_files/Papers/LILIEN%2026%20Anne%20T.%20Coughlan%20and%20Kissan%20Joseph.pdf](http://www.kellogg.northwestern.edu/faculty/coughlan/htm/personalpage_files/Papers/LILIEN%2026%20Anne%20T.%20Coughlan%20and%20Kissan%20Joseph.pdf)
4. Sales Commissions - advantage, percentage, disadvantages, Basic compensation plans for salespeople, Encyclopaedia of Small Business, [Online], [Cited 19.04.2016], Available from Internet: <http://www.referenceforbusiness.com/small/Qu-Sm/Sales-Commissions.html>
5. DONALDSON, B., The importance of financial incentives in motivating industrial salespeople, The Journal of Selling and major Account Management 1:1, July, 1999
6. BAKER, M., The Marketing Book, Butterworth-Heinemann, 2002, 834 p.
7. CHUNG, D., How to Really Motivate Salespeople, Harvard Business Review, [Online], [Cited 30.04.2015], Available from Internet: <https://hbr.org/2015/04/how-to-really-motivate-salespeople>