Sales Employees Compensation: An Optimal Balance between Fixed and Variable Pay

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Abstract

This research paper proposes an economic concept and a financial framework to help human resource (HR) managers in marketing firms determine whether their compensation packages are effective. Paper also provides a brief definition of agency theory and discusses fixed versus variable compensation, the significance of variable compensation and how choice of pay plan affects operating leverage and the break-even point. With an illustration, this research describes the advantages and disadvantages of variable compensation and tabulates the optimal balance of fixed versus variable compensation costs. Finally paper provides detailed calculations on the evaluation of the optimal variable pay ratio. Findings of the research shows that decisions about fixed and variable compensation will help to maximize the value of the firm.

Keywords
Compensation; variable pay; operating leverage; break-even point (BEP); economic value added (EVA)

Notes

Author Biography

Pankaj M. Madhani received an MBA degree from Northern Illinois University and an MS in computer science from Illinois Institute of Technology, Chicago. He holds bachelor’s degrees in chemical engineering and law, both from Gujarat University. He has more than 26 years of corporate and academic experience in India and the United States. He is currently working as an associate professor at ICFAI Business School and is now working on his doctoral thesis on sales force compensation. He has received The Best Teacher Award from IBS Alumni Federation in 2012. He has published various management books and more than 170 book chapters and research articles in several academic as well as practitioner journals such as World at Work Journal and The European Business Review. He is frequent contributor to Compensation & Benefits Review. His research interests include sales force compensation, corporate governance and strategic management.