Aligning Your Compensation Plan with Your Business Model

By Dan Jensen

Direct selling and network marketing companies come in many different flavors. We find many whose approach is to invite recruits to purchase products for their own personal use and then share with friends and family. Others teach their recruits to find customers to whom they sell their products for a profit. Many companies employ a party-plan model while others focus on a one-on-one model. Some companies have a mixture of all these approaches.

Where your company falls on this spectrum of direct selling business models should influence your approach to field compensation more than any other factor. A Xango compensation plan, for example, would not work with a Mary Kay business model. An Avon compensation approach would not work with a Melaleuca style of business. They are incompatible. I am constantly surprised by how often I see companies promoting a compensation strategy that is out of alignment with their core business model. In many cases, this will eventually be a fatal mistake for their business. For others, sales will hit a “brick wall” no matter what the company tries to do – all because their compensation plan is out of alignment with their business model.

The two extremes of business models could be described as the Internal Consumption model and the Retail Customer Model. Most companies fall somewhere between these two extremes as illustrated below:

Internal Consumption — Retail Customers

Internal Consumption is where the products or services are personally consumed by the sales force much like a buying club. Selling to customers focuses on selling products to people who are not participating in the business opportunity and who are willing to pay above the typical wholesale distributor price for their own personal use because they see an excellent value even at the retail price often as a result of a compelling presentation.

The Starting Point in Compensation Plan Design

Before you design or correct your compensation plan, it is absolutely essential that you decide where your business should be on this spectrum of business models. Once you decide, then drive a “stake in the ground” and work to align every aspect of your business to that decision and, most of all, align your compensation plan and incentives strategy. The table below shows some of the most important differences between the two models that require alignment and attention:

Internal Consumption	Selling to Customers
Inexpensive sign-up for new recruits	Higher sign-up cost protects retail profits

	of seller – fewer customers sign up only to get a discount
Stronger team overrides paid early	Plan offers strong incentives for higher selling volumes
Career path advancement is very easy to appeal to more passive participants	Career path advancement requires stronger commitment and competency in team building, training, selling
High attrition is assumed	Low attrition is achievable
$$ per hour proposition[1] depends on overrides from recruiting	$$ per hour proposition must be immediately felt through retail selling
Company funds all earnings	Customer profits funds large part of earnings for young recruits
Requires high product profit margin to support competitive compensation plan	Can support strong earnings with less product profit margin due to retail profit
Requires more recruits to achieve sales targets	Requires fewer but more productive recruits to achieve sales targets
Requires less training	Requires more training
People love the product naturally	People love the product naturally but it might take a compelling demonstration
Eventually collapses if product demand is opportunity driven	Product demand is not opportunity driven. The business builds organically
Legally vulnerable due to the payment of commissions without retail customers	Legally stronger
Pricing strategy focuses on wholesale price	Pricing strategy focuses on retail price
Business is focused on recruiting	Business is focused on selling and then recruiting

Product Pricing Strategy and Compensation Connections

Where your business model stands in the spectrum must determine your product pricing strategy and how much you will spend in field compensation to be competitive. The following table tries to illustrate the differences:

	Internal Consumption	Selling to Customers
Retail Price	Few Buy at RP	$100
Wholesale to Distributor	$75	$75
Typical Profit to Seller	$0	$25
Commissions paid by Company	$25 to $38	$10 to $30

[1] See my December, 2007, Direct Selling News article, *Your Dollar per Hour Proposition*

In the Internal Consumption model, everybody buys at the wholesale price. Rarely does a distributor sell the product at retail because the prospective customer is offered a compelling reason to "sign up" by purchasing an inexpensive "kit" so they can enjoy the distributor discount on their purchases. Even if the kit is expensive, it would often be loaded with high product value so that it compels them to join to get the product at a deep discount through the kit.

There is a very important weakness to this approach that must be addressed through the compensation plan. When the customer signs up as a distributor to get the wholesale price, there is no profit margin to the seller or recruiter. Instead, the company must have sufficient margins to pay the recruiter enough of a commission so their dollar-per-hour proposition[2] is sufficient to make it all worth their time. We see, therefore, that the Internal Consumption model requires a higher payout in a compensation plan to compensate for the lack of retail profits. How much is necessary? Few companies following this business model would be competitive paying out less than 38% of wholesale revenue. If they did, in most cases their recruits would quickly find it a poor opportunity and move on to something better. This is a common source of high attrition rates.

In the business model with a stronger emphasis on selling to customers, we see in the preceding table that the customer pays more than wholesale price giving a profit margin to the seller. This discount (and profit) to the seller often ranges from 20% to 50% off the retail price depending on the type of products and the company. Note also that a 25% discount (profit) from retail would be equivalent to a 33% commission on the wholesale price ($25 of $75 = 33%). Thus, a customer biased business model usually does not need to pay out as much as internal consumption model for their overrides. For example, if a company paid out 25% for overrides in addition to a 25% profit margin off retail, they would trump the 40% payout of an internal consumption based competitor. This can be a significant competitive advantage for direct selling companies with a retail bias and one they often fail to emphasize in their training.

Other Compensation Plan Issues

Here is a very short list of a few of the issues that the compensation plan must address due to the nature of the business model you choose to follow:

Internal Consumption Model

- Higher percentages offered to young recruits on their first recruits such as a Fast Start program might offer
- Simple payout explanations to entice the many passive participants who often have no specific income goals and do not look at it as a business
- Very deep payout reach for leaders who must earn on huge numbers of people purchasing very small amounts

---

[2] See my December, 2007, Direct Selling News article, *Your Dollar per Hour Proposition*

- Auto-ship incentives where possible to encourage consistent personal consumption
- Less competency requirements due to the higher level of passive involvement and lower commitment levels among the majority of the sales force

Customer Selling – Retail Model

- Strong incentives for higher levels of personal sales
- Strong incentives for teaching others to achieve high levels of personal sales
- Career path is driven by competency based requirements with strong rewards for advancement
- Consistency in selling is rewarded well
- Team based rewards for business builders
- A well designed recognition system complements the compensation plan to offset a higher level of discouragement found in a stronger selling environment.

Conclusion

Your business model is the single most important factor in determining the type of compensation approach you follow. Your incentives strategy must also be in perfect alignment. Companies that achieve this alignment, find the wind in their sails and are able to build upon their past successes toward higher and higher sales targets.

About the author

Dan Jensen has earned an enviable track record working with new and existing direct selling companies to develop winning compensation plans that build sales and recruiting. Working with hundreds of new start-up companies as well as many direct selling giants in the last 28 years, Dan has acquired a broad and unique perspective on what makes successful companies succeed, and what makes some fail. In 1978, he founded Jenkon, an industry leading software provider for the direct selling industry and then retired in 1999 to follow his passion of compensation plan design. Dan was recently honored to receive the coveted DSA Partnership Award in 2007 for his contribution to the success of many direct selling companies worldwide. He is the only person to have received this annual award twice, in 1997 and again in 2007. He has been married for 33 years, has five children, ten grandchildren, and loves every minute of life. His web site is found at www.danjensen-consulting.com and his email is dan@danjensen-consulting.com.