Motivation by commission based pay

In today's competitive environment, companies are constantly striving to survive and grow by pushing their sales department to grow sales and in turn their bottom line. As a great motivational tool, most companies that rely stronly on their sales force will use incentives contracting such as commission based pay.

According to Washington (2009) , commisions are " a form of variable pay by which staff earn a cut of the income they create for their employer". As a result, the company directly links its perfomance to those of its sales staff so that their income is dependent on the company's sucess.

According to Interest and Octaviani (2009), a selling agent has two direct tasks: (1) prospecting for customers and (2) advising on the product's suitability for the specific needs of the customers. Consumers usually rely on information and advice provided by representatives of a seller when purchasing unfamiliar products. Therefore, having a knowledgable and ethical sales force is key to having a high customer service company that will lead to customers being satisfied.

Yet comanies fail to realize that having their sales staff on commission based pay will only increase sales and higher profits in the short-term. Long-term it will have a negative effect on the company's reputation and growth. This paper will argue that having a company's sales force on commission-based pay will lead to lower customer satisfaction and in turn hurt the company's bottom line. As customers become aware of fradulent selling techniques, customers will loose trust with the company, decreasing customer satisfcaion. This will, in turn, lower custoer service brand image and therefore, loss of those customer. As a result, the company's sales and profits will decrease.

This paper will start by first discussing the benefits of commission based pay such as having a transparent reward structure, having access to resulr oriented employees and having the ablity to share risks with sales force. The paper will then discuss all the risks associated with adopting a commission only compensation model such as creating disloyalty to the organization, severe flunctuations in earnings for the sales staff and having a short-term focus versus a long-term focus.

It will continue to discuss the effects it has on the company's customers such as making the wrong recommendations, overstating benefits and loosing customer trust. The company also is negatively affected by commission based pay by having negative effects on employee relations, loss of reputation and the liability of being sued. The paper ends with giving recommendation on the best way to overcome the problem and suggests that companies that care about customer service levels should adopt a mixture of commission and salary base pay.

Benefits of Commision Based Pay

Commission Based pay can be rewarding for both the employer and the employee. It gives staff assurance and confidence that they are contributin to the company's sucess (Washington, 2009). Having an engaged and motivated sales staff can be vital for some comapanies as they can be the only source of income for the company. Commissions are usually a common way of rewarding top performers in a company. According to Washington

(2009), “ commission based pay leads to a transparent rewards structure based on success.

Aggresive selling through commission based pay is not something that companies should always fear. Meyers (2010) argues that agresive selling will sometimes increase customer satisfaction levels especially when the firm offers a product or service the customer was not aware he/she needed. The difference between bad aggresive selling and good aggriseve silleing is making sure the customer feels as if they can trust the sales person’s advice.

MacAlpine, a McKinsey consultant, which is dicussed in Meyer’s article (2010), discusses that selling solutions to people’s problems while making their lives better is the key aspect of a good sale and should be the top goal for both the company and the front-line sales representative. The author continues to argue that commissions are a great way to “ inject sales motivation into the workforce”(Meyer, 2010) but too many companies fear that it will detract from customer service and customer relationship. In fact, when a customer accepts a product or service that is offered through aggresive selling, the customer satisfaction level actually improves because the firm was able to offer a product or service, the customer did not know he/she needed it (Meyer, 2010). Anticpating customer wants and needs before they themselves are aware of it is the true key way in building an effective sales force.

Caruth (2006) argues that by having a commission based pay, a company is able to motivate their sales staff to exert more effort for every customer they try to service. That may not necerssrily mean it will result in a closed sale as over aggresiveness can lead the customer to get frusrated and see the whole experience in a negative way. Nevertheless, it also benefits the company by improving their human resources prcatices in recruitment. An organization that uses commission based pay is likely to attract results-oriented sales personnel “ who value a high earnings potential and the freedom of action that may come with it” (Caruth, 2006). As a result an organization can have a competotive advantage by using commission based pay in recruiting top talent. Straight commission plans tend to quickly eliminate incompetent sales personell, as the compaany can quicly and effectively use compensation plans as a means for perfoamance measures (Caruth, 2006)

Furthermore, it allows an organization to share its risks and rewards with its salespeople. Therefore, employees become aware that their own sucess depends on how well they are able to suceed at their given job and be able to meet their goals (Caruth 2006). When they become aware of this link between the company’s sucess and their own level of income, it motivtaes them to put the extra effort in closing each sale.

Commisson Based Pay can benefit companies in tremendous away. Apart from creating a trasnparent reward structure system, it gives assurance and confidence to the sales person knowing they are contributing to the sucess of the company. In turn, the company has access to results oriented employees and has the ability to share risks with its sales force.

Risks of Commission Based Pay

Meeting the company’s demand, however, may sometimes change the company’s goals towards achieving high customer satisfcation. When a sales person only thinks about the money they are going to earn from the sale rather than finding the right deal for the customer, the shift changes from customer satiscation to financial gains. This in the long-run can have a negative effect on the company’s financial standing.

One great disadantages of a commission-only approach to sales compensation is that “ commission-only approach encourages salespeople to think of themselves as free agents rather than company employees thereby creating a greater than usual sense of disloyalty to the organization” (Caruth, 2006). In turn for the sales person themselves, it creates dramatic overpayments or underpayments, leading desparete for income sales people to pursue unethical selling techniques such as misrepresentation of a product’s benefits.

When salespeople experience severe fluctuations in earnings from period to period due to variations in sales volumes, it may lead the company to observe higher employee turnover, increasing their recrutment and selection costs (Caruth, 2006) . Added expenses to the company only hurts its bottom line in the long-run.

Salespeople on commission based pay may be “ tempted to seek out easy sales rather than cultivate more potentially profitable long-run customers” (Caruth, 2006). As a result, short-term, company sales and profits will increase but in the long-term, it will have a negative impact on the company’s reputation and growth as customer’s percetption of the company will decrease.

Misseling techniques

According to Inderst and Ottoviani (2009), misseling is the “ questionable practice of a sales person selling a product that may not match customer’s specific needs”. In their paper, Misseling through agents, they argue that when the firm provides steeper incentives to its sales force, “ the agents will be more tempted to inflate the perceived value of the product or to recommed the purchase, even if the product is innapropriate for the customers they indentify” (Inderst & Ottaviani, 2009). Firms that missell through their own employees may be help vicariously liable, damaging their reputation with their current customer base. On a harsher note, when misseling occurs through independent intermediaries, a companty is at risk of being sued or face regulatory sanctions incuuding loss of business licence (Inderst & Ottaviani, 2009).

Fraud accucatsion over auto repair sales staff on commissions cost Sears $15 million in refunds and other legal costs. Sear’s auto repairs were accused of padding their commissions by falsesly diagnosing brake and alignment problems. As a result after the errupted scandal, Sears has stopped paying commissions and elimated the job of the service adviser. Their new compensation plan is now based 60% base salary and 40% on customer satisfcation reviewed through customer satisaction cards (Driscoll, 1994).

Effecs on the company’s business strategy

According to Washington (2009), a large proportion of commission based pay will encourage a company's sales staff to behave in ways that are not aligned with the company's overall strategy especially if that company has at its core value customer satifsction. Employees will become focused on gaining short-term benefits such as the monetary gains made from the current sales while forgeting about the long-term ideals of the company. (Washington, 2009)

Forgetting other job tasks:

High proportions of commissions will result in a company's sales staff focusing all of their attention and time on activities that carry monetary incentives while forgeting about equally important aspects of their jobs (Washington, 2009). For example, a clothing sales staff on commission will focus all their time on finding prospectinve new customers that enter the store and selling them items while forgeting to maintain the visual appearance of the store including folding and putting away discarded clothes after a customer has tried them on. As a result, the store's appearence becomes disorganized, affecting its image and future customer's perception of the company. In the long-run the store receives a negative image , affecting customer satisfcation levels.

Entering new markets:

Lastly, commission based pay will make it difficult for a company to open up new territories because of the reluctance of salespersons to " perform the necessary missionary sales work" (Caruth, 2006). Due to enterng a new market, the company will have to deal with the available product/services from competitors already servicing that market. Therefore, the sales process is more intense and requires huge amounts of up-front selling time. As a result, the new product/service is “ often not afforded the requisite sales effort because the sales time required is too excessive for the amount of compensation received” (Caruth, 2006).

Commission orientetd employees will not be satisfied with performing duties that although beneficial for the company in the long-run, will have a negative impact on the employee’s level of income. Caruth goes on to state that “ commissions should not be relied upon to drive long-term market share development” (2006). He argues that while commissions have their benefits it provides little incentive for development of new markets or the introduction of new products. “ It is easy and convenient for sales personnel to continue spending their time selling established product lines and earning sufficient income levels” states Caruth (2006).

Effects on Customers

Companies spend large amounts of sums each year trying to influence the purchasing behaviour of customers towards their products or service. Apart from the adveristng campaign, “ the customer’s opinion of the credibility and integrity of the firm’s reputations” are of paramount importance (Volkman & Henerbry, 2010). According to Volkman and Henebry(2010) some companies directly address the fundamantal element of credibility in their adveristing campaign “ by making statements attesting to the company’s credibility about its claims.” At the same time many companies engage in commission based compensation that increase their reputation risk while “

concurrently employing advertising campaigns that attempt to improve their reputation with their customers (Volkman & Henerbry, 2010).

Due to the world wide web boom, today's customers are more educated and more prepared to see through a seller's techniques. Armed with information about the product they are considering purchasing, they enter the seller's store aware of misseling technniques. When the information argued by the sales staff does not match the information previously researched by the consumer, the client's perception of the company is one of the seller trying to use misselling techniques.

Volkman and Henebry(2010) irrepebly argue that while most companies have " increased the use of incentive contracting" such as commissions, they have also " simultaneously expressed increased interest in maintaing or improving the reputation of their firm" (Volkman & Henerbry, 2010). Their research shows that these two interests are incongrous and that the use of incentive contracting will not align the interests of the company with those of its sales staff and will expose the compay to increased reputation risk (Volkman & Henerbry, 2010).

By incorporating Finnerty's compensation model, the researhsers demonstrate in their work that a salesperson working with incentives will increase the company's reputational risk by " misrepresenting the product or service of the firm" (Volkman & Henerbry, 2010). They argue that this " is a function of the existence of asymmetric information between the salesperson and thecustomer" and give as an example " customer knowledge base, the inability of management, to monitor a salesperson's s actions, the lack of a timely penalty for a salesperson's aberrant actions, and the relative level of salesperson'scommission to base compensation" (Volkman & Henerbry, 2010).

In their research, they demonstrate that " incentive contracting, such as commissions, may encourage a sales staff to seek excessive risk thereby decreasing the firm ' s reputation and corporate value" (Volkman & Henerbry, 2010).

Companies should refrain from using commission based pay if they are concerned about their reputation and if they " operate in an environent of a high degree of customer asymmetric information" such as when the sales staff is more knowledgable about the products and services sold than its customers (Volkman & Henerbry, 2010). If they do, they need to have a " systematic monioring process that includes customer questionaaires related to promises and statementds made by the sales staff" (Volkman & Henerbry, 2010). Companies that work in industries where asymetric infotmation is happening between the customer and its sales staff are financial services, automotive repair and electronic goods (Volkman & Henerbry, 2010).

Prudential Insurance Company suffered significant damage to its reptation and was forced to pay $1. 1 billion to former customers due to exxagerated claims made by its sales staff. Other companies such as Citigroup and AIG were also negatively affecred, by having to deal with financial losses, threats of suits and degradation of reputation due to the use of commisions as a means of compensating sales staff(Volkman & Henerbry, 2010).

Some companies such as Best Buy, Charles Schwab, Trans-Source Financial Center, PRIN and Virgin Fiancial are now averstisging no commission payment package to its sales staff in order to reasure customers that they are attempting to decreate unethical behaviour by eliminating the incentives created by commissions (Volkman & Henerbry, 2010).

In his article When your name’s on the store, Murray(2006), argues thatcustomers have become aware of the differece between “ motivation by pay cheque” and real passion for selling a product or service. He states that big retail stores can not match the superior selling services of smaller companies due to service representatives aggresively selling a product which they get commission on (Murray, 2006). It seems that their primary goals and objectives differ. While big corporations solely think about increasing net profits in order to pay their shareholers, smaller companies strive to survive by thinking of creating loyalty with their customers long-term. This leads to a higher customer service level and in turn a higher customer satisfaction.

The sales force incentive scheme based on sales commission may induce the short-term focused salesperson to misrepresent the value of an upgraded product or service (Kalra& Srinivasan, 2003). By exagerting the value of its added features, the company will have lower profits due to a reduction in customer satisfcation levels (Kalra& Srinivasan, 2003). While big companies focus millions of dollars on software and employee training programs for their staff in order to create a sense of customer intimacy, smaller stores survive and grow because they excel at building relationships with their customers (Murray, 2006).