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A cross-national investigation of incentive sales compensation

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Abstract

Why do managers choose one sales compensation form rather than another? Theoretical answers typically focus on the type of plans managers *should* design, not on the factors that managers *actually* consider. Managers from various national origins pursue and weigh objectives through experience in a way that theoretical models may not capture. Incorporating conceptualizations from a wide range of disciplines, we specify a model examining the influence of cultural factors on sales compensation decisions of managers (incentive vs. fixed pay and parity vs. equity allocation). The model, tested with data collected from bank managers across six European countries, illustrates the importance of considering national culture when designing sales force compensation policies applied across multiple countries. We also find evidence that most European bank managers accept incentive pay to motivate salespeople but, perhaps paradoxically, overwhelmingly reject equity allocations to achieve control and parity. We discuss the implications of our findings for research on international governance systems and the diffusion of sales force management practices.

Keywords: Distributive justice; Compensation; Performance pay; Sales force management; National culture

1. Introduction

B2B salespeople are often the most direct link between a firm and its customers. They usually know a firm's clients better than any other employee and work in extended teams away from direct supervision. Increasingly, good teamwork is a determinant factor in winning sales and building long-term partnering relationships. These factors create important compensation design issues for managers in charge of their motivation.

One fundamental concern for managers wanting to motivate sales teams is how to distribute financial incentives among team members (Ramaswami & Singh, 2003). Specifically, managers need to decide, among other things, (1) how much of remuneration should be contingent upon achievement and (2) how financial incentives should be distributed among sales team members. The distribution of performance rewards is particularly interesting and generates much theoretical debate about appropriate allocation rules (Meindl, 1989). Awards can be based on individually differentiated performance (i.e., equity rule) or equally divided among all members of a sales team (i.e., parity rule). Both types are reflected in actual salesperson pay plans. For example, some firms like Dun and Bradstreet, split all sales commissions equally across salespeople in each team (Churchill, Ford, Walker, Johnston, & Tanner, 2000, p.114) while others such as FedEx, opt for individual bonus and commissions tied to the individual performance of salespeople (Cohen, Gilbert, & Ligos, 2004).

However, there are several reasons to question the applicability of these theoretical prescriptions and the transferability of existing practices for European sales force management. First, cross-cultural compensation literature is fairly limited (Harvey, 1993; Werner & Ward, 2004). Second, most sales force compensation researchers propose normative rules for managing compensation within "traditional selling environments" (Brown, Evans, Mantrala, & Challagalla, 2005) rather than take into account new developments in sales practices such as team selling. Third, with few exceptions (e.g., Coughlan & Narasimhan, 1992; John & Weitz, 1989; Krafft, Albers, & Lal, 2004),

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most of the literature on salespeople compensation addresses the specific question of optimal compensation structure (i.e., optimal ratio of incentive to total compensation). It proposes how managers *should* design their sales force compensation plan with the intent of maximizing long-term profits under a variety of conditions, not on the type of factors that managers *actually* consider. This leads to the fourth reason to examine this issue, namely that the selling environment is becoming rapidly international and that culturally diverse managerial decision-makers are increasingly common among multinational firms. Verifying that national cultures of managers are sources of variance in compensation decisions has the potential to provide insight into the differences in practices that have been evidenced across cultural contexts. Furthermore, most human resource management research investigates the influence of employee characteristics on merit increase decisions (Heneman, 1990). Less is known about the influence of manager orientations, values (Gully, Philips, & Tarique, 2003) or motives learned through experience (Bowman, 1963). To date, only one study (Lal, Outland, & Staelin, 1994) links the perceptions of the manager to specific types of sales force compensation plans. Since individual values are widely presumed to be influenced to one degree or another by personal environmental factors, including a person's national culture, a more diverse set of decision-makers may lead to a more diverse set of pay plans.

The overall objective of this article is to study the design of sales force compensation plans in a cross-cultural context. More specifically, we seek to: (1) highlight differences across regional cultures in sales compensation and reward allocation decisions, and (2) evaluate the relative influence of managerial criteria on sales force compensation decisions.

2. Conceptual framework

In Fig. 1, we present a theoretical framework based on different conceptual approaches developed in the human resource management, management and marketing literatures. Our contention is that managers design sales force compensation schemes by relying on insights developed in these fields as well as idiosyncratic factors related to their personal and cultural characteristics. The model includes three relationships. The first relationship describes the effect of regional culture on compensation structures. The importance of regional culture is based on the following: (1) the many observations that sales force compensation varies not only within countries but also across countries (e.g., Hay Paynet Survey, 2002) and (2) the international compensation literature (e.g., Schuler & Rogovsky, 1998).

The second relationship describes the influence of key managerial decision criteria on two compensation components (level and allocation of incentive). These criteria stem from the resulting difficulties in motivating and controlling salespeople in the new sales environment (Jones, Brown, Zoltners, & Weitz, 2005): (1) the use of team selling (sales force harmony, shirking prevention, social control, pay dispersion) and (2) the increasing interest in long-term customer relationships (long-term versus short-term goals for salespeople). Specifically, our model suggests that managers consider both the overall *level of effort* they want salespeople to achieve as well as the *direction of this effort* when developing compensation plans. We are guided by a number of studies investigating factors stimulating and influencing salespeople effort (e.g., Coughlan & Sen, 1989; Darmon, 1974; Joseph & Thevaranjan, 1998).

The third relationship examines the effects of control variables on compensation. Note that our model will be restricted to variables related to salespeople and sales managers. Other factors, such as market characteristics or industry norms are not being considered here. We discuss each part of the model next and present our formal hypotheses.[1]

2.1. Regional culture and compensation design

Culture and incentive compensation. We take as our point of departure Ronen and Shankar's cultural representation of Europe (1985), which was based upon an extensive review of cross-cultural managerial studies. In their view, countries with geographical proximity, common language roots and religion, tend to share similar values. We use part of their cultural categorization (Anglo: United Kingdom; Germanic: Austria, Germany; and Latin: France, Italy, Spain, cultural clusters) since it is consistent with a number of more recent surveys (e.g., Trompenaars, 1993).

Hofstede's uncertainty avoidance dimension (1980; 1991), examined in branding (Erdem, Swait, & Valenzuela, 2006; Roth, 1995) and consumer innovations (Steenkamp, ter Hofstede, & Wedel, 1999), is particularly relevant to our study. Uncertainty avoidance is defined as a diffuse sense of unease about a situation. When cultures are high on uncertainty avoidance, managers are presumed to focus on risk avoidance and reduction. Conversely, in low uncertainty avoidance societies, managers should be open to risk taking. Gomez-Mejia and Welbourne (1991) argue that multinational corporations should minimize variable pay in countries with high uncertainty avoidance scores. In support of this view, Gooderham, Nordhaug, and Ringdal, (1999) found German firms were using calculative practices (i.e., including incentive reward systems) significantly less than British firms in a multinational study of human resource management practices. Similarly, Tosi and Greckhamer (2004) found a negative relationship between the proportion of variable to total CEO compensation and uncertainty avoidance.

Relating these ideas and findings to sales force compensation settings, we suggest that uncertainty avoidance is related to risk aversion. Since there are uncertainty and associated risks in most effort-sales relationships, managers belonging to cultures where uncertainty avoidance is high are likely to prefer compensation plans that reduce uncertainty, and therefore choose fixed pay plans. Latin and Germanic countries, where uncertainty avoidance is high, are likely to provide a cultural

[1] We do not hypothesize a direct relationship between regional culture and managerial decision criteria as, to the best of our knowledge, there is no theoretical background pertaining to the influence of national origin on managers' decisions pertaining to salespeople's effort level and direction. We thank an anonymous reviewer for raising the issue.