

## ASSET MANAGEMENT COMPENSATION

### Sales Compensation—Is it Time for Change?

**SALES COMPENSATION** has become a multi-faceted and increasingly complex pay and business issue in the wealth and asset management space. In the work we do as compensation advisors, we have heard the same reflections again and again across cycles. Sales person X is paid too generously during the good times. Sales person Y is not paid a sufficient quantum for business development and building relationships during the challenging times. But one key theme remains consistent, and that is managers are often less satisfied with where their firm is on the topic of sales compensation. Some of the fault occasionally lies with the strategy or the Firm, but more often than not, much of the issue is inherent in the incentive design. The legacy practice of defaulting to and replicating standard sales commission models has limited flexibility, sub-optimized alignment, and clearly hurt several firms in their mission to gain market share.

**AS A BACKDROP, PROPOSED REGULATORY STANDARDS** from both the SEC and Department of Labor requiring a fiduciary standard are threatening to change how wealth and asset managers manage their client facing sales professionals. Under the proposed rules, sales representatives would be required to only select investments in the best interests of investors. The mandate may limit not only the ability to sell select financial solutions, but also impact how traditional incentives and commissions are derived. And while the proposed rules initially apply to retirement-based assets (e.g., ERISA plan assets), the industry is bracing for the inevitable inclusion of broader and/or other classes into the fold. And while the regulatory impact may not be quite so fulsome, it is likely the rules will alter the traditional means of doing business

The business model and sales process in asset management is clearly changing. For most firms, legacy sales compensation practices are no longer ideal, and in fact limiting growth. Johnson Associates clearly sees effective change and a way to address the evolving environment.

in some form. In this context, levered or formulaic commission based incentives may become problematic. For several firms, the objective of “putting a client’s best interest before profits” has accelerated the process of reassessing the overall business paradigm and particularly how they pay for and incentivize sales.

**INEVITABLY THE SALES PROCESS AND THE ASSOCIATED INCENTIVES WILL EVOLVE** with changing regulation and the broader environment. And while the regulatory issue has a near-term impact on sales in the institutional retirement context, it has a clear implication for the broader universe of sales in the asset management space. Assuming the required standard is “prioritizing a client’s best interest”, then to put it simply, the model of “go produce X and get paid Y” cannot hold. But if so, what is the alternative? Should it be fully discre-

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tionary if the fiduciary rule applies? Should it be a hybrid structure? Should there be special adjustments for retirement plan assets? While firms are thinking about the impact now, it may not be until 2017 or 2018 where the outcome is fully realized. And whether it is because of the change in regulation or simply because of changes in the broader investor context, it is clear that many asset managers are trying to better manage the issue of sales compensation today to gain a competitive advantage going forward.

**THE TRADITIONAL WORLD OF SALES** compensation, at least in long-only asset management, was perhaps more steady, consistent and straightforward. A large proportion of professionals had an objective program, flows were easier to monitor and the pay for performance paradigm was a combination of tracking and administration. But the environment gradually evolved. Institutional clients became more sophisticated and demanded more information. The typical sale became a longer-tailed process. The sale required multiple business partners from within the selling firm, and multiple parties on the client side (client senior management, consultant leads, vendor and operational representatives, and other intermediaries). The sale would differ depending on the channel or geography. The sale would differ depending on product. The sale would differ depending on the type of investor (sovereign, family office, pension fund, or corporate institution). The standard sale now includes a greater number of factors and has

become more multi-faceted as the landscape becomes more nuanced and complex.

**AS THE ENVIRONMENT EVOLVES, MORE FIRMS ARE REEXAMINING THE TRADITIONAL SALES PROTOTYPES.** Paying for performance in the sales context now involves setting, tracking, attributing, and rewarding a range of objectives that represent value contribution, as it relates to asset sales. It has become clear:

- *No longer does one plan and one size fit all*
- *No longer can the incentive be a simple formula*
- *No longer can we overlook qualitative contributions*
- *No longer can we ignore attribution*

Ultimately an alternative, or rather, a hybrid means of rewarding business development professionals will be the most viable solution.

**ALIGNING TO THE STRATEGIC SALES MODEL** is a primary checklist item when evolving the incentive paradigm. Too often, firms will skip to the sales redesign stage before understanding the objectives, philosophy, and approach (i.e., akin to a doctor treating the patient without an exam). The degree of objectivity that is sensible within sales compensation is related to the strategic focus (who to sell to, what to sell, where to sell, etc.). Complex, long-tailed, multi-product sales to well-informed clients might tend towards more discretionary paradigms. While the standardized, shorter-timeframe, narrow product offerings might tend towards more objective approaches. And while the drivers of a reasonable pay construct can be numerous, the key is to align the reward to the strategy, to the extent possible.

**BUILDING ON THE STRATEGIC ALIGNMENT, UNDERSTANDING WHAT TYPE OF SALESPEOPLE YOU HAVE** is the next critical question when evolving sales compensation (see on the following page). The profile of sales professionals can vary dramatically. And while many comparators think, or at least hope, they have the “do-it-all” sales leader or highly experienced marketing team, the results

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## AS THE ENVIRONMENT EVOLVES:

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### **NO LONGER:**

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- ◆ *Can the incentive be a simple formula*
- ◆ *Can we overlook qualitative value-add*
- ◆ *Can we ignore attribution*



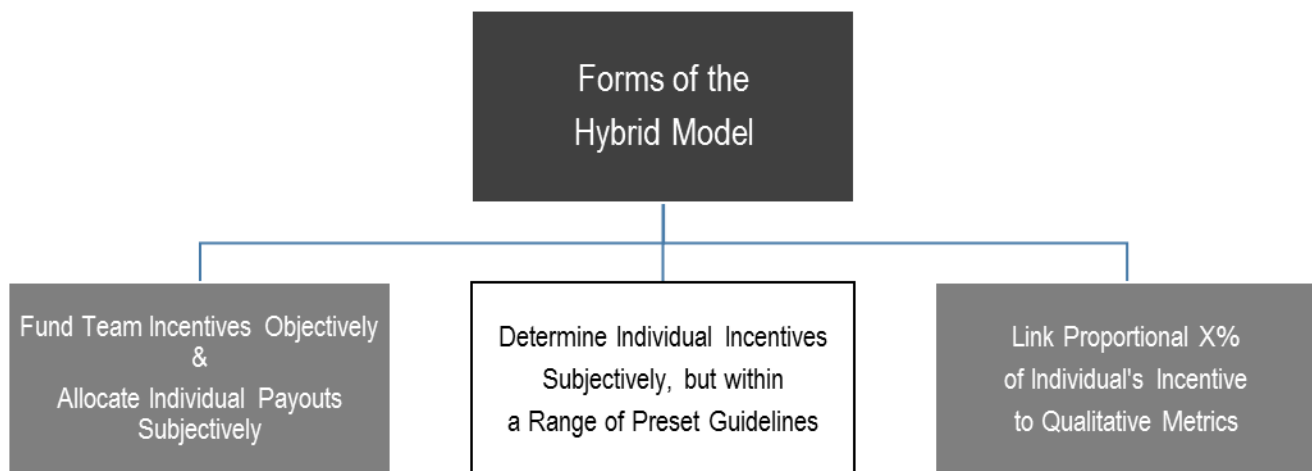
<b>Contribution</b>	Solid	Top contributor	Star / Change Agent
<b>Sourcing</b>	Via support network	Support & Independent	Independent
<b>Pitches and Follow-on</b>	Co-leads/Participates	Leads / Co-Leads	Leads
<b>Investment and Product Knowledge</b>	Proficient	Highly proficient	Subject matter expert
<b>Functional Overlap</b>	Focused skillset	Select overlapping skills	Several overlapping skills

quite often indicate otherwise. The point is there are clear nuances and they matter. Perhaps your incumbent sales leader is the individual with the indispensable contact list, and can open the introduction no one else can. Or your salesperson is the solid process oriented professional who can navigate a highly operational and RFP heavy sales process. Or perhaps your sales leader is the “closer” type, who can lock in multi-year commitments. Depending on the degree of specialization, value-add, and expertise, a more nuanced paradigm may be required in certain cases.

**A GREATER DEGREE OF DISCRETION** is often the initial direction management considers as they contemplate various changes in sales compensation. Assuming the business has a good understanding of the strategy to align to, and the profile of the incumbent, a degree of discretion can be a very useful tool in motivating various qualitative behaviors. And while select discretion can work in some cases if managed well, there is a reduced probability of success with full discretion given the behavioral make-up of the typical production-based sales professional. Imagine a professional who has been trained to perform in a highly objective system his or her entire career. And next, the transparency and alignment

of such a reward system is eliminated. How does the sales person track performance? Why should the sales person maximize results? And importantly, how does the sales person stay motivated? It is tempting to say that the sales person should trust the system. But in practice, that limits the probability of success. It is less reasonable to expect someone who has worked in an “eat what you kill” context for an extended period of time to simply shift over to a “trust me” approach. In such cases, some form of transition might be required.

**WITH MEANINGFUL DISCRETION, THE PRIMARY BUSINESS GOALS MUST BE IDENTIFIED AND THEN REWARDED.** Assuming a degree of discretion is explicitly part of the paradigm, it will be important for a firm to track and communicate what it will pay for. A firm may desire to reward trackable and measurable objectives such as cross-sell of products, other ancillary business referrals, and development of new products. Or a firm may track and reward on more qualitative items such as rolling out a new sales strategy, team building, professional training, investor relationship management, and/or customer satisfaction. The goals can vary depending on the philosophy, and having a clear understanding of the objectives ahead of time minimizes the potential for disagreement on the back end.



**IF A SYSTEM HAS DISCRETION**, it is important for a manager to apply it, if and when available. There are case studies where a meaningful element of discretion is structured into a sales incentive program, and unfortunately, the discretionary dollars paid are broadly the same across all incumbents. In that context, there is effectively no discretion. There must be serious evaluations of performance and then meaningful differentiation. Otherwise, the discretionary element, small or large, just becomes an entitlement and has little impact on behaviors. And while this is part of the execution of the program, it is just as important as the design. Because as great as a design may be, the pay program cannot and should not run the business. The decision makers still need to execute on the sensible incentive structure in order to maximize impact of a well-designed sales compensation program.

**WITH DISCRETION COMES THE OPPORTUNITY TO UTILIZE A HYBRID SYSTEM.** And while hybrid can mean many things, it is fundamentally a sales incentive paradigm that is partly objective, with helpful elements of subjectivity - to varying degrees. There remains a formulaic or objective calculation, but it is often done at a group or aggregate level. The sales team produces X and the team is entitled to Y. But the key design feature is that there is flexibility on the allocation of dollars to account for the potential qualitative items that are key to closing a sale in today's environment.

The allocation process will require rules and guideposts, but importantly there is the increased ability to flexibly reward outsized or unexpected contributions.

**WHAT ABOUT SPECIAL INCENTIVES?** Special overrides and kicker incentives can serve a useful purpose in more narrowly defined scenarios, but they are often too focused to operate in the normal course. In many instances, special incentives often increase the probability of unintended or unexpected outcomes. And in most cases, it is perhaps best to consider special incentives in one-off or outlier scenarios. For example, kicker incentives may be helpful in a turnaround or a prolonged down business cycle. And in the normal course, most of the behaviors that overrides and kickers incent can be achieved with some degree of discretion. Discretion has the similar and helpful feature of allowing for recognition of extraordinary efforts. So while special incentives have a place in select scenarios, there are often alternative compensation tools to consider before structuring one-off designs.

**WHAT ABOUT SALES IN THE FINANCIAL ADVISOR CONTEXT?** We have been focused primarily on sales in generic asset management, but rewarding sales extends far beyond into the realm of wealth and high-net-worth managers. Given uncertainty around the impact of the fiduciary rule, the impact on pay remains to be determined. The evolving standard does imply that

again, the regulators will have a significant influence on where sales compensation ends up for financial advisors and brokerage professionals, but in any event, the status quo on advisor compensation is unlikely to continue.

**SO IS AN OVERHAUL THE MOST SENSIBLE DIRECTION** for your sales compensation paradigm? If it is, the hybrid incentive plan is one potential and often helpful approach to align and motivate behaviors. Of course a thorough assessment by an independent expert is always helpful in diagnosing and treating any potential motivational and incentive issues. But whatever pay paradigm ultimately makes sense for your firm and your context, there are a number of tried and true guideposts when evaluating sales compensation:

- **Keep it simple** – Avoid structuring a plan for all scenarios; it is easy to over-engineer and lose focus
- **Minimize caps** – Rewarding for extraordinary upside results reinforces the entrepreneurial mindset
- **Use both carrots & sticks** - Incent desired behaviors and penalize those that do not align with objectives
- **Continue to reinforce alignment** – Repeating links to the overall Firm helps institutionalize the focus on broader value creation, and less on silo behaviors
- **Establish a workable system** – A world class system is of little use if it cannot be implemented

**IN CONCLUSION**, sales compensation has and continues to be a focal point of senior managers within asset and wealth management firms. In the current environment of increasing competition and growing pressures on market share, finding the in edge sales compensation and rewards becomes not only a pay issue but also a business issue. It is clear the old playbook does not always maximize outcomes in a fluid and evolving environment. And to provide the highest probability

## CONSIDERING PROGRAM CHANGE?

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at winning new and repeat mandates, the sales professionals need to be fully aligned, committed, and invested in the process. If there are structural issues in your sales program, there is a significant opportunity to learn from the successes and failures of others. An experienced compensation consultant can help provide the critical insights if and when you should decide to review the design and implementation of your sales plans.

*Please contact us with any questions on this issue or similar matters.*

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