

# When to Pay Commission

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The timing of commission payments affects sales force motivating, cash flow, and how practical it is to compute commission accurately and promptly.

The most common times to pay commission are on:

- Booking
- Invoicing
- Receipt of partial payment
- Receipt of full payment
- When project milestones are reached

When delivery of the product or service spans a long time, Commission may be paid in pieces at several points in the sales cycle and during delivery or implementation.

Here are the pros and cons of each of these methods.

## **Booking**

Pros:

Rewarding salespeople immediately after they make the sale is the most powerful motivator because it provides immediate positive feedback.

Cons:

Since you pay commission before you get paid, this can be tough on cash flow. Also, it can be hard to recoup the commission if the order is cancelled or changed – perhaps impossible if the salesperson has left the company or the commission was paid to an independent rep.

Also, computing this type of commission creates technical problems. Most accounting and ERP systems don't keep an audit trail of order changes and cancellations. Therefore, it may not be practical to automate adjustments due to order changes. However, tracking changes manually is guaranteed to create errors, which will adversely affect sales force motivation and result in overpayment.

Although few companies pay on bookings, some do. Paying on bookings is more common for long projects, such as construction. Some companies combine payment on bookings with one of the other methods paying, for example, half of the commission when the order is booked and the balance when it's invoiced.

## ***Invoicing:***

### Pros:

Since, after bookings, this is the earliest time to pay, it's the second best motivator. Also, if you compute Commission manually, this is the easiest method to use: every accounting system includes reports of invoices for a month.

### Cons:

You may pay commission on more sales than you get paid for and salespeople have no incentive to help collect receivables.

As with payment on bookings, this can be tough on cash flow. That's especially a problem if your product is seasonal, creating lean months when you purchase inventory and fat months afterwards when you get paid.. Also, this method will create problems if your customers frequently pay short, have a high default rate, or often return goods. However, you may be able to overcome this by "clawing back" commission if an invoice hasn't been paid in full in a certain number of days.

This is the second most common time to pay commission.

## ***Receipt of Partial Payment:***

### Pros:

This is easier to measure than full payment if you're computing Commission manually, because you don't have to figure out if a payment fully paid an invoice, and credits have no effect on commission due. All you need is a list of payments for the period. Also, it has the advantage that you pay out of what you've received, just as the previous method does – although, in this case, you've incurred all of the expense but perhaps received only part of the cash.

### Cons:

If your commission rates depend on the product or service being sold, paying on partial payment is very imprecise, since there's no way to know to which invoice line(s) a payment applies. If the lines have different rates, or the invoice includes non-commissionable items such as freight or tax, the commission paid will be only approximate.

Not all commission software supports this method of computation. Furthermore, when short payments are due to disputes, salespeople will have less motivation to resolve those disputes because they've received part – perhaps most – of their commission. This timing is less common than either payment on receipt of full payment or payment on invoicing, but more common than payment on bookings. If most customers pay most invoices in full, this method has about the same effect as paying on receipt of full payment, so you might end up choosing based on which method is easier to compute with your software.

## ***Receipt of Full Payment:***

### Pros:

You pay out commission from money you have in hand, so this is good for cash flow. Also, this motivates salespeople to help collect outstanding amounts from customers.

### Cons:

If you have commission software that does this for you, the only con is that, psychologically, it isn't as good a motivator as the methods that pay earlier. If you're computing Commission manually, paying on receipt of full payment can be very time-consuming. Some accounting systems have a clear indication that an invoice has been fully paid; others don't. If yours doesn't, you're left with the very manual process of figuring out which invoices were open last month but are closed this month. Most of the transactions closing the invoice will be payments, so you can figure out which payments fully closed invoices, but a credit memo might also close an invoice, so you need to check those as well.

This is the most common time to pay commission.

## ***Project Milestones:***

### Pros:

Commission payments are usually linked to the receipt of a customer payment, so you're paying with money you have received. Salespeople don't have to wait until the end of a long project to get paid, which would be a very poor motivator, and it encourages them to keep the customer happy throughout the term of service.

### Cons:

Commission reports available in most ERP systems don't bring in data about projects. Frequently, projects are tracked either manually or with a different software package. Therefore, this method can involve a lot of manual work, which leads to errors, delays in Commission, and many days of work each period in the accounting department.

This method is used for long-term projects, such as construction, service contracts, and subscriptions. The trigger to pay commission may be a G/L transaction to recognize revenue, an entry in project management software, or the passage of a certain amount of time. This method is usually used with one of the other methods, most often payment on bookings. It is the least common method.

## ***Summary:***

When designing a commission plan, it's important to select the best payment schedule to satisfy your companies objectives. There are several alternatives, and your choice will affect sales force motivation, cash flow, and the practicality of doing the computations.