Sales Compensation in a Recurring Revenue Business

Webinar sponsored by Xactly, July 2017

Prepared by Donya Rose
Leader, Sales Compensation Plan Design Practice | Xactly Corporation

Xactly has prepared this document for the benefit of attendees at the above named event. This document is incomplete without the accompanying discussion and contains proprietary material. This document is incomplete without the accompanying discussion and contains proprietary materil. The document may not be reproduced, either in total or in part, circulated, or quoted from without the expressed written permission of Xactly.

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

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

Who does what?

Recurring revenue from the start

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

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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		

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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

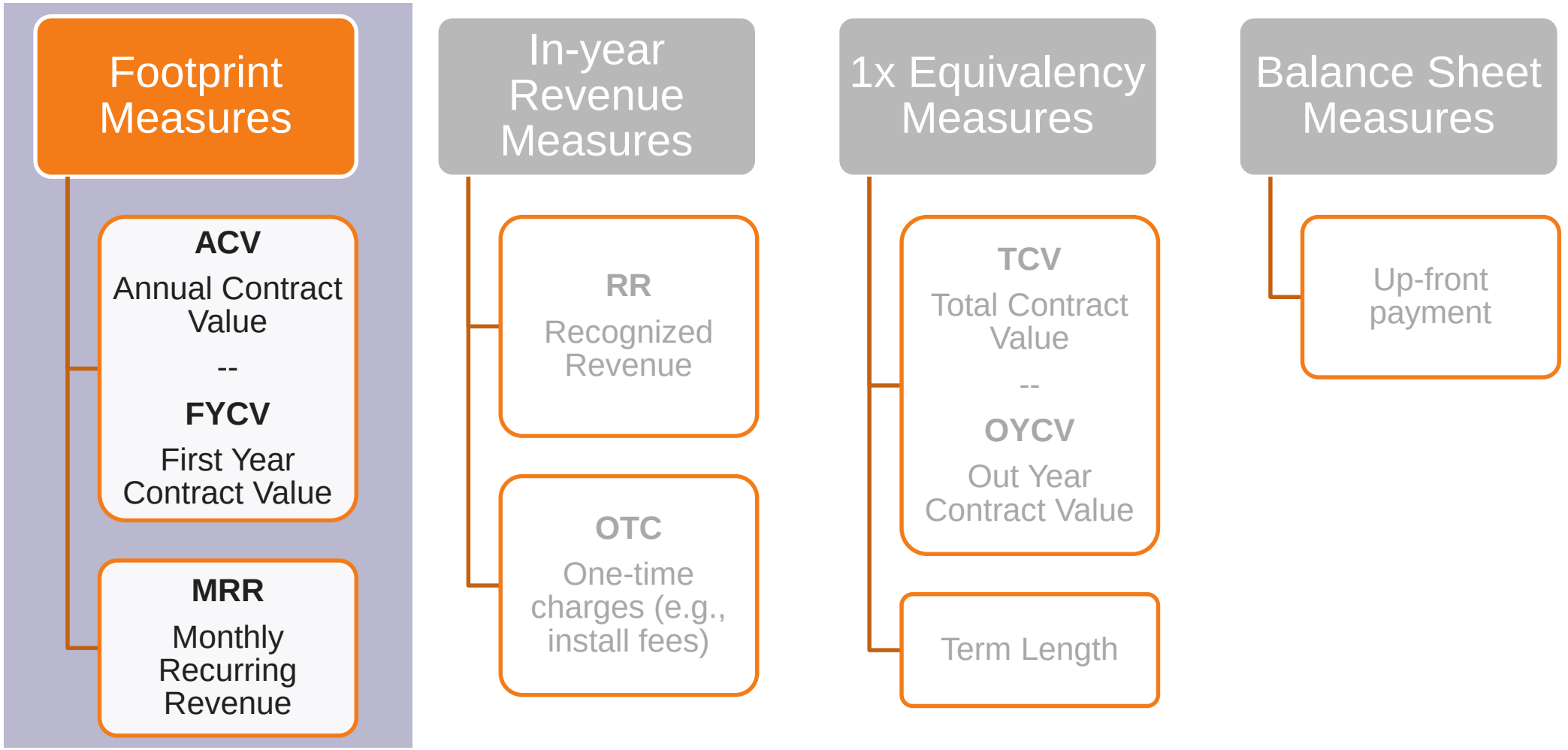
Balance Sheet Measures

Up-front payment

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

Measuring sales contribution

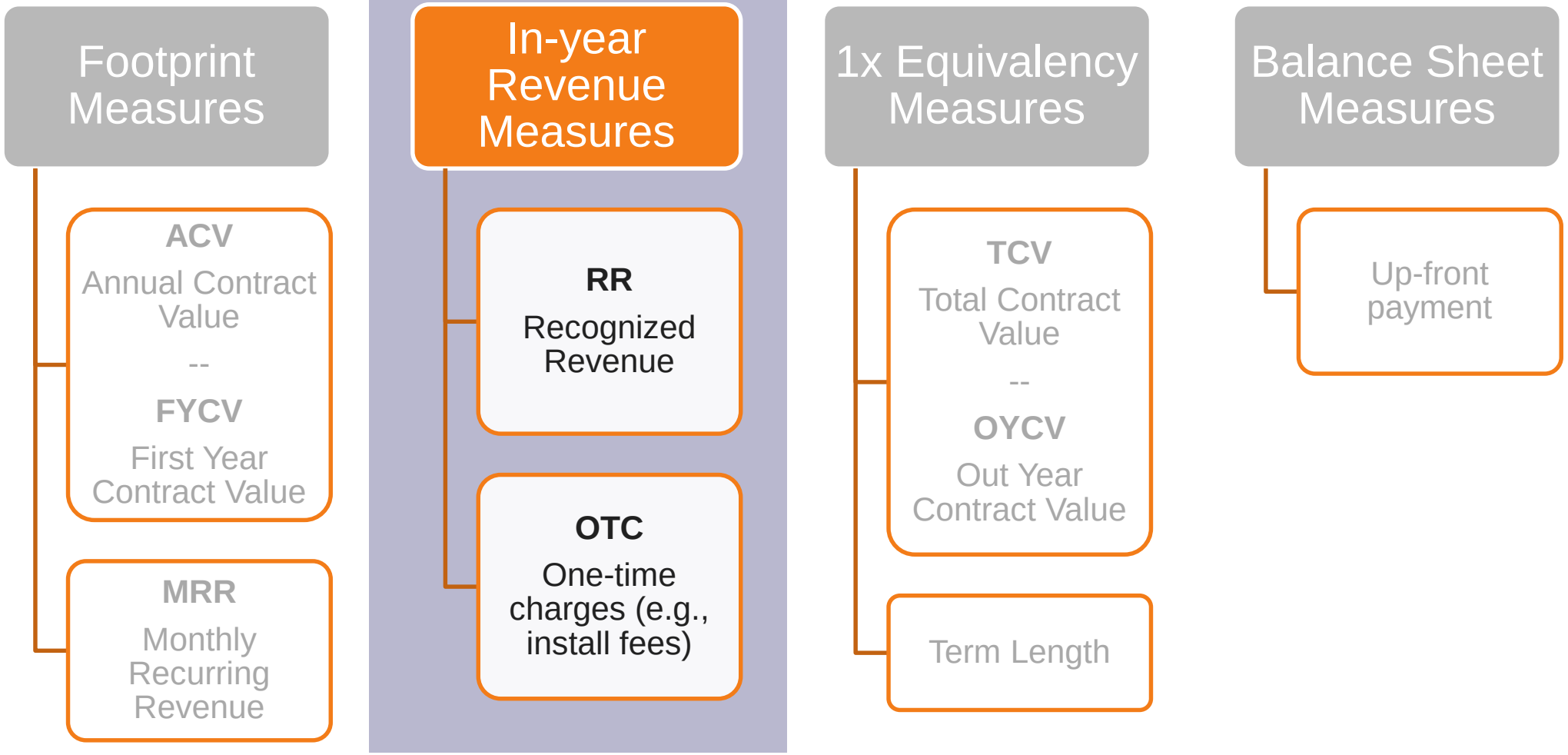
- **The primary measure in the plan must be a footprint measure**
- Expanding and maintaining the customer base is the foundation of recurring revenue success



©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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



©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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**

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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

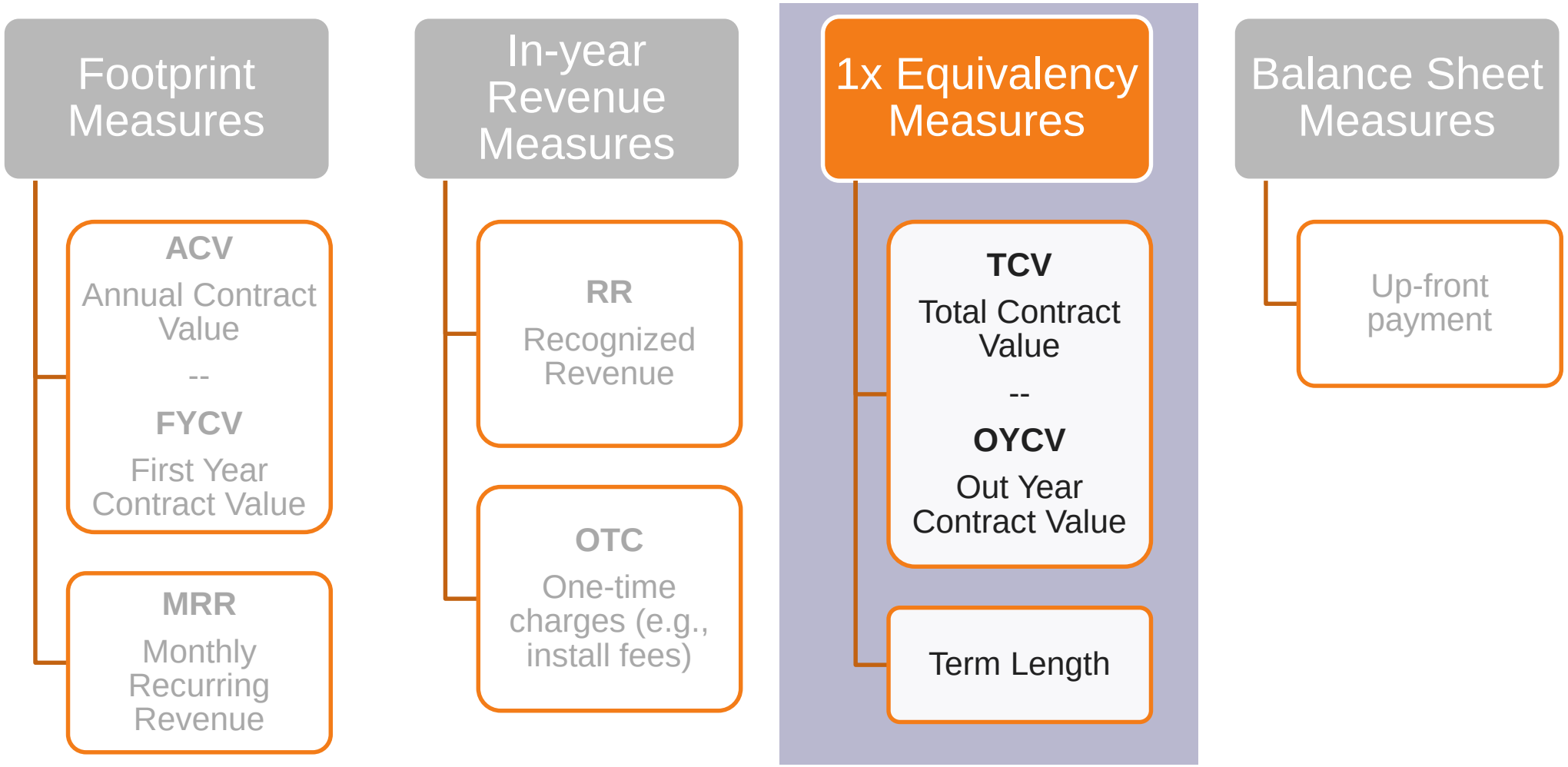
Earlier sales are better, much better

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

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

Measuring sales contribution

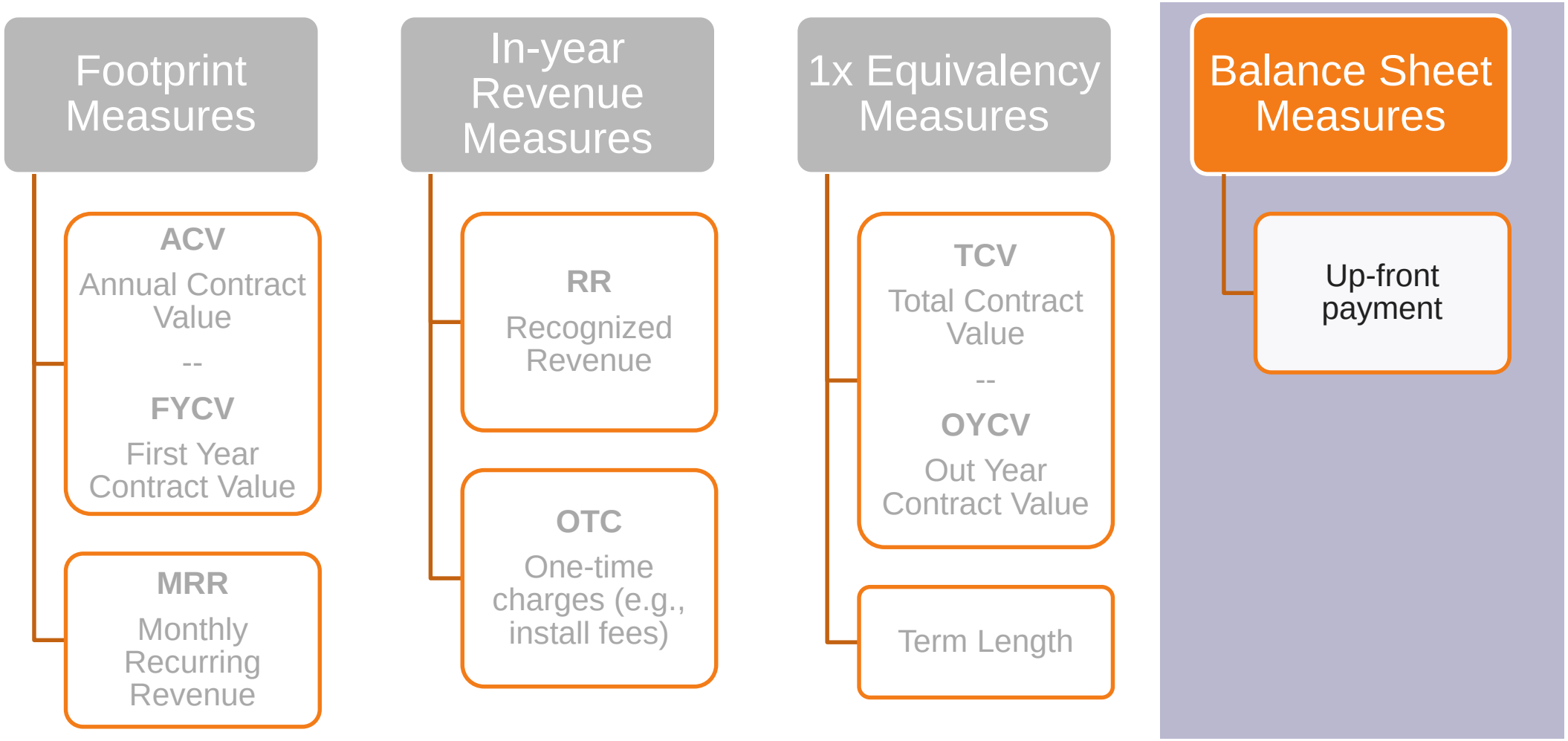
- **Total Contract Value** is often preferred by sales people, but rarely a good measure to include
- **Out Year Contract Value** makes an excellent secondary measure to incentivize longer term length
- **Term length** is great as a modifier, unless renewal rates are high



©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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



©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

Example Plan 1: Recurring revenue startup (transactional business)

<table>
<tr><th>Plan features</th><th>New Sales Rep</th></tr>
<tr><td>Total Comp at Target</td><td>$90,000 = $45k base + $45k target incentive</td></tr>
<tr><td>Measurement period</td><td>Monthly quota, paid monthly</td></tr>
<tr><td>Primary measure</td><td>Monthly Recurring Revenue Added
Quota = $3.659 MRR per month
<table>
<tr><th>% of Quota Attained (Monthly YTD)</th><th>Commission Rate</th></tr>
<tr><td>110% +</td><td>150% MRR</td></tr>
<tr><td>90% - 110%</td><td>125% MRR</td></tr>
<tr><td>0% - 90%</td><td>100% MRR</td></tr>
</table></td></tr>
<tr><td>Term modifier</td><td>Commission Adder for terms > 1 year
<table>
<tr><th>Term</th><th>Commission Adder</th></tr>
<tr><td>3 years</td><td>+ 20% MRR</td></tr>
<tr><td>2 years</td><td>+ 10% MRR</td></tr>
<tr><td>1 Year</td><td>No adder</td></tr>
</table></td></tr>
</table>

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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

<table>
<tr><th>Plan features</th><th>New Sales Rep</th><th>Key Account Mgr</th><th>Renewal Rep</th></tr>
<tr><td>Total Comp at Target</td><td>$160,000 = $80,000 base + $80,000 target incentive</td><td>$180,000 = $100,000 base + $80,000 target incentive</td><td>$105,000 = $60,000 base + $45,000 target incentive</td></tr>
<tr><td>Measurement period</td><td>Quarterly quota, paid quarterly</td><td>Annual quota, paid quarterly</td><td>Quarterly quota, paid quarterly</td></tr>
<tr><td>Primary measure</td><td>ACV Added
Quota = $500k/qtr
<table><tr><th>Act % Quota</th><th>Commission Rate</th></tr><tr><td>150% +</td><td>6% ACV</td></tr><tr><td>100 - 150%</td><td>8% ACV</td></tr><tr><td>0% - 100%</td><td>4% ACV</td></tr></table></td><td>ACV Added
Quota varies with book
<table><tr><th>Act % Quota</th><th>Payout Rate per 1% Quota</th></tr><tr><td>120% +</td><td>$400</td></tr><tr><td>100 - 120%</td><td>$1000</td></tr><tr><td>0% - 100%</td><td>$200</td></tr></table></td><td>ACV retained
Quota = 90%
<table><tr><th>ACV retained</th><th>Payout Rate per 1%</th></tr><tr><td>90% +</td><td>$1125</td></tr><tr><td>75% - 90%</td><td>$750</td></tr><tr><td>0% - 75%</td><td>$0</td></tr></table></td></tr>
<tr><td>Term modifier</td><td colspan="3">Retention rate is high, so longer terms are not beneficial</td></tr>
<tr><td>One-time charges</td><td colspan="3">1% Commission on all one-time charges sold (does not relieve primary quota)</td></tr>
</table>

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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

<table>
<tr><th>Plan features</th><th colspan="2">New Sales Rep</th></tr>
<tr><td>Total Comp at Target</td><td colspan="2">$180,000 = $90,000 base + $90,000 target incentive</td></tr>
<tr><td>Measurement period</td><td colspan="2">Annual quota, paid quarterly</td></tr>
<tr><td>Primary measure</td><td colspan="2">First Year Contract Value
Quota = $2.5M per year
<table><tr><th>Act % Quota</th><th>Commission Rate</th></tr><tr><td>150% +</td><td>3.20% FYCV</td></tr><tr><td>100 - 150%</td><td>8.00% FYCV</td></tr><tr><td>50% - 100%</td><td>3.20% FYCV</td></tr><tr><td>0% - 50%</td><td>2.13% FYCV</td></tr></table></td></tr>
<tr><td>Secondary measures</td><td>Out Year Contract Value
Quota = $1.25M per year
<table><tr><th>Act % Quota</th><th>Commission Rate</th></tr><tr><td>All values</td><td>1.33% OYCV</td></tr></table></td><td>Up-Front Payment
Quota = $1M in OYCV per year
<table><tr><th>Act % Quota</th><th>Commission Added</th></tr><tr><td>All values</td><td>+0.67% OYCV paid up-front</td></tr></table></td></tr>
</table>

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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)

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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)

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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)

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.

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

©2017 Xactly Corporation. All rights reserved. Proprietary & Confidential.