CommissionCalc Automates Incentive Plans for Distributors and Manufacturers

Of all types of businesses, distributors and manufacturers have, by far, the most varied commission rules. This isn't surprising, since they sell many different products into as many different markets. For example, lighting products may be sold at a higher price than the "standard" and the commission often includes most of the premium; packaging products, having slim margins often base commissions on gross profit rather than sales. However, much of the variation results from each company having its own unique marketing strategy. For example, management may want to:

- Promote certain product lines, either because they're the most profitable lines or because they're trying to break into a new market
- Authorize salespeople to give discounts, but make sure they don't give away the store
- Encourage new customer acquisition
- Coordinate selling efforts with seasonal promotions

This paper describes many of the rules we have encountered computing commissions and rebates for the food industry.

Who gets paid?

The salespeople may be employees, independent reps, or both. Frequently there are both inside and outside salespeople, each group having its own rates and rules. In some cases, each inside salesperson automatically gets a percentage of certain outside reps' sales, even though the inside salesperson is not identified on the invoice. Other companies pay a team commission to all inside reps or to all outside reps in a particular region. In addition to these salespeople, distributors may get rebates from the manufacturers whose products they sell and regional sales managers may get an override on their reps' sales. Sometimes support personnel, such as an engineer or consultant who helps sell a technical product, are included in the commission plan.

When the shipping location is not the same as the billing location, commission may be paid to the salesperson for the billing location, the salesperson for the shipping location, or a combination of the two. Even if a customer buys directly from the manufacturer or distributor, the rep responsible for that customer usually receives a commission. This is also true of internet sales, which are complicated by the large number of customers and the fact that the products may be shipped anywhere in the world.

One source of error is manual entry of the salesperson ID on the invoice. This can happen if the salesperson who made the sale is different from the usual salesperson for that customer, or if commission is split when salespeople in different regions cooperate on a sale. In these cases, order entry personnel are often responsible for changing the salesperson on the order, but they may forget or not know about special circumstances.

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This causes errors and lost time. To prevent that, the commission software must be able to override incorrect data on invoices *before* commission is calculated. Also, it must maintain an audit trail of these overrides.

How is commission calculated?

Rates often vary by salesperson, customer, and item, but many other factors may also be used. Discount percent is one. Invoice date (for special promotions), product line, customer type, region, costs on related purchase orders, trade show promotions, sales quota or tier, and shipping method, to name just a few, can all affect the rate. Critically, these methods are usually combined. For example, one salesperson may be commissioned based on discount while another works on a quota, and a third's rate depends on both discount and quota.

Please see our companion paper on quotas and tiered payments for a more detailed description of plans which include them.

Occasionally, sales volume of one product affects the rate paid on another. For example, a salesperson may have a separate quota for each product line and have his or her commission reduced across the board for each unmet quota.

And, no matter what the rules, there are always exceptions. For example, even if rate is not usually based on discount, special pricing can affect commission on an individual order or for a single customer. The commission software must allow for exceptions to prevent manual changes to reports which should be final.

Most commonly, the rate is multiplied by revenue. The second most common method is to use gross profit, perhaps adjusted by adding overhead, shipping cost, or other items to product cost. In a few industries, such as food, the rate may be an amount per unit.

Bonuses may be paid, or prizes awarded, for reaching one or more targets.

When sales are done through independent reps – which they often are – each one may negotiate his or her own compensation terms. Therefore, there may be as many variations as there are reps.

When is commission paid?

There are four common commission payment triggers: Pay when the invoice is cut, when full payment of the invoice has been received, when a partial payment has been received, or part when the invoice is created and part when payment is received. However, these aren't the only methods. For example, some companies pay a fixed amount of time after the invoice is cut, or pay when their customer resells the product.

Although paying commission on invoicing rewards the salesperson quickly for making sales and is, therefore, a good motivator, it may cause cash flow problems. In addition, there is a risk that the salesperson gets paid but the customer doesn't pay the invoice. Therefore, when this method is used, commission may be charged back if payment is received late or written off. A few companies charge back commission in tiers; for example, half of the

commission may be charged back if the invoice isn't paid in 90 days and the balance if the invoice is still open at 120 days. Paying on invoicing is the second most common method.

Paying commission on receipt of full payment avoids the problem of non-payment and partial payment by the customer. If salespeople help in collections, paying on full payment encourages them to get their customers to pay promptly; reducing commission if payment is too late provides a further incentive. When aiding collections is an objective of the plan, commission reports should show open invoices and the commission which will be paid when they are paid off, plus any amount which will be forfeited if payment is not received by a date specified on the report. Paying on receipt of full payment is the most common method.

Paying on receipt of partial payment by the customer is not as accurate as the other methods because there's no indication in the accounting system of which part of an invoice is being paid. If the customer is paying for freight only, one would want not to pay any commission; if they're paying for one product and not another, one would want to use the correct product's commission rate. But accounting software typically doesn't apply payments to individual invoice lines, so the partial payment must be pro-rated among all items sold on the invoice.

The benefit of this method is that it may seem fairer to the salesperson, especially if almost the entire invoice has been paid or if part of the payment is delayed due to a dispute for which the salesperson is not responsible. Sometimes this method was originally used because it was easy to compute – salespeople got a percentage of total cash received from their customers – and it is retained when more sophisticated commission software makes it unnecessary. Although this is less common than either of the above methods, some companies do pay on receipt of partial payment.

Lastly, a manufacturer may sell to a distributor and pay the distributor a rebate when the product is sold to the final customer. These end-user sales are not in the manufacturer's accounting database. Instead, the commissions are paid based on a file provided by the distributor identifying end-user sales for the month. Similarly, commission may be paid to the company's salesperson when goods are sent from a customer's distribution center to one of their stores, or sold to an end user. When one of these methods is used, it typically applies only to sales to certain customers.

And, as if all of the issues above weren't enough, these rules keep changing with varying market conditions, new brokers, new customers, and renegotiations.

Rule-driven software – and *only* rule driven software – can accommodate these complexities. CommissionCalc is unique among rule-driven commission software packages in that it is affordable for companies of all sizes and is easy to set up and use. Many manufacturers and distributors are saving thousands of dollars in overpayment and days of work each month by using CommissionCalc.

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For more information about CommissionCalc, contact sales@commissioncalc.com, browse to www.CommissionCalc.com, or call 888-962-6667 x22.