More risk, less ability to pay: The compensation catch-22 for hiring salespeople at entrepreneural ventures

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Introduction

When entrepreneurial ventures grow to a certain size they often need to hire salespeople (Zoltners et al., 2006). However, finding and recruiting the right salespeople can be challenging for entrepreneurs. One such challenge is ability to offer competitive compensation. Smaller firms often have a less reliable cash flow and a tighter profit margin than larger firms, which can inhibit growth (Garnsey and Heffernan, 2005). Although smaller firms must invest to avoid being squeezed out by competition, they are also sensitive to available funds (Aoun and Hwang, 2008). It may be risky for the firm to offer competitive fixed pay and benefits because if a salesperson does not perform well, then the firm has misallocated valuable funds. Because variable compensation is awarded based on performance, it ensures that salespeople pay is commensurate with their performance (Cadsby et al., 2006); thus, on the surface, variable compensation appears less risky for entrepreneurs. Nevertheless, reliance on variable pay may have a serious downside for recruiting.

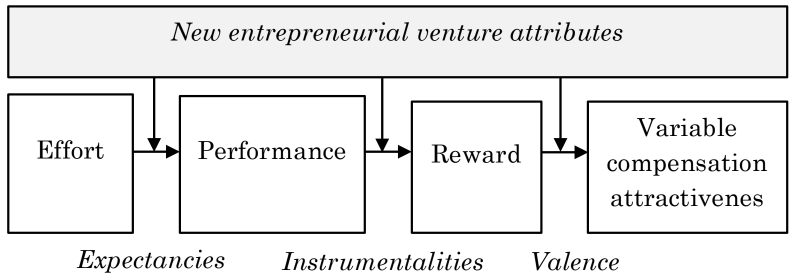
Previous research has already shown the variable pay is perceived to be risky (Kuhn and Yockey, 2003; Cadsby et al., 2007). Using the expectancy theory, we propose that salespeople feel that variable pay is even riskier at new entrepreneurial ventures than more well-established firms. According to expectancy-theory, salespeople evaluate the effort needed to achieve a given performance and whether they will receive a valuable reward for achieving that performance (Vroom, 1964). Because there is less specialization in sales roles in new entrepreneurial ventures (Zoltner et al., 2006) salespeople will perceive a greater workload at new ventures but, due to less intensive marketing efforts, salespeople should also perceive that it is harder to make sales. Thus expectancies should be greater. Furthermore, new ventures are more prone to going bankrupt (Shepherd et al., 2000) so there is less certainty that performance will culminate in a reward. Finally, there are fewer intangible rewards associated with variable compensation so reward valence should be lower. In total, salespeople should perceive variable compensation to be less attractive and more risky, ceteris paribus, at new entrepreneurial ventures than larger firms. Rouzies et al. (2009) demonstrated that firms must provide more take-home pay to salespeople when they use a higher percentage of variable compensation because of higher market risk for salespeople. Given that the market risk is even greater in new entrepreneurial ventures, entrepreneurs should have to offer an even greater percentage of variable pay to offset salespeople's perceived risk. Thus, in order to recruit talented entrepreneurs they will have to spend more on variable pay than a larger firm, which will in turn cut into their profit margin and make them less competitive. The theoretical implications of the model proposed in this paper are (1) to propose that entrepreneurs pay more for human capital when using variable compensation, and (2) to explain how firm attributes influence risk perception of variable compensation. The managerial implications suggest ways in which entrepreneurs can mitigate perceived risk to salespeople and thus reduce the cost of recruiting sales talent.

Expectancy Theory

The expectancy theory of motivation proposed by Vroom (1964) is that motivation is driven by three factors: expectancy, instrumentality, and valence. Expectancy is the belief that effort will result in a given level of performance. Instrumentality is the expected probability that a given level of performance will result in a reward. Finally, valence is the desirability of a particular reward. Expectancy theory has been applied to a large number of settings, including incentive to become an entrepreneur (Renko et al., 2012), motivating professional salespeople (Nasri and Charfeddine, 2012; Oliver, 1974) and designing sales contests (Murphy et al., 2004); hence, there is strong precedent for applying it to recruiting salespeople in entrepreneurial ventures.

Research has shown that the perception of expectancy, instrumentality, and valence varies based on a variety of factors such as past experience, communication feedback or information from others (Renko et al., 2012). We argue that it can also vary based on institutional factors, including ability to hire sales support, marketing budget, firm stability/tenure, and sales force size.

Figure 1: Expectancy model variable compensation attractiveness



Expectancies

Expectancy is the amount of effort required to obtain a certain level of performance (Murphy et al. 2004). Expectancies are thus influenced by (1) the amount required effort to achieve a level of performance and (2) the certainty of the relationship between effort and performance. Expectancies would be lower if the perceived effort to achieve a certain level of performance increases or if the link between effort and performance becomes weaker. We contend that new entrepreneurial ventures factors relate to both the amount of effort salespeople must put forth and the certainty that effort will translate into performance.

According to Arndt and Harkins (2013), salespeople benefit from sales support on sales-related activities in which the workload, complexity, customization, and/or prequalification risk are high, particularly when training and turnover are higher. However, many entrepreneurial ventures do not have the funds or management structure to hire dedicated sales support, particularly when sales are uncertain. Indeed, Zoltners et al. (2006) recommends little specialization in the sales force for new start-up firms. Furthermore, they often do not have time to provide extensive sales training. As a result, salespeople may have a broader range of tasks assigned to them than in a larger more established firm. For example, salespeople selling capital equipment may have to spend more time providing technical assistance to customers than if they had a dedicated support staff. Similarly, salespeople in new entrepreneurial ventures may have a more difficult time coordinating meetings because they do not have a dedicated service coordinator. Salespeople will likely be responsible for a greater number of sales activities in entrepreneurial ventures than in more established firm which in turn will cause salespeople to perceive their work effort per sale to be greater.

P1: Salespeople will believe that making sales will require more work in new ventures than in more established firms.

Furthermore, it may be more difficult to close sales in new entrepreneurial ventures. Although research has shown that advertising is an inefficient method of generating sales, especially in the long term, there is a positive relationship between advertising and sales volume (Luo and Donthu, 2005; Assmus et al., 1984). In particular, branding and company reputation improves customer value (Cretu and Brodie, 2007), making it easier for salespeople to sell. Alignment between salesperson control systems and brand image increases performance (Hughes and Ahearne, 2010). Given that established firms have a stronger brand image than new firms, as well as more money to devote to advertising, salespeople selling for established firms should have an advantage over salespeople selling for entrepreneurial ventures. Without marketing efforts, salespeople have to build demand on their own, establish trust between the customer and a firm customers have never heard of, and provide additional background information. As a result, it should be easier to make sales in more established firms than new entrepreneurial ventures.

P2: Salespeople will believe that making sales will be more difficult in new ventures than in more established firms.

Instrumentalities

Instrumentalities may be lower in new entrepreneurial ventures as well. Instrumentalities are essentially whether people trust that they will receive rewards they have earned. Instrumentalities in new entrepreneurial ventures depend in part on the ability and willingness of entrepreneurs to provide promised variable compensation. Many entrepreneurial ventures do not survive through their first few years of operation, a phenomenon that scholars call the "liability of newness" (Shepherd et al., 2000). Some estimates put failure rate as high as 40% in the first year and 90% over the first 10 (Timmons, 1990). If a firm fails, the entrepreneur will not have funds to pay salespeople. Because new ventures are more likely to go bankrupt than more established firms, potential salespeople likely view the instrumentalities of variable compensation as lower in new firms. Additionally, because new ventures lack reputation, salespeople may also worry about the legitimacy of the business. There are some pyramid schemes and scams that specifically target salespeople. These schemes are prevalent enough that the U.S. Securities and Exchange Commission has deemed it necessary to set up a website alert to warn salespeople to "beware of these hallmarks of a pyramid scheme" such as a "complex commission structure" (sec.gov, 2013). Thus, salespeople may be concerned about the willingness of the firm to provide promised rewards as well.

P3: Salespeople will believe that new ventures will be (a) less able and (b) less willing to provide promised variable compensation than they would for more well-established firms.

Valence

Even if the dollar value of a reward is identical between a new entrepreneurial ventures and a more well-established firm, the valence of the reward may be somewhat lower. In larger firms, variable compensation is often accompanied by intangible rewards as well. Top earners are often given public praise, which has been shown to be an important motivating factor (Kohli 1985). Also, high earning salespeople are more likely to be identified for promotions. However, in new venture, there may not be enough salespeople to single out top earners for praise and may not be room, at least in the short term, for advancement. Thus, while even when the monetary rewards are identical, the valance may be higher in the more established firm.

P4: Salespeople will perceive comparable compensation to have a lower valence in new ventures than in more established firms.

Theoretical implications

The theoretical implications of this research are two-fold. First, this model proposes one reason why entrepreneurs struggle to hire talented salespeople: They spend more on human capital when they use variable compensation. While it has been assumed that entrepreneurs can compensate for lack of cash by offering variable compensation (commission or a stake in the firm), they must offer more than a more well-established firm beyond simply overcoming the lack of fixed pay. As a result, the cost of hiring sales talent is an additional barrier to growth. In addition to undermining the success of the new venture, this disadvantage suppresses competition between new ventures and more well-established firms.

Second, this theoretical model proposes that firm attributes can influence compensation attractiveness. A variety of firm factors can influence expectancies, instrumentalities and reward valence, and these factors can make compensation more or less attractive. Hence, two firms may offer an identical compensation package and yet have different compensation attractiveness. The theoretical model demonstrates how firms can assess their compensation and make adjustments to improve attractiveness.

Managerial Implications

Using the theoretical model as a framework, new entrepreneurial ventures may be able to compensate for some of their disadvantages. When recruiting salespeople, it is beneficial to provide sufficient information in job ads (Mathew and Redman, 2001). For expectancies, entrepreneurs can address perceived workload. For example, although lack of dedicated sales support may increase workload, it also may be an opportunity to learn more aspects of the career and have more control over sales tasks. To improve the perceived link between work effort and performance, entrepreneurs can include salespeople in marketing efforts. Marketing and sales integration has been shown to have a number of advantages for firms (Rouzies et al., 2005). In a smaller venture, it may be easier to integrate. Instrumentalities can be developed by working to build trust with the salesperson. Trust is comprised of expertise and benevolence (Wood et al., 2008). As such, the entrepreneur should spend time discussing the viability of the product and business to establish expertise, and build-rapport with the salespeople to establish benevolence. Reward valance can be bolstered by offering more intangible rewards. For example, some small firms post their salesperson of the month in a public setting. It would be possible to publically reward a salesperson by acknowledging his/her efforts on a building sign or in the local newspaper. Also, managers might consider offering to promote from within the firm if and when the new venture grows. Finally, it is important to remember that pay attraction is only one aspect of hiring. Firm culture, autonomy and other factors might also attract salespeople. Entrepreneurs should emphasize these alternative benefits.

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Relevance to marketing Educators/Researchers, and/or Practitioners: This paper has two theoretical contributions and several managerial implications. The theoretical contributions are to (1) explain why it is a disadvantage for entrepreneurs to rely on variable compensation to recruit salespeople, and (2) to propose that firm attributes can influence compensation attractiveness. These theoretical contributions have practical implications as well. By understanding the reasons why new ventures must pay more in variable compensation, entrepreneurs can work to mitigate these disadvantages by addressing limitations in expectancies, instrumentalities, and reward valences.

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