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Inspire Performance

Sales Compensation in a Recurring Revenue Business

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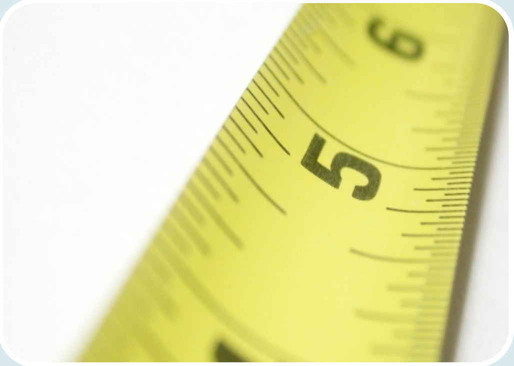
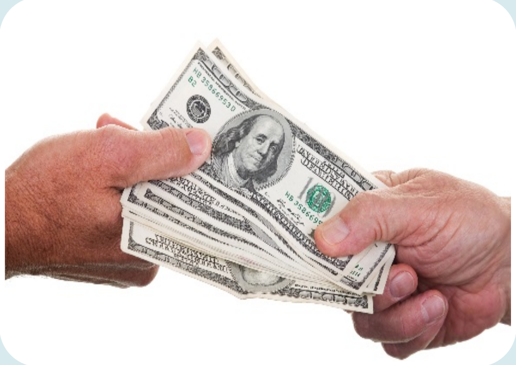
What’s so tricky about recurring revenue sales comp?





Who does what?

- New business
- Renewals
- Upsells

How to measure?

- Recurring revenue stream
- Total Contract Value
- Term & terms

Payment triggers?

- Contract
- Billing
- Revenue
- Cash

What about…

- Transitioning from one-time to recurring?
- Quotas and the AOP
- Usage based contracts

There's a lot we won't discuss today

Motivated sales people…

- Right risk/reward balance
- Right upside opportunity
- Straightforward compensation mechanics

focused on the most important sales...

- Measures aligned with company strategy
- Fair and attainable performance standards/goals
- Limited choice in how to make money

working collaboratively...

- Measured at the right level of aggregation (company, region, team, individual)
- Include the right sales crediting policies (layered, splits, …)
- Individual and sales management plans aligned

to create value

- Appropriate cost of compensation at all likely levels of sales productivity
- Reasonable effort required to track, report and administer

Who does what?

Recurring revenue from the start

<table>
<tr><th colspan="2" rowspan="2">Sales responsibility</th><th colspan="4">Business maturity stage</th></tr>
<tr><th>Launch</th><th>Early success</th><th>Growth</th><th>Maturity</th></tr>
<tr><td rowspan="5">Recurring Revenue</td><td>New logos</td><td>Sales Rep</td><td rowspan="5">Sales Rep</td><td rowspan="2">Sales Rep</td><td>New Sales Rep</td></tr>
<tr><td>Add-on sales</td><td rowspan="4">n/a</td><td rowspan="3">Key Account Manager</td></tr>
<tr><td>Account Management</td><td rowspan="3">Renewal Team</td></tr>
<tr><td>Key Account Renewals</td></tr>
<tr><td>Transactional Renewals</td><td>Renewal Team</td></tr>
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Who does what?

In a business moving from 1x → RR

Sales responsibility	*Recurring Rev Business maturity stage*							
	Launch		*Early success*		*Growth*		*Maturity*	
	1x	*RR*	*1x*	*RR*	*1x*	*RR*	*1x*	*RR*
New logos	New Sales Rep		New Sales Rep		New Sales Rep		New Sales Rep	
Add-on sales	Key Account Manager		Key Account Manager		Key Account Manager		Key Account Manager	
Account Management								
Key Account Renewals	n/a				n/a		n/a	Renew Team
Transactional Renewals						Renew Team		

Measuring sales contribution

Footprint Measures

- **ACV**
  Annual Contract Value
  --
  FYCV
  First Year Contract Value
- **MRR**
  Monthly Recurring Revenue

In-year Revenue Measures

- **RR**
  Recognized Revenue
- **OTC**
  One-time charges (e.g., install fees)

1x Equivalency Measures

- **TCV**
  Total Contract Value
  --
  OYCV
  Out Year Contract Value
- Term Length

Balance Sheet Measures

- Up-front payment

Measuring sales contribution

- **The primary measure in the plan must be a footprint measure**
- Expanding and maintaining the customer base is the foundation of recurring revenue success

Footprint Measures
- **ACV** Annual Contract Value -- **FYCV** First Year Contract Value
- **MRR** Monthly Recurring Revenue

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Balance Sheet Measures
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Measuring sales contribution

- **Recognized Revenue** may be used at a sales leader level to keep a good focus on selling early in the year
- **One-time charges** are great as a secondary measure when sales people have discretion over offering & pricing these

Footprint Measures
- **ACV** Annual Contract Value -- **FYCV** First Year Contract Value
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But how do I know if I'll hit my revenue number based on recurring revenue added?

This is where the "Rule of 78" comes in

In this example, a sales person sells 1,000 of MRR per month for 12 months, resulting in 78,000 of in-year recognized revenue

Month Sold	*Recognized Revenue by Month*												*Total in-year Revenue*
	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*	
1	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	**12,000**
2		1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	**11,000**
3			1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	**10,000**
4				1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	**9,000**
5					1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	**8,000**
6						1,000	1,000	1,000	1,000	1,000	1,000	1,000	**7,000**
7							1,000	1,000	1,000	1,000	1,000	1,000	**6,000**
8								1,000	1,000	1,000	1,000	1,000	**5,000**
9									1,000	1,000	1,000	1,000	**4,000**
10										1,000	1,000	1,000	**3,000**
11											1,000	1,000	**2,000**
12												1,000	**1,000**
Total													**78,000**

Implications of the Rule of 78

If your time period is different from 12 months, use the more general formula:

N = number of months over which revenue will be recognized

Recognized Revenue = [(N)*(N+1)/2] x MRR

For example, if N=12 and MRR=1,000

[(12)*(13)/2] x 1,000 = 78,000

For example, if N=6 and MRR=500 (mid-year product launch)

[(6)*(7)/2] x 500 = 10,500

Earlier sales are better, much better

The sooner the sale is made, the more revenue this year, and the more revenue in total

Measuring sales contribution

- **Total Contract Value** is often preferred by sales people, but rarely a good measure to include
- **Out Year Contract Value** makes an excellent secondary measure to incentivize longer term length
- **Term length** is great as a modifier, unless renewal rates are high

- Footprint Measures
  - **ACV** Annual Contract Value -- **FYCV** First Year Contract Value
  - **MRR** Monthly Recurring Revenue
- In-year Revenue Measures
  - **RR** Recognized Revenue
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- Balance Sheet Measures
  - Up-front payment

Measuring sales contribution

- **Up-front payment** can be incentivized with added compensation, especially in longer term deals, in recognition of the cost of capital to the business

Footprint Measures
- **ACV** Annual Contract Value -- **FYCV** First Year Contract Value
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Balance Sheet Measures
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Measurement period

Considerations	*Monthly*	*Quarterly*	*Annual*
Deal size	Small	Medium	Large
Number of deals per year	Many	Medium	Few
Sales cycle length	<4 weeks	1-3 months	4-9 months, or more
Market-based seasonality	Negligible	Minimal	May be significant

The measurement period is the period for which the goals are set

- Several considerations guide the choice of measurement periods
- In recurring revenue, use the shortest measurement period that works for your business to ensure consistent focus on closing all year long

Sales crediting and payment triggers

Triggers	
Events	Contact signed
	Go-live date set
	Customer live
	First invoice
	First cash received
	X months from go-live
Ongoing	As revenue is recognized
	As cash is received

WHAT is "triggered"

- **Quota credit**
  - Typically at signing
- **Payment**
  - Pay when 2 things have occurred:
    1. Primary sales job is complete
    2. The value of what has been sold is known
  - Often split between signing and first cash
- **Earnings**
  - Typically when cash is received

Example Plan 1: Recurring revenue startup (transactional business)

Plan features	*New Sales Rep*
Total Comp at Target	$90,000 = $45k base + $45k target incentive
Measurement period	Monthly quota, paid monthly
Primary measure	Monthly Recurring Revenue Added Quota = $3.659 MRR per month
Term modifier	Commission Adder for terms > 1 year

% of Quota Attained (Monthly YTD)	Commission Rate
110% +	150% MRR
90% - 110%	125% MRR
0% - 90%	100% MRR

Term	Commission Adder
3 years	+ 20% MRR
2 years	+ 10% MRR
1 Year	No adder

Example plan 2: Recurring revenue mature business (enterprise sales)

Plan features	***New Sales Rep***	***Key Account Mgr***	***Renewal Rep***
Total Comp at Target	$160,000 = $80,000 base + $80,000 target incentive	$180,000 = $100,000 base + $80,000 target incentive	$105,000 = $60,000 base + $45,000 target incentive
Measurement period	Quarterly quota, paid quarterly	Annual quota, paid quarterly	Quarterly quota, paid quarterly
Primary measure	ACV Added Quota = $500k/qtr	ACV Added Quota varies with book	ACV retained Quota = 90%
Term modifier	Retention rate is high, so longer terms are not beneficial		
One-time charges	1% Commission on all one-time charges sold (does not relieve primary quota)		

New Sales Rep:

Act % Quota	Commission Rate
150% +	6% ACV
100 - 150%	8% ACV
0% - 100%	4% ACV

Key Account Mgr:

Act % Quota	Payout Rate per 1% Quota
120% +	$400
100 - 120%	$1000
0% - 100%	$200

Renewal Rep:

ACV retained	Payout Rate per 1%
90% +	$1125
75% - 90%	$750
0% - 75%	$0

Example plan 3:
Recurring revenue with variable payments by year (enterprise sales)

Plan features	***New Sales Rep***	
Total Comp at Target	$180,000 = $90,000 base + $90,000 target incentive	
Measurement period	Annual quota, paid quarterly	
Primary measure	First Year Contract Value Quota = $2.5M per year	
Secondary measures	Out Year Contract Value Quota = $1.25M per year	Up-Front Payment Quota = $1M in OYCV per year

Primary measure (First Year Contract Value):

Act % Quota	Commission Rate
150% +	3.20% FYCV
100 - 150%	8.00% FYCV
50% - 100%	3.20% FYCV
0% - 50%	2.13% FYCV

Out Year Contract Value:

Act % Quota	Commission Rate
All values	1.33% OYCV

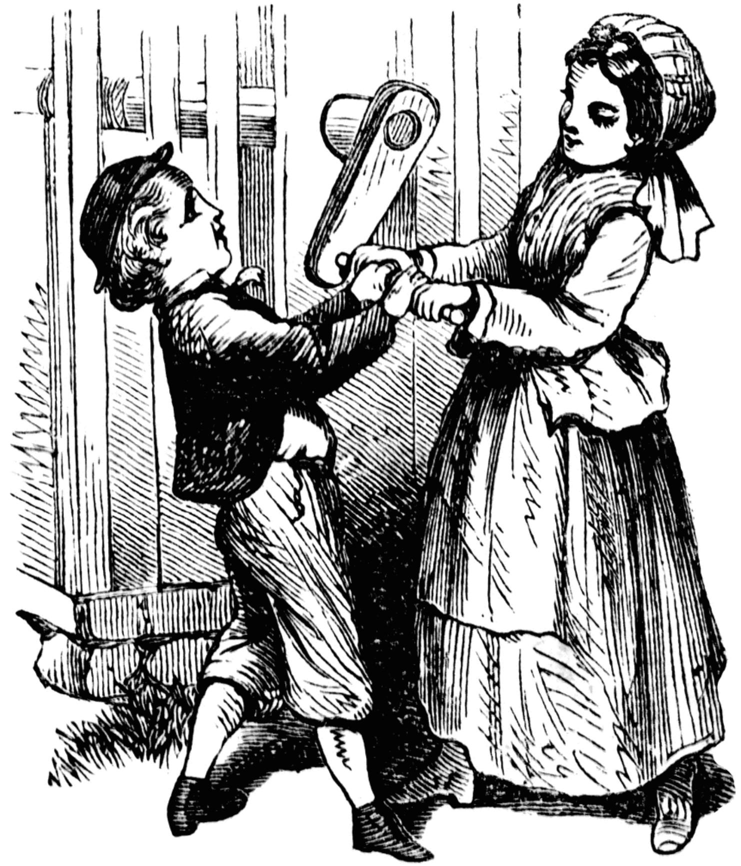
Up-Front Payment:

Act % Quota	Commission Added
All values	+0.67% OYCV paid up-front

Tricky situation #1

Usage-based contracts

- When what is sold is an agreement for a rate, perhaps with a minimum volume, significant payment early in the cycle may not be advised
- Example solution:
  - Signing bonus paid based on deal characteristics, size/potential of the customer, ~10-20% of expected deal comp
  - Pay monthly for the next 6 months based on actual volume (at a higher rate that would be offered if payments went on longer)

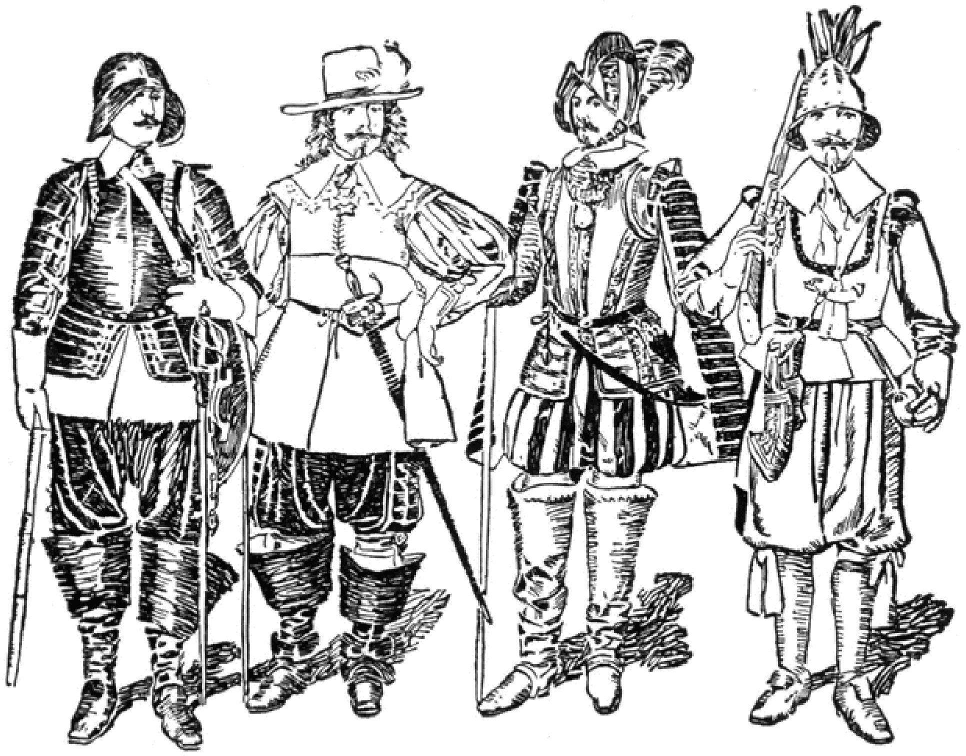


Tricky situation #2

Enterprise sales with many sales roles involved

- Roles involved may include
  - Account Executive
  - Product Specialist
  - Global Account Manager
  - Services Seller
  - Channel Manager

- Whether to split sales credit or "layer" it depends…
  - To foster independent selling and minimize the use of scarce resources, consider splitting credit
  - To foster collaboration and involvement, consider 100% credit for everyone who should be involved, with involvement anticipated in the quota (and thereby reducing the payout rate)



Common pitfalls in recurring revenue sales compensation

Paying on TCV

- Risks: Sales people hit quotas and earn target comp selling longer term deals, and the company misses Revenue goals
- Better approaches:
  - Pay on ACV or MRR, with uplift for added term length
  - Pay on FYCV, with a separate lower-rate component for OYCV

Annuity tails……………………………….

- Risks: Successful sales people can live on the past without adding new business; concurrently administering multiple comp plans
- Better approach: Pay as early in the sales cycle as makes sense so that next year's focus is on next year's expanding footprint

Common pitfalls in recurring revenue sales compensation

Commission rates that don’t change as the business scales

- Risks: Sales productivity climbs due to business investment (brand value, complimentary products, channels…), and sales compensation goes way beyond market value
- Better approach: Keep your eye on market value, and adjust payout rates and target comp in alignment with market value (which means your rates will go down if you’re getting marketplace traction)

What about ASC606, the new account standard?

For more information on ASC606, see http://xactlycorp.com/revenue-recognition-accounting-resources/

The primary effect will be on revenue and sales compensation cost accounting

- 1x software license fees may need to be recognized over a multi-year period, making them more SaaS-like for revenue recognition
- The compensation paid for both one-time software licenses and SaaS may need to be expensed over an extended period, requiring capitalization of some sales compensation

Plan design implications

- Sales crediting may need to shift to align with recognized revenue for 1x licenses