

Lifetime commissions are a life sentence on profitability

Category: Execution

I am happy to pay referral commissions to people who bring me business but I hate paying out commissions for longer than a year. This may seem like common sense, but I was very surprised during a conversation I was having at a board meeting with ten of my clients to learn that a number of them were paying for referrals under multi-year commission agreements.

The most egregious of these was a professional services firm that had been introduced to a new client ten years ago. The referrer had no ongoing relationship with the client, and added no value after the initial introduction. Ten years later, my client was still paying 10% of the gross to the referrer. Fortunately, there was nothing in writing and we were able to unwind the arrangement.

While we were discussing this several other people said that they also had multi-year commission arrangements, and at least 3 of them went away with a determination that the existing commission arrangements would be revised wherever possible and new arrangements put in to place for the future.

If you have ongoing referral commission arrangements you may or may not be able to renegotiate them. What you should do immediately however is to produce a written document that sets out what your referral commission policies are. This gives your position more authority and makes the people referring business to you less likely to argue about it.

When I am on the other side of the equation, of course, I always look for multi-year commissions, and it is surprising how often people acquiesce. If you do have to give multi-year commissions, then at least have them declining over time.

While on the subject let me just say a word about sales commissions. Depending on the length of the sales cycle and the type of sale, it may be appropriate to give sales people multi-year commissions, but there are significant dangers that lurk in that pond.

When I first started my computer service company, I put in place a commission program that paid 10% of the gross on new service contracts, and a renewal commission of 5% if the contract renewed. I quickly learned the folly of my ways when my top sales person sold \$1,000,000 of maintenance one year. I was very happy to write the commission check for the new business, but became alarmed at the implications of the renewal commission. A few years like this, I thought, and the guy won't ever need to leave the office to make a new sale.

The dynamics of that business were that renewals were generated by the quality of the service that we provided, and that most accounts really became house accounts. What we ended up doing was letting the sales person keep only the larger relationships or those where there was a significant possibility of more business, and the remainder of the accounts were handled by the contract department at renewal time.

The big problem with recurring commission for sales people is that it can make them too comfortable. In a world where there are both hunters and gatherers, you don't want the hunters turning into gatherers because of the way that you choose to pay them. Remember, you get the behaviors you pay for, not the ones you say you want.