Creating an **Effective** and **Motivating** Incentive Compensation Plan

White Paper

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Considerations for Effective Plan Design

Incentive Compensation is one the most important drivers for sales force productivity and effectiveness. Sales teams today continue to form a significant driver of a firm's topline, and hence having an engaged sales force is critical for corporate success. Compensation budgets today are a significant spend for any firm, and hence gaining optimal ROI out of this spend is a topic of key research. There are many areas in an Incentive Compensation program that contribute to high impact.

Practitioners and incentive plan designers would readily attest to the fact that a **well-designed incentive plan** forms the bedrock of any successful high impact incentive compensation program.

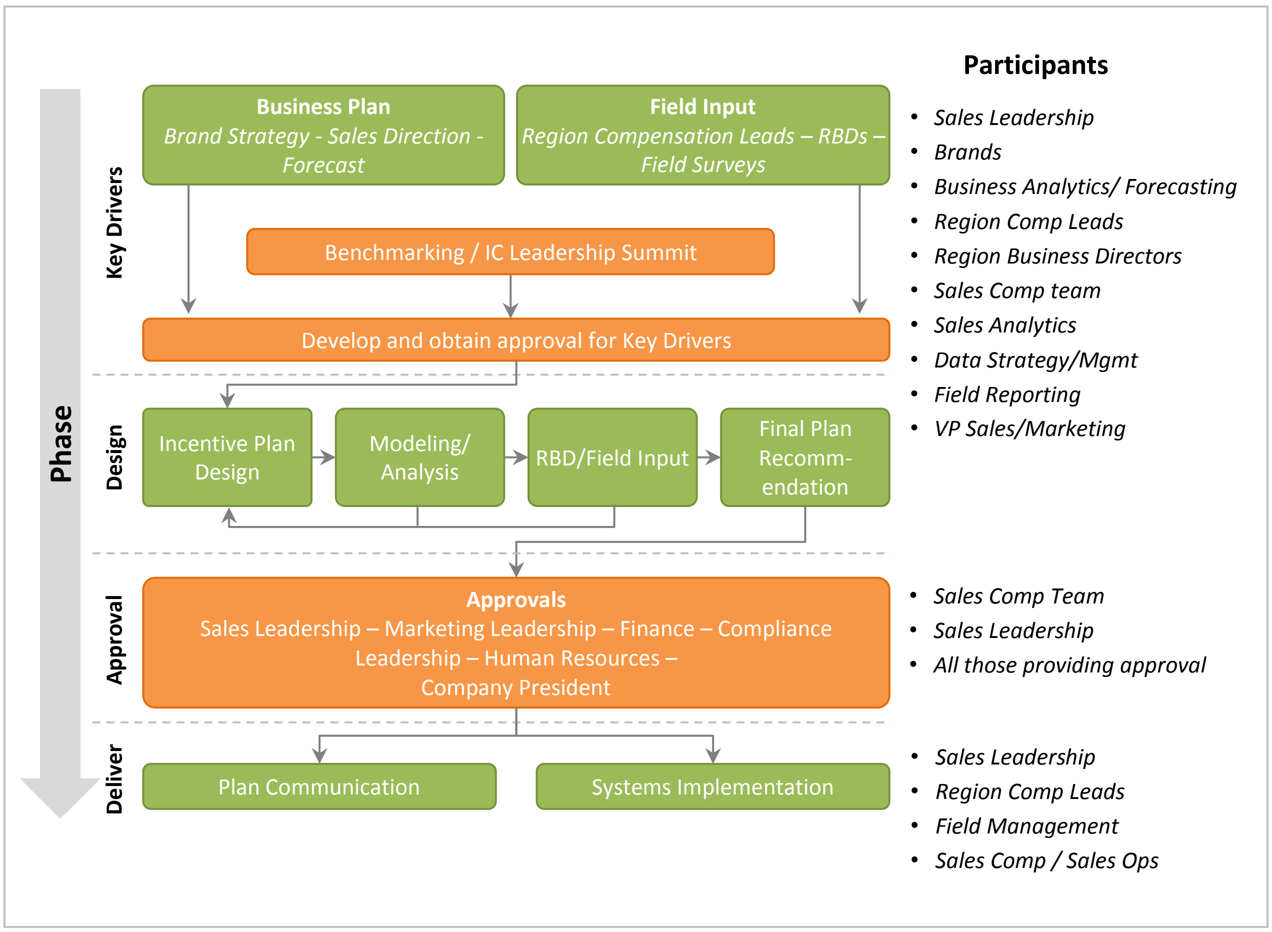
Hence careful time needs to be spent on designing a plan, and enough time also would need to be planned for presenting the plan to the organization for buy-in and alignment.

There are key guiding principles that need to be kept in mind when designing or evaluating compensation plans. This paper outlines these key guiding principles. This also includes an outline of a robust design process.

High Impact Design Process

Designing a high impact incentive plan requires alignment across the organization, since it drives and promotes behaviors in the field. Compensation design owners need to ensure that they involve representation from Sales Leadership, Brand or Product teams, Finance, Business Directors, Business Analytics, Sales Analytics, Field Reporting and Data Management. It is recommended that a core design team be identified with representation from each one of these departments. This core design team will identify areas of improvement, and conduct workshops as part of a structured process. Other stakeholders would participate in joint or individual workshops to provide input and feedback.

The design process stands a better chance of success if key drivers are identified early on. These drivers include components of the business plan like brand strategy, corporate objectives, sales objectives, direction, and forecasts. The IC design would strive to gain alignment with these key drivers.



Field input or Voice of Customer (VOC) is often included as a key input for identifying areas of improvements. Depending on time and budget one can use focus groups or surveys to gain field input. Field input will be augmented by a plan health diagnostics to identify important plan effectiveness metrics like engagement rate (number of reps attaining at least target) and pay for performance spreads etc. on the current plan.

Furthermore, every three years it would be appropriate to conduct benchmarking studies on how competition is rewarding its field, and how current plan compares on key dimensions like target incentive, pay for excellence, thresholds, etc.

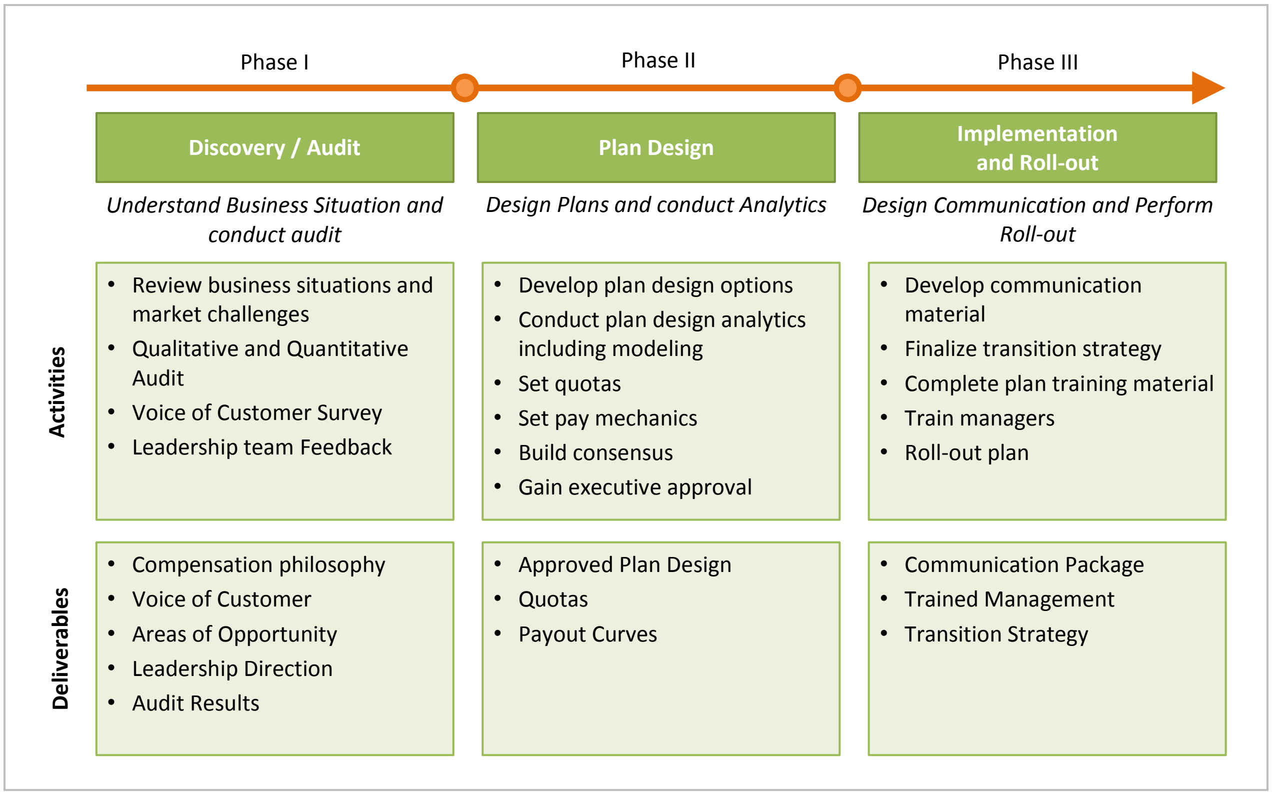
Finally, it is critical to gain approval from all crucial stakeholders on identified key drivers for IC design. This approval is typically gained in a workshop setting where compensation philosophy is also reviewed.

Once key drivers have been identified and approved, plan designers can start designing a plan that meets these drivers.

Plan designers have many options in their tool kit to meet plan drivers. This often leads to creation of multiple scenarios that get pressure tested for fairness and equity. Typically the challenger (top three) scenarios are presented to a focus group (region directors) to result in a final plan recommendation. This discussion has a balance of qualitative rationale, analytics, and the degree of change management included in making these decisions.

Once approvals are in place on the final plan, communication is rolled-out, and sometimes communication strategy becomes extremely important for ensuring plan effectiveness. Communication strategy needs to be discussed as a topic in itself, and a well thought out strategy would drive smooth transition into the new plan.

Finally the plan administration processes and systems need to be updated for accurate, reliable fulfillment of IC reporting.



The figure above represents a phased view of the design process, and outlines key activities that need to be included in the sales compensation team's work plan. Aspects of these activities and deliverables need a more complete discussion that are out of scope for this paper, but it serves the reader well to outline these here since they make an integral part of any successful roll-out.

Guiding Principles for Effective IC Plans

As discussed above, IC plans need to go through a structured process to ensure compliance and alignment in the organization. When designing an incentive plan, it is important to frame the design in a manner that complies with a few key guiding principles. If the principles are applied, the plan will be robust, equitable, and motivating.

These principles are outlined in the chart below, and they represent the foundation of a successful IC program. This paper will go into detail for each guiding principle.

My IC Plan Should…

Drive Accountability
- Rewards and drives accountability for financial outcomes

Align with Job Design
- Rewards and motivates workforce on aspects of job duties

Align with Brand Strategy
- Motivates field force to fulfill brand specific growth and volume objectives

Be Fiscally Responsible
- Plan should guard against unexpected/ unintended consequences
- Provides flexibility and control in managing incentive budget

Be Flexible
- Should be able to flex with evolving selling and services roles
- Ability to add/drop brand from team or individual geo portfolio

Be Simple
- Easy to communicate to the field
- Reasonable number of metrics

Additional Considerations
- Disruption/Change Management
- Administrative Burden

Guiding Principle	Challenge
Aligned with Strategic Objectives	Ignored often in design process with micro focus on “To Do”
Simple	Increased complexity
Pay for performance	Accountability and measure of influence challenged with team selling and multiple selling roles
Equity	High regional variances, geo-tailored selling models
Motivation	Reduced motivation by over-engineered
Fiscally responsible	Challenges in forecasting, quotas, design parameters

Align with Strategic Objectives

One of the most important principles is to align with the strategic objectives identified as part of the key drivers. This ensures that the plan reacts to the brand, sales and corporate strategy demands. For example, a focus on growth is best addressed by volume metrics, but a focus on combating the competition to defend market position would be best met by inclusion of market share metrics. A well designed plan will have a clear link between a performance metric and strategic objective, and this link will drive the sales force to adapt its behavior to meet company goals.

Simple

The simplicity guiding principle is the most often missed. IC plans tend to get complicated over time, due to trying to meet the demands of each brand constituent. Plans tend to become less effective the moment there are more than three metrics. Also, metrics that have less than 20% weighting will get dismissed by the sales rep. Further payout mechanisms (i.e. method to convert performance into earnings e.g. payout curves) need be simple so that the sales rep can have clear line of sight on how improvement in performance results in additional dollars. Frequently, companies over-engineer IC plans, with complicated payout mechanics and a high number of metrics. These plans certainly cannot serve to enhance performance of the average rep. The sales team should focusing on selling, and not on spending cycles trying to understand their IC plan or crunching numbers to see if the incentive department computed it correctly. Sometimes complexity gets introduced in business rules like sales crediting, and they are equally disruptive to effectiveness of the plan. The more complex a plan becomes, the less motivating it is to the sales team. This will distract them and take away from their core job - selling!

Pay for Performance

Pay for performance is a core guiding principle, and perhaps impacts motivation of top performers the most than other principles discussed. Plans need to be focused on rewarding performance that can be established quantitatively. Qualitative metrics tend to introduce discord in the team. To keep the sales team motivated, it is important to pay the high performing reps proportionately more money than low performing reps. Companies look to retain the best talent, so it is important to compensate accordingly. Also, having a lucrative bonus for high achievers is a motivator for the average or low performing reps to strive towards.

Another aspect of pay for performance is rewarding reps for sales that they can influence or impact – accountability. Rewarding reps for accounts they own, or for their target prescribers, scores higher on accountability. It recognizes performance more than giving reps credit for all sales in the territory. This has to be balanced with opportunity to be given credit for new accounts or relationships sales reps build over time. Accountability also comes into the picture when the IC plan designer needs to decide between team or individual goals. Team goals tend to have risks of slack performance vs. star performance, where a star performer can raise team performance and low performers tend to get unfair rewards. This has an impact on motivation as well.

Equity

One of the most important factors to a motivating incentive plan is to have it be equitable. As far as possible there should be equal opportunity to earn rewards regardless of your territory composition. This guiding principle at times would come in conflict with the simplicity guiding principle. In quest of fairness, plan designers tend to have more complex metrics and methodology, especially given markedly different territory dynamics across the nation. Volume, market share and potential would differ significantly, and this tends to get amplified with access, distribution and managed care issues. Sophisticated analytics are needed to drive fairness in these situations, and these analytics are not easy to communicate effectively to the field. Goal setting is often a means to attain fairness within the field force. It can minimize issues as long as the methodology behind the goals takes into account local trends and dynamics across the country.

Fiscally Responsible

A well-designed plan needs to be fiscally responsible and should protect the compensation budget against runaways, unintended consequences and forecast inaccuracies. The design should have flexibility to control and manage the incentive budget. Plan designs need to be pressure tested with variances in standard deviations, and movement in average attainments, to see impact on the payout budget. Conservative, aggressive and baseline scenarios need to be studied, before making a final plan recommendation. Further payout mechanics needs to have fiscal-risk mitigation features to protect excessive payouts when forecast inaccuracy occurs, or goal setting turns out to be very conservative. In cases where protection is not provided you will have to answer questions like: “What is wrong with the quota methodology that is making you pay the field more than budget?” or “Why did you not pay based on a bell curve?” Being fiscally responsible implies to pay the sales team within the budget and based on a bell curve attainment distribution. It is also important not to pay only 50% of the budget, but rather 95% to 110% if corporate objectives are met. It keeps the sales team motivated and compensation budget is fiscally protected within normally accepted variance.

Motivating

Another key driver to a successful incentive plan is that it is motivating to the sales team. Motivation tends to depend on many factors, including having the IC plan aligned by all the above guiding principles. Other factors also include: reasonable goals, timely reporting, and error-free results. If a sales person reviews the plan documentation and thinks it is either unachievable or not applicable, the motivation will plummet, and engagement rates will drop. This will lead to poor sales calls, market share loss, and poor adherence to other metrics. However, if the sales team feels they have an incentive plan that is achievable and are motivated, they will look to go the extra mile.

Other Considerations

There are other elements that require mention, while not being guiding principles.

While designing IC plans, designers should also pay attention to design a plan that does not present a high cost administrative burden. For example, ranking plans require less administrative cost than quotas, but this differential tends to disappear the moment one tries to make ranking more fair with use of rank pools (or cluster of territories based on similar local dynamics). A plan that includes MBOs introduces burden for managers, and a plan that includes customer satisfaction metrics would require significant spend on surveys.

Disruption or change management should also be considered, and sometimes if the degree of change is large then it forces firms to contemplate pilots before they can transition into a full scale roll-out.

Building an IC plan that brings all the guiding principles together requires orchestrated and diligent efforts. Keeping these guiding principles in mind when designing an incentive plan will provide a solid foundation, increased buy-in, motivate the sales team, and align your plan with corporate stakeholders' goals.

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