Best Practice

Breakeven Analysis for Staffing, Measurement & Compensation Planning

Executive Summary

Breakeven analysis is a simple to use Best Practice for addressing the following challenges sales organizations typically face:

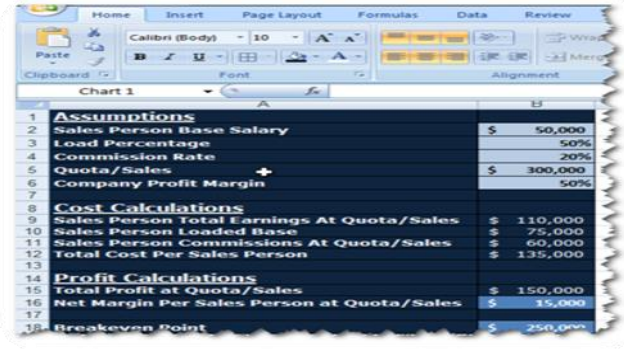
1. Justifying the addition of sales headcount necessary to achieve the company's revenue objectives.

2. Evaluating sales person performance in terms of their net contribution to the company's profitability.

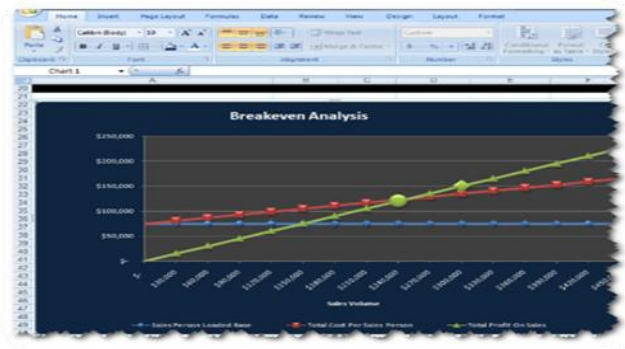
3. Cost-justifing compensation plan changes that will drive the desired behavior through incentive setting, while simultaneously allowing the company to achieve its profitability targets.

The breakeven analysis tool performs computations necessary to solve these challenges.

Breakeven Point: Where the total revenue received from a salesperson equals total costs associated with the person and product/service delivery efforts.



Your data goes in the light blue boxes…



…and the tool computes for you the breakeven point.

Problem Statement

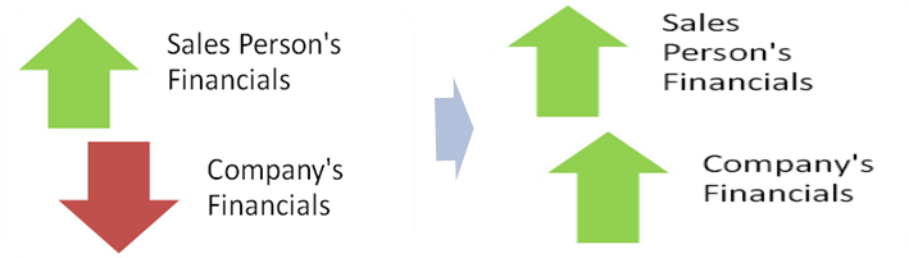
This document addresses three key problem areas faced by sales organizations:

1. Sales organizations need a tool to cost justify the addition of sales headcount necessary to achieve the company's revenue objectives.

2. Sales organizations need a tool to evaluate sales person performance in terms of their net contribution to the company's profitability.

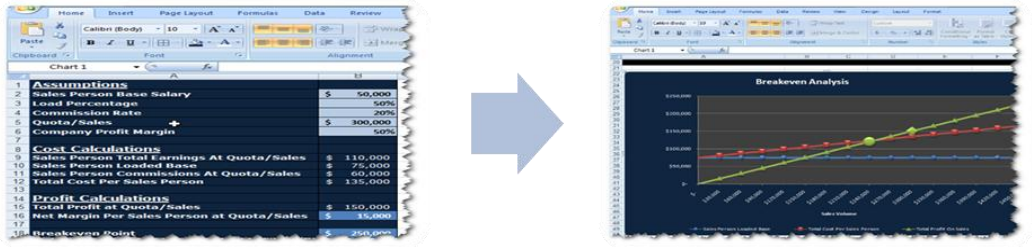
Q4 STACKED RANKINGS BY PROFIT		
RANKING	SALES PERSON NAME	MARGIN CONTRIBUTED
1	Suzy Miller	$ 700,000
2	Bill Smith	$ 432,534
3	Steve Jones	$ 398,234
4	Tom Franks	$ 354,213
5	John Johnson	$ 324,810
6	Tom Fisher	$ 263,412
7	Jane Walker	$ 211,124

3. Sales organizations need a tool to cost justify compensation plan changes that will drive the desired behavior through incentive setting, while simultaneously allowing the company to achieve its profitability targets.



Solution Summary

Breakeven analysis provides sales organizations the tool to ensure goals and headcount levels are set appropriately to generate profitable returns. This document will show you how to use breakeven analysis to achieve these goals as well as teach you how to use the companion tool to perform the calculations.



Elements of the Solution

To find your breakeven point, you will be required to input some basic data about the cost of your sales force. Once you have entered this data, the tool will calculate several important factors for you to consider. The following is an explanation of each of the elements that are involved in this process.

The Inputs

Base Salary	The fixed annual base pay for a sales person.
Load	The percentage added on top of Base Salary to cover costs of having a sales person on-board (e.g. taxes, benefits, technology, travel, etc.)
Commission Rate	The rate paid to a sales person for each dollar in new sales. If the commission rate is tiered, this amount should represent the blended rate.
Quota	The annual quota assigned to a sales person.
Profit Margin	The gross profit margin, excluding sales costs, for each dollar in new sales. If the profit margin varies across different products and/or services, this amount should represent the blended rate.

The Outputs

Total Earnings At Plan	A sales person's total fixed annual base pay plus total commissions at plan. *(Base + Commissions at Plan)*
Loaded Base	Total fixed annual base pay plus load for a sales person. *(Base + Load)*
Commissions At Plan	Total commissions paid to a sales person at quota. *(Commission Rate * Quota)*
Total Cost Per Sales Person	Total cost per sales person at plan – base plus load plus commissions at quota. *(Loaded Base + Commissions At Plan)*
Total Profit On Sales At Quota	Total profit, excluding sales costs, assuming revenue production matches quota. *(Quota * Company Profit Margin)*
Net Margin Per Sales Person	Net margin produced per sales person. This represents the difference between the Total Profit On Sales and Total Cost Per Sales Person. *(Total Profit On Sales At Quota – Total Cost Per Sales Person)*

The Breakeven Formula

The Breakeven Formula is the tool that finds your Breakeven point based upon the inputs listed above. The following is an explanation of how it is designed, how it works, and how to use it with the tool provided.

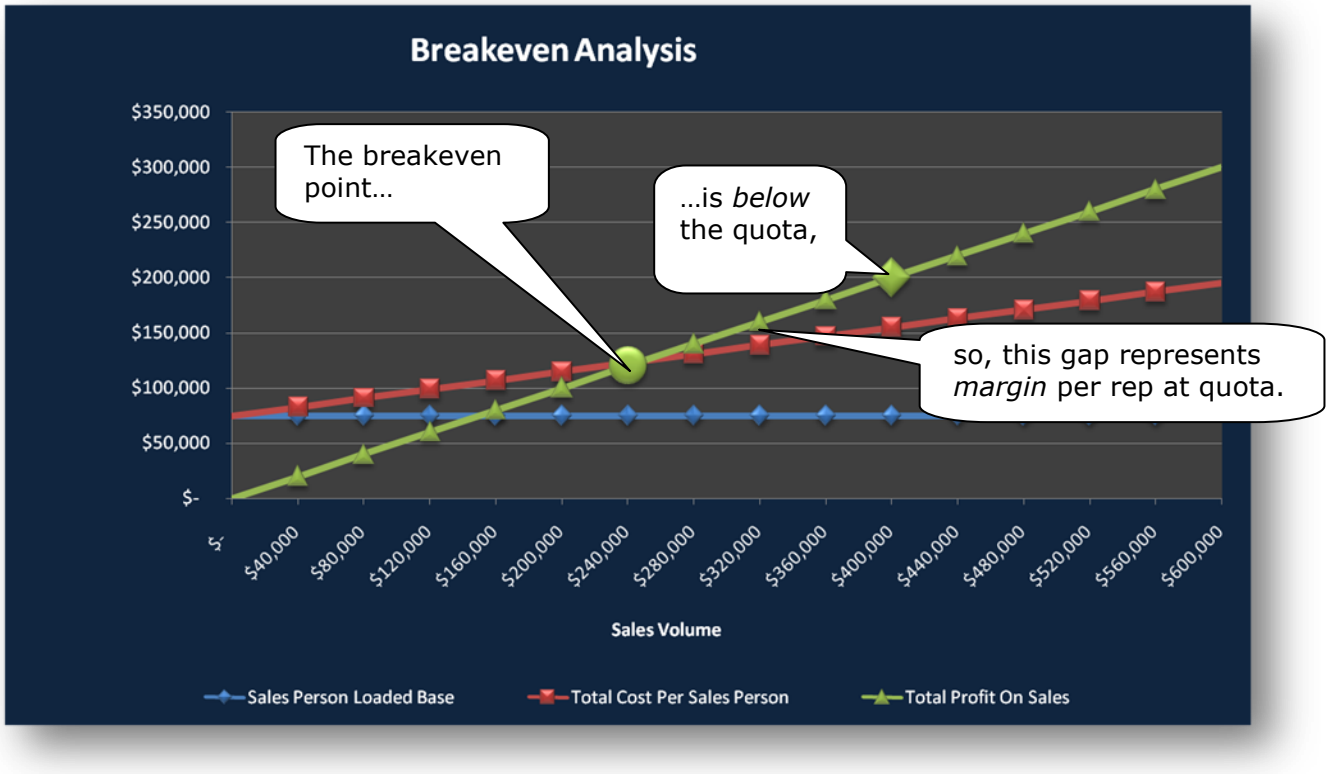
- Solving for the Breakeven Point will tell a sales leader the required Revenue Production a Sales Person must produce to offset all the costs associated with the sale and product/service delivery.

$$Breakeven\ Point = \frac{Sales\ Person\ Loaded\ Base}{(Company\ Profit\ Margin - Commission\ Rate)}$$

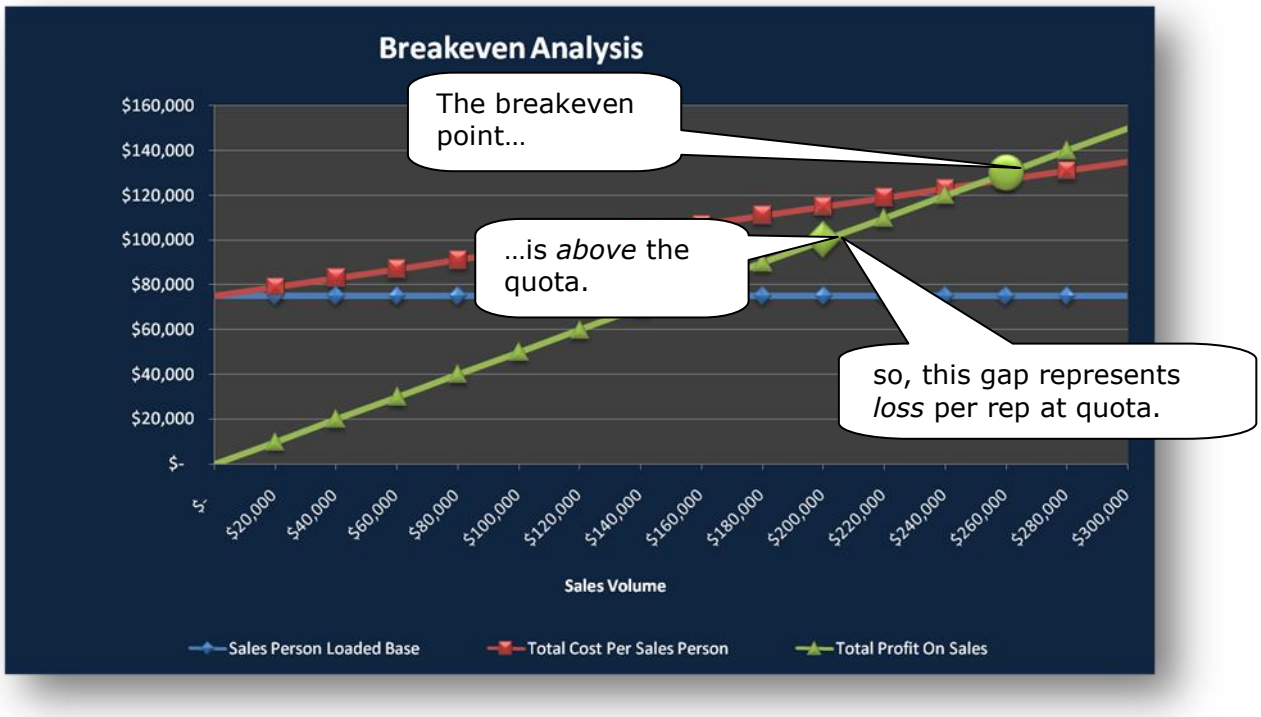
"Sales Person Loaded Base"- This is total fixed costs, including salary, taxes, benefits, technology, travel, etc. required to keep the sales person on the payroll

"Company Profit Margin minus Commission Rate"- This is the contribution margin for each dollar in new sales that remains after covering the cost to deliver the product/service and pay the sales person commission

- If the calculated breakeven point is below the assigned quota and the sales person will be able to achieve that number, then the company has cost justified the additional headcount.



- If the calculated breakeven point is above the assigned quota, then hiring the sales person will hurt the company's overall profitability. A company may decide to go forward with the hire for strategic reasons such as:
    - Prioritization of growing top line revenue at the expense of profitability
    - Strategic need to grow market share
    - In the near future, operational efficiencies will be implemented that will improve profit margins and cost justify the additional sales headcount



Solution Details/Examples

To this point, a theoretical overview of breakeven analysis has been provided. To fully demonstrate how to apply these concepts to address specific business challenges like headcount justification and compensation planning, the following examples are provided.

Applicability to Staffing

Breakeven analysis can be used in the staffing process to determine how much revenue sales people must produce to cover their costs.

For example assume the company wants to hire a sales person with a $50,000 base and a 20% commission rate. The company believes a $300,000 quota is attainable and wants to know if hiring the sales person is a good investment. The breakeven calculator produces the following results:

Assumptions	
Sales Person Base Salary	$ 50,000
Load Percentage	50%
Commission Rate	20%
Quota/Sales	$ 300,000
Company Profit Margin	50%
Cost Calculations	
Sales Person Total Earnings At Quota/Sales	$ 110,000
Sales Person Loaded Base	$ 75,000
Sales Person Commissions At Quota/Sales	$ 60,000
Total Cost Per Sales Person	$ 135,000
Profit Calculations	
Total Profit at Quota/Sales	$ 150,000
Net Margin Per Sales Person at Quota/Sales	$ 15,000
Breakeven Point	$ 250,000

With a base of $50K,…

…a load percentage of 50%,

…a commission rate of 20%,

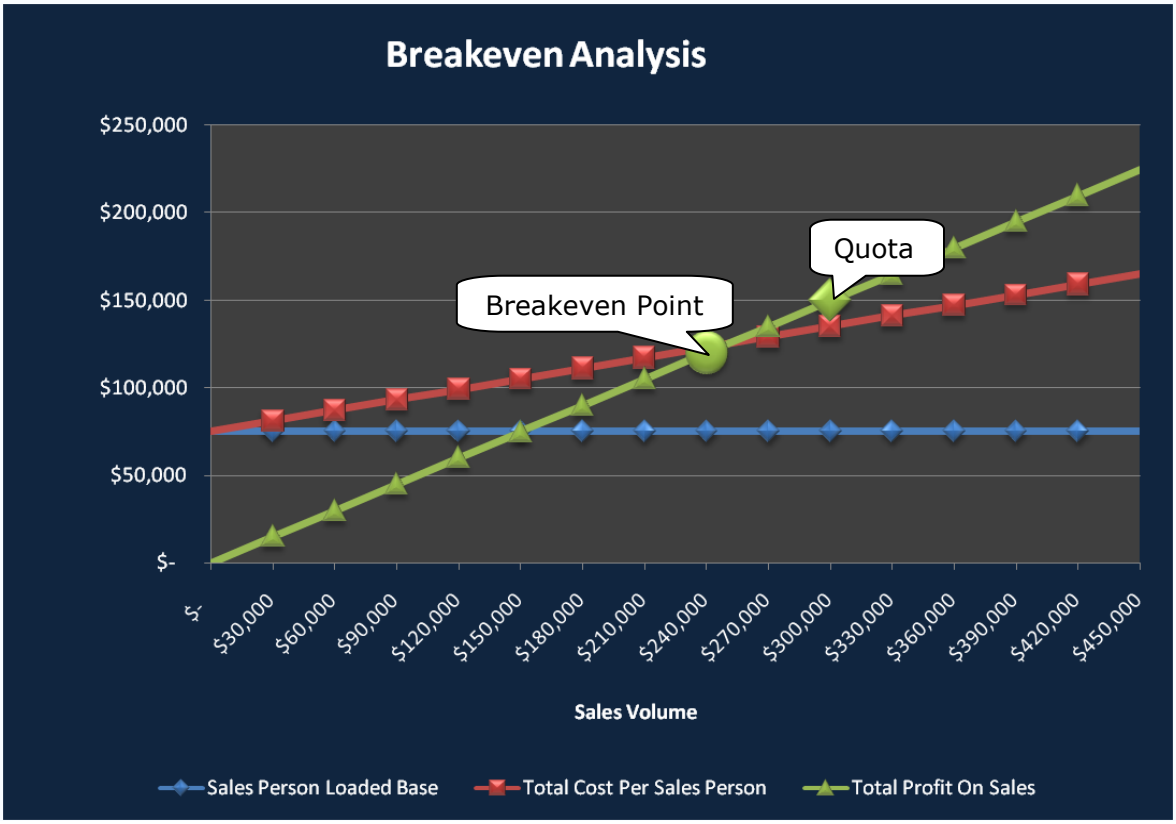
…a $300,000 sales quota,

…and a 50% profit margin,…

…there will be $15k net margin per sales person…

…and you will need at least $250k in sales to break even.

- As long as the hired sales person produces $250,000 in revenue, the person will produce a profit for the organization. If the person achieves the $300,000 quota, the company will make $15,000 on the hire.



Applicability to Measuring Sales Person Profitability

Breakeven analysis can be used to evaluate sales person performance. By stack ranking each sales person in terms of Net Margin, a company can effectively determine those individuals producing the highest returns. This is a more effective means of measuring sales performance than top line revenue production because all the costs associated with employing the sales person are weighed against the productivity being produced.

Assumptions	
Sales Person Base Salary	$ 50,000
Load Percentage	50%
Commission Rate	20%
Quota/Sales	$ 1,000,000
Company Profit Margin	50%
Cost Calculations	
Sales Person Total Earnings At Quota/Sales	$ 250,000
Sales Person Loaded Base	$ 75,000
Sales Person Commissions At Quota/Sales	$ 200,000
Total Cost Per Sales Person	$ 275,000
Profit Calculations	
Total Profit at Quota/Sales	$ 500,000
Net Margin Per Sales Person at Quota/Sales	$ 225,000
Breakeven Point	$ 250,000

Make sure the commission rate is the blended rate if tiered.

Input the sales person's actual sales volume.

The margin on that sales person is displayed here.

Q4 STACKED RANKINGS BY PROFIT

RANKING	SALES PERSON NAME	MARGIN CONTRIBUTED
1	Suzy Miller	$ 700,000
2	Bill Smith	$ 432,534
3	Steve Jones	$ 398,234
4	Tom Franks	$ 354,213
5	John Johnson	$ 324,810
6	Tom Fisher	$ 263,412
7	Jane Walker	$ 211,124

Applicability to Compensation Plans

Breakeven analysis can be used in the compensation planning process to help in determining what percentage of compensation should be fixed and what percentage should be variable.

For example, assume the company decides the Sales Person Total Earnings at Plan to be $110,000.

One way to accomplish this is with a $50,000 base and a 20% commission rate on $300,000 in quota. With these assumptions, breakeven calculator produces the following results:

Assumptions	
Sales Person Base Salary	$ 50,000
Load Percentage	50%
Commission Rate	20%
Quota/Sales	$ 300,000
Company Profit Margin	50%
Cost Calculations	
Sales Person Total Earnings At Quota/Sales	$ 110,000
Sales Person Loaded Base	$ 75,000
Sales Person Commissions At Quota/Sales	$ 60,000
Total Cost Per Sales Person	$ 135,000
Profit Calculations	
Total Profit at Quota/Sales	$ 150,000
Net Margin Per Sales Person at Quota/Sales	$ 15,000
Breakeven Point	$ 250,000

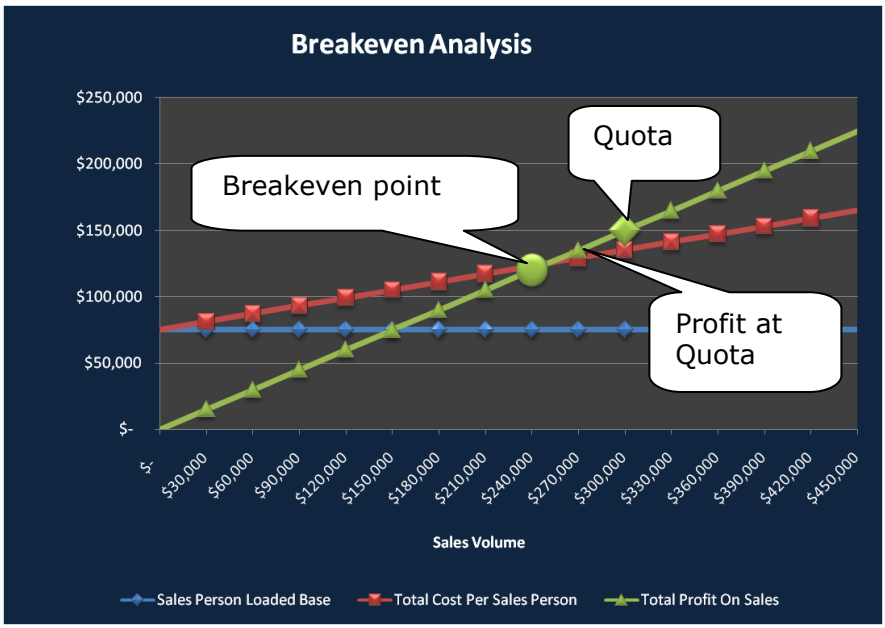
With a base of $50,000

…a commission rate of 20%,

…on a $300,000 sales quota,

The target compensation is achieved.

…and at least $250k in sales is required to break even.

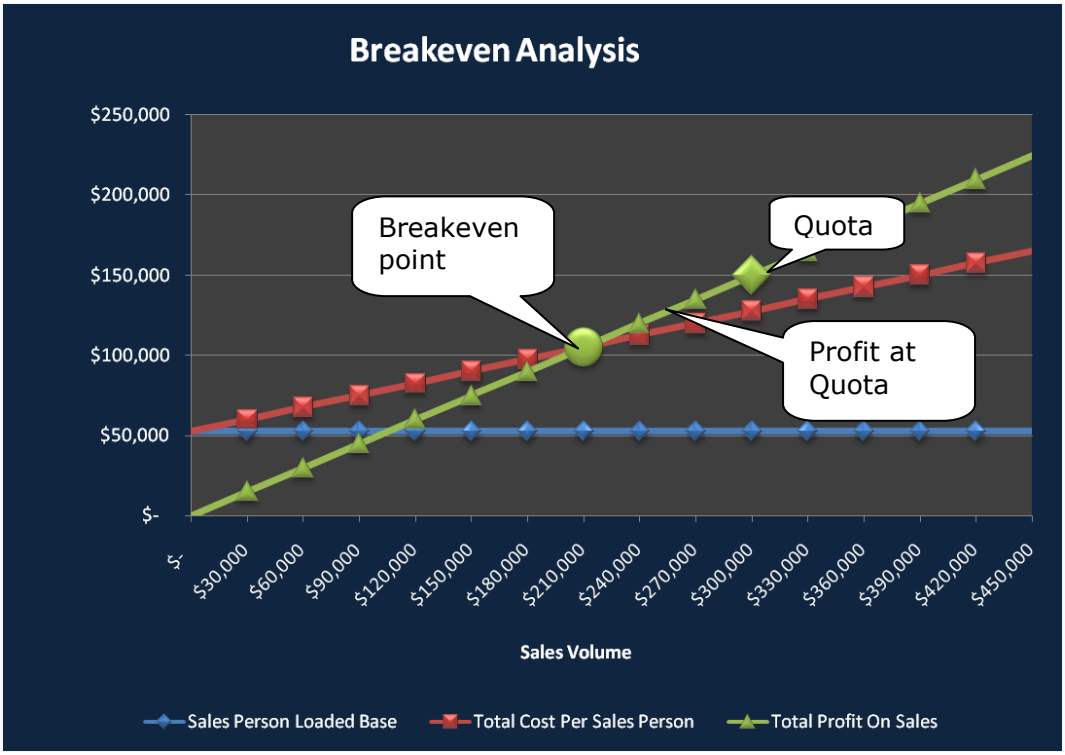


- An alternative way to arrive at $110,000 is to have a $35,000 base and a 25% commission rate. With these assumptions, breakeven calculator produces the following results for comparison:

Assumptions	
Sales Person Base Salary	**$ 35,000**
Load Percentage	**50%**
Commission Rate	**25%**
Quota/Sales	**$ 300,000**
Company Profit Margin	**50%**
Cost Calculations	
Sales Person Total Earnings At Quota/Sales	$ 110,000
Sales Person Loaded Base	$ 52,500
Sales Person Commissions At Quota/Sales	$ 75,000
Total Cost Per Sales Person	$ 127,500
Profit Calculations	
Total Profit at Quota/Sales	$ 150,000
Net Margin Per Sales Person at Quota/Sales	**$ 22,500**
Breakeven Point	**$ 210,000**

New Net Margin Number

New Breakeven Point

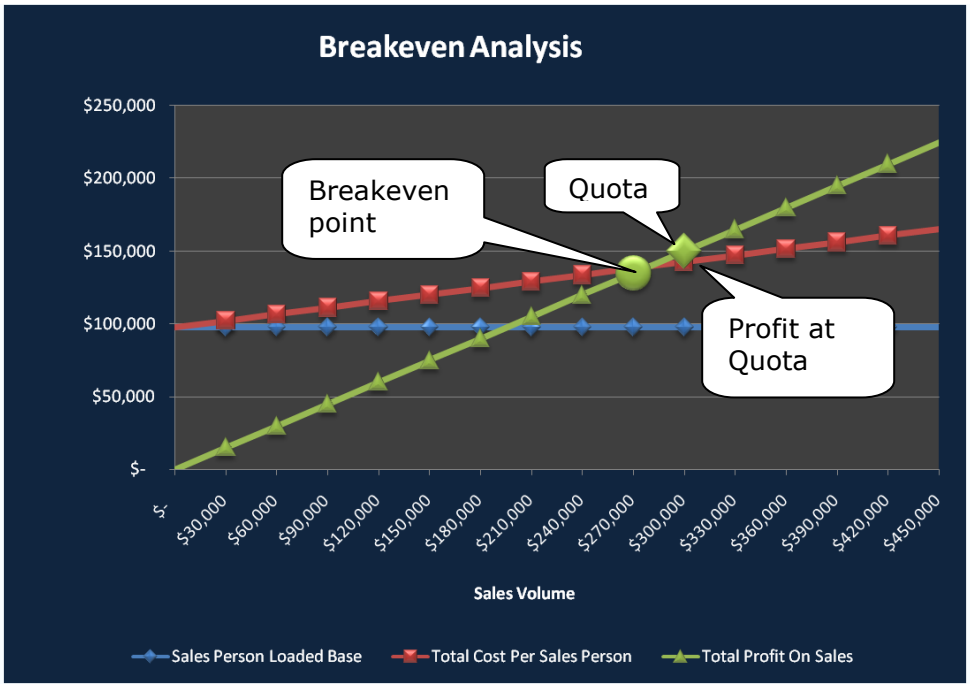


Or assume the company wants to keep the Sales Person Total Earnings At Plan at $110,000, but decreases the leverage in its compensation plans. Instead of paying a $50,000 base and a 20% commission rate, the company can pay a $65,000 base and a 15% commission rate. With these assumptions, breakeven calculator produces the following results:

Assumptions	
Sales Person Base Salary	**$ 65,000**
Load Percentage	**50%**
Commission Rate	**15%**
Quota/Sales	**$ 300,000**
Company Profit Margin	**50%**
Cost Calculations	
Sales Person Total Earnings At Quota/Sales	$ 110,000
Sales Person Loaded Base	$ 97,500
Sales Person Commissions At Quota/Sales	$ 45,000
Total Cost Per Sales Person	$ 142,500
Profit Calculations	
Total Profit at Quota/Sales	$ 150,000
Net Margin Per Sales Person at Quota/Sales	**$ 7,500**
Breakeven Point	**$ 278,571**

New Net Margin Number

New Breakeven Point



This example shows the sensitivity between Base Salary, Commission Rate, and the Breakeven Point for three compensation plan scenarios where the Sales Person Total Earnings At Plan remains constant at $110,000:

	Scenario1	Scenario2	Scenario3
Sales Person Base Salary	$ 35,000	$ 50,000	$ 65,000
Commission Rate	25%	20%	15%
Sales Person Total Earnings At Plan	$110,000	$110,000	$110,000
Breakeven Point	$210,000	$250,000	$278,571

The more highly leveraged the compensation plan, the lower the breakeven point and therefore, the lower risk for the company to keep the Sales People on the payroll. More highly leveraged compensation plans provide more motivation for sales people to achieve their sales objective because more income is at risk. This is an effective Best Practice used by leading companies to transfer its profit risk across the entire sales force so no single person or entity bares too much of the risk

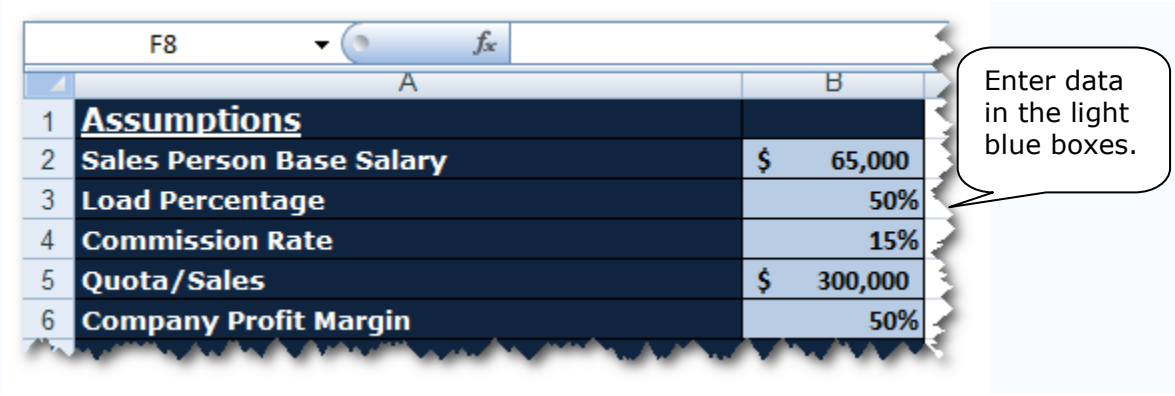
Limitations

Break-even analysis is only a supply side (i.e. costs only) analysis, as it says nothing about whether the quota set and the expected revenue production is attainable. A company needs to use historical sales person performance to make this sure this assumption is set reasonably.

Resources

A breakeven analysis tool makes computing the breakeven point a very easy task. All that is needed is the following 5 inputs:

1. Base Salary
2. Load
3. Commission Rate.
4. Quota/Sales
5. Company Profit Margin

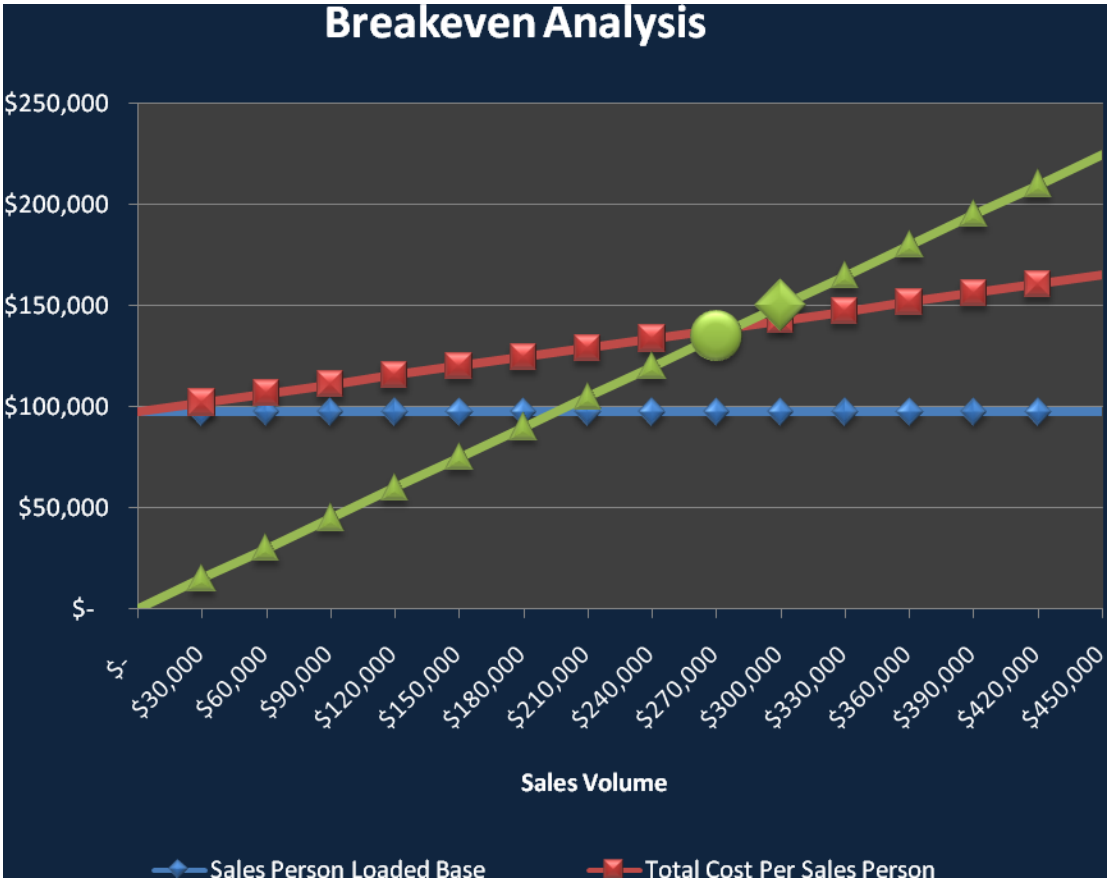


Once those inputs are plugged into the model, it will produce the following 7 outputs per Sales Person:

1. Total Earnings At Quota/Sales
2. Loaded Base
3. Commissions at Quota/Sales
4. Total Cost
5. Total Profit At Quota/Sales
6. Net Margin at Quota/Sales
7. Breakeven Point

8	**Cost Calculations**	
9	Sales Person Total Earnings At Quota/Sales	$ 110,000
10	Sales Person Loaded Base	$ 97,500
11	Sales Person Commissions At Quota/Sales	$ 45,000
12	Total Cost Per Sales Person	$ 142,500
13		
14	**Profit Calculations**	
15	Total Profit at Quota/Sales	$ 150,000
16	Net Margin Per Sales Person at Quota/Sales	$ 7,500
17		
18	Breakeven Point	$ 278,571

It also generates a plot that shows Sales Person Loaded Base, Total Cost Per Sales Person and Total Profit On Sales at different Sales Volume Levels.



Recommended Next Steps

With these computations, the examples above should be used as a guide the next time staffing headcount justification needs to take place, or compensation plans need to be identified.

Summary of the steps required to justify headcount:

1. Plug inputs into the breakeven analysis tool
2. Compare the breakeven point to the annual quota
3. If breakeven point is greater than the annual quota, hiring the sales person will lose the company money. Proceed with caution
4. If the breakeven point is less than the annual quota, so long as the sales person can achieve the quota amount, the hiring decision is a good investment for the company

Summary of the steps required to stack rank sales people by net margin:

1. Plug inputs into the breakeven analysis tool
2. Stack rank sales people by the Net Margin Per Salesperson

Summary of the steps required to justify compensation plan changes:

1. Plug inputs into the breakeven analysis tool
2. Compare the breakeven point and net margin in multiple scenarios to achieve a balance between the company's risk and how much base compensation is required to keep sales people onboard.

Conclusions

Breakeven analysis has been shown as an easy to use resource for the following challenges, be sure to keep this in mind next time you are faced with one of these tasks:

1. Sales organizations need a tool to cost justify the addition of sales headcount necessary to achieve the company's revenue objectives. Comparing the sales person quota amount to the breakeven point will determine if hiring the person is a good investment for the company.

2. Sales organizations need a tool to evaluate sales person performance in terms of their net contribution to the company's profitability. Stack ranking sales people by net margin is the most effective measure of a sales person's contribution to company profitability.

3. Sales organizations need a tool to cost justify compensation plan changes that will drive the desired behavior through incentive setting, while simultaneously allowing the company to achieve its profitability targets. Comparing multiple compensation plan scenarios helps a company determine the appropriate base vs. variable compensation rate to use.

Sales Benchmark Index
Phone: 888.556.7338
Fax: 404.551.5244
info@salesbenchmarkindex.com