THE SALES MANAGEMENT ASSOCIATION

Sales Management Association Webcast

Using What-if Analysis to Manage the Risk of Comp Plan Changes

18 September 2013

Presented by

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About The Sales Management Association

A global, cross-industry professional association for sales operations and sales management.

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Today's Panelists

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TODAY'S TOPICS

Overview

- What is what-if analysis and why should you do it?
- Specific questions you might want to answer
- Pitfalls to avoid

Case Example

- Situation
- Scenario 1
- Scenario 2

Conclusions

Q&A

WHAT IS *WHAT IF* ANALYSIS?

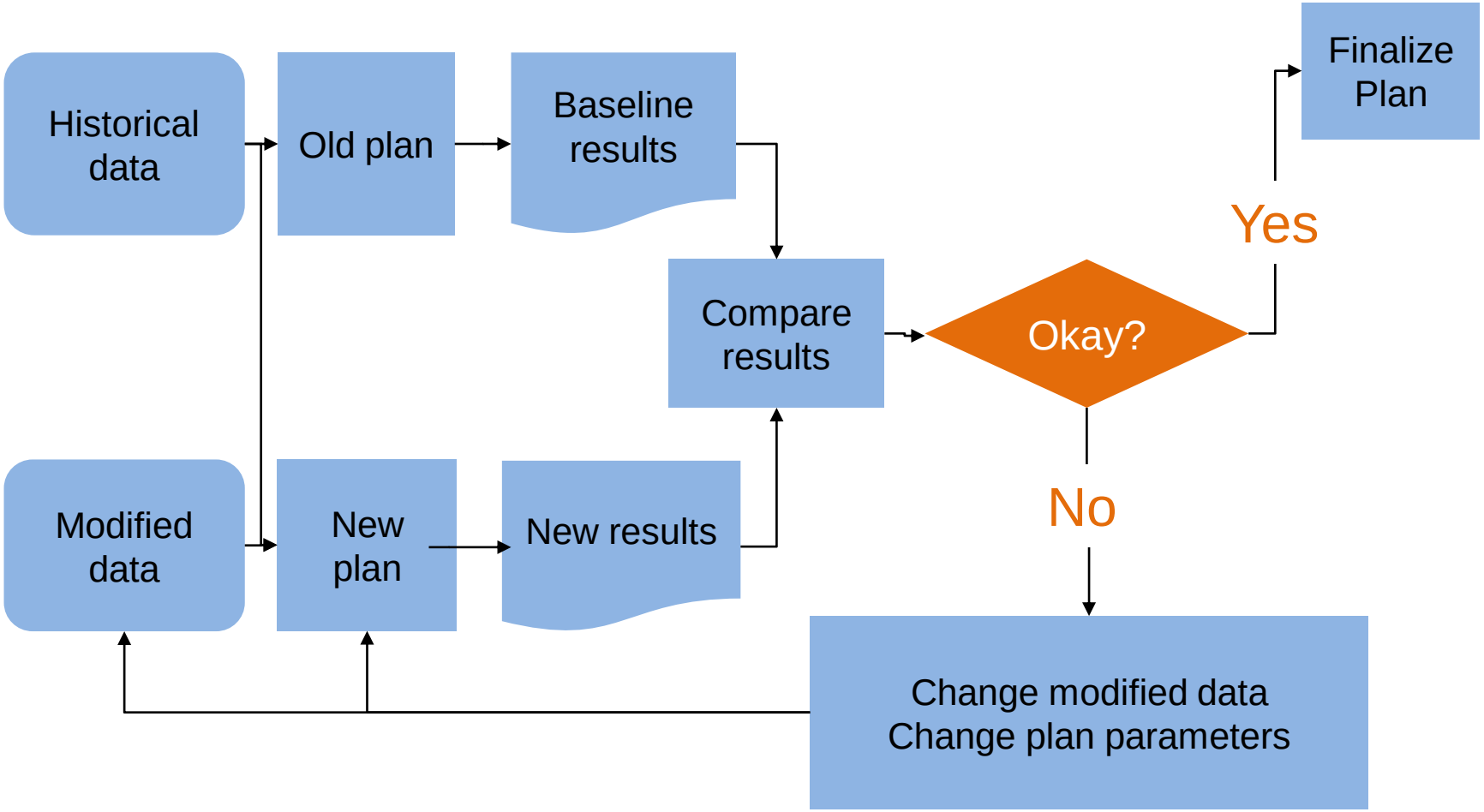
‘What If’ analysis allows you to forecast the impact on plan payouts resulting from changes to:

- Plan Design
- Individual Performance
- Territory Definitions
- Quotas
- Sales Force

Why bother?

- Avoid unintended consequences
- Budget more strategically
- Improve effectiveness

HOW IT WORKS


Historical data
Old plan
Baseline results
Finalize Plan
Yes
Compare results
Okay?
Modified data
New plan
New results
No
Change modified data
Change plan parameters

Change the Inputs – Examine the Outputs

If we change these inputs…

- Pay mix
- Performance measures
- Crediting rules
- Timing of credit
- Territory definitions
- Quotas
- Payout curve
- Caps or decelerator

What happens with these outputs?

- Overall payout -- increase or decrease?
- Compensation costs -- increase or decrease?
- Will participation and payout dispersion be optimal?
- Windfalls?
- Is pay correlated with the right measures of performance?
- Will the right individuals benefit?

IMPLICATIONS OF *WHAT IF* ANALYSIS

Consider the impact on overall payout

- Is it ***greater*** or ***less*** than expected?
- Is ***more*** or ***less*** dispersed than expected?

Consider strategic changes

- Modify the plan?
- Need to make exceptions?
- Need to alter the budget?

FOUR COMMON PITFALLS WITH WHAT-IF ANALISYS

	PITFALL	DETAILS	SOLUTIONS
1.	Not appreciating that the historical data may not be valid	▪ Because of temporary situations, future performance may differ dramatically from past performance	▪ You may want to run a scenario with modified historical performance that is more likely to reflect future performance
2.	Unrealistic dummy data	▪ If a performance measure is new or modified, you may need to create dummy data ▪ Just creating a normal distribution around 100% is seldom the best informed choice	▪ Carefully consider how performance may play out and design data around that ▪ If performance cannot be predicted, you may need different mechanics for the measure
3.	Not running enough scenarios	▪ Only assessing results on historical performance will not protect you from unintended consequences	▪ Run “optimistic” and “pessimistic” scenarios and consider what might happen if these occur
4.	Incorrectly assessing why the results have changed	▪ It is easy to jump to the wrong conclusion about why payouts have changed ▪ If you adjust the plan based on a faulty conclusion you may make matters worse	▪ Don’t just look at overall payouts. You need to examine payouts by individual and payouts by measure

Case Example

The role:

- Account Executive role
- Sells new contracts and is also responsible for the retention of existing contracts (hunter/farmer role)
- 22 AEs on the team

We will use *What If* Analysis to examine prospective changes to the sales incentive plan

Annual target incentive = **$50,000**

Measure 1: *Member retention*

(70% weight = $35,000 annual target incentive for the measure)

- Incentive form: Quota-bonus with continuous (not stepped) payout curve
- Parameters: 50% of target incentive is paid at threshold of 70% retention, 100% of target paid at 85% retention, and 150% of target paid at 95% retention, capped

Measure 2: *New members*

(30% weight = $15,000 annual target incentive for the measure)

- Incentive form: Flat commission
- Parameters: $10 per new member (implied quota = 1500 new members)

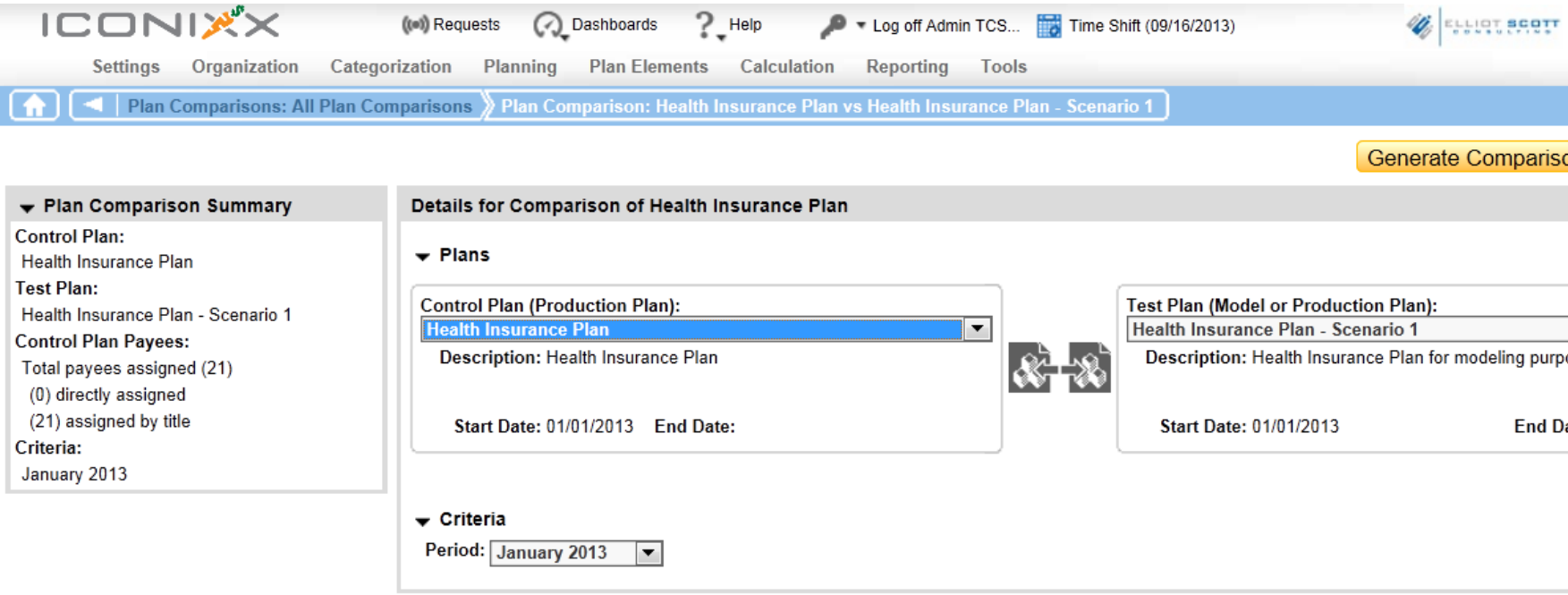
Rationale for plan change:

- Drive new sales
- Increase payout differentiation on the retention measure
  - I.e., pay more to high performers and pay less to low performers
- Keep overall cost unchanged

Plan change details under consideration ("scenario 1"):

- Increase commission rate from $10 per member to $15 per member (implied target incentive at same quota of 1500 members = $22,500)
- Decrease target incentive on retention measure from $35,000 to $27,500 (keeping total target incentive for the whole plan unchanged)
- Make the retention payout curve steeper:
  - Move threshold retention up to 75% (from 70%)
  - Pay 200% of target incentive at 95% retention (instead of 150%)

SCENARIO 1 — RUNNING A PLAN COMPARISION IN ICONIXX



SCENARIO 1 — RUNNING A PLAN COMPARISION IN ICONIXX

Details for Comparison Results of Health Insurance Plan

Control Plan (Production Plan):
Health Insurance Plan

Test Plan (Model or Production Plan):
Health Insurance Plan - Scenario 1

Cost Comparison

Category	Control Plan	Change	Test Plan
Cost per $1000.00	$568.50	$22.72 ▲	$591.22
Cost per Payee	$49,543.49	$1,980.08 ▲	$51,523.57

Payout Comparison

Category	Control Plan	Change	Test Plan
Average Payout	$47,291.51	$1,890.08 ▲	$49,181.59
High Payout	$69,000.00	$10,750.00 ▲	$79,750.00

SCENARIO 1 — RUNNING A PLAN COMPARISION IN ICONIXX

Payee Comparison

Payee Name	Control Plan	Change	Test Plan
Alexandra D Hayashi	$44,860.00	$805.00	$45,665.00
Benito A Buchholz	$45,523.33	($1,863.33)	$43,660.00
Darwin K Burkett	$7,830.00	$3,915.00	$11,745.00
Denis M Summer	$69,000.00	$10,750.00	$79,750.00
Elinore J Greenhaw	$58,920.00	$5,210.00	$64,130.00
Freida P Dudley	$36,676.67	($9,661.67)	$27,015.00
Janna P Mulloy	$59,240.00	$5,870.00	$65,110.00
Kenneth A Rhodes	$0.00	$0.00	$0.00
Kevin R Pohl	$42,803.33	($3,223.33)	$39,580.00
Loretta N Belmont	$51,870.00	$1,185.00	$53,055.00
Lorrie O Ping	$68,750.00	$10,000.00	$78,750.00
Manuel Q Merrit	$42,580.00	($1,460.00)	$41,120.00
Myrna I Dicken	$66,590.00	$9,545.00	$76,135.00
Portia F Domenico	$49,000.00	$125.00	$49,125.00
Renea S Rowland	$61,660.00	$7,080.00	$68,740.00
Samuel G Angle	$41,800.00	($4,100.00)	$37,700.00
Shelby G Rumery	$47,456.67	$603.33	$48,060.00
Shelley H Ranieri	$44,796.67	($726.67)	$44,070.00
Sherril E Brassell	$60,180.00	$5,465.00	$65,645.00
Spencer C Bradeen	$55,790.00	$3,145.00	$58,935.00
Vance L Chevalier	$40,713.33	($2,018.33)	$38,695.00
Willy B Matula	$44,373.33	$936.67	$45,310.00

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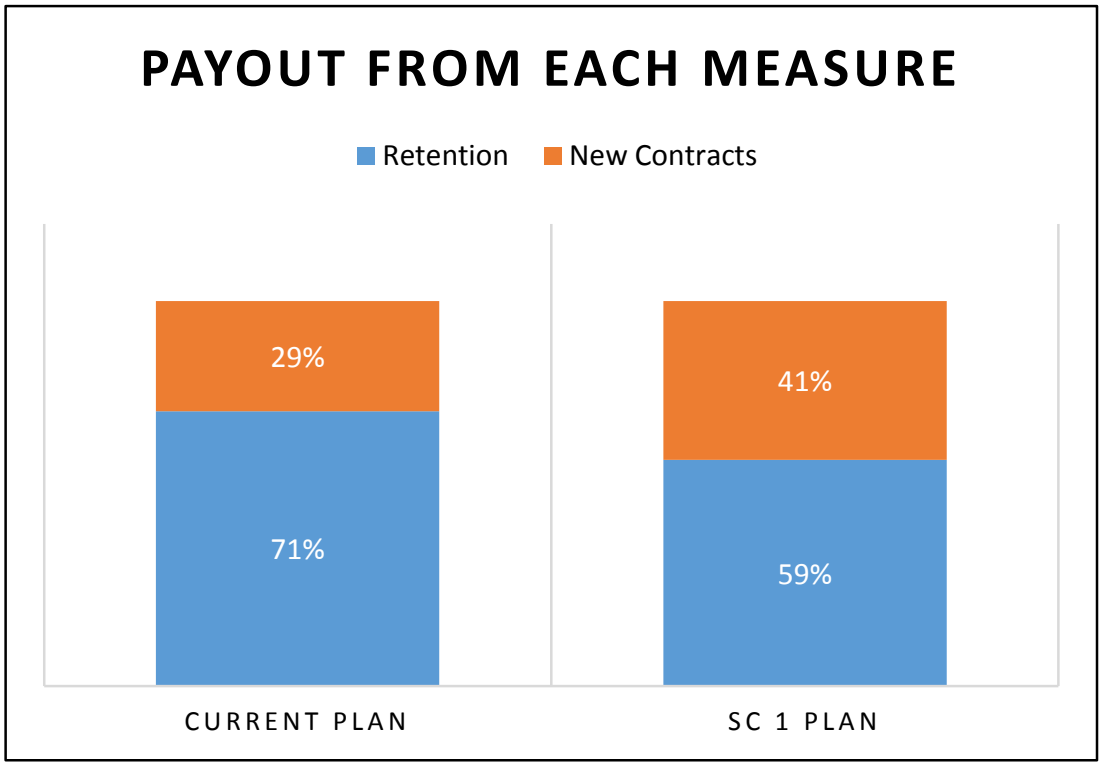
Does the plan drive new sales?

- There's certainly more money to be made on it…



Does the plan drive new sales (cont.)?

- Is total incentive more highly correlated to new contracts than before?

Correlation of measures to total payout

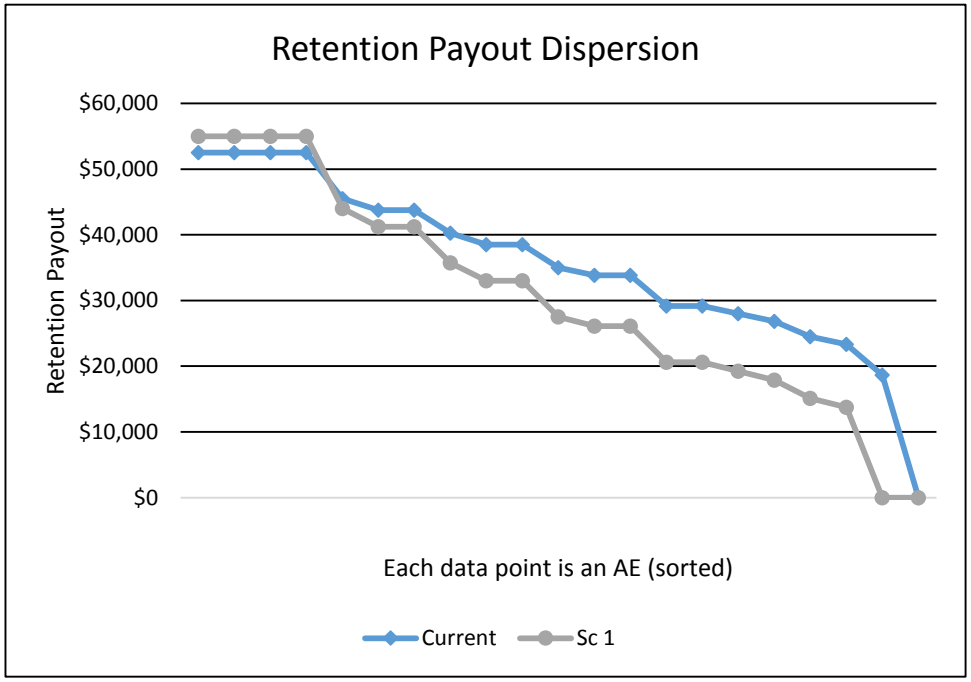
	Current Plan	Sc 1 Plan
Retention	85%	88%
New Contracts	29%	28%

- Interestingly, total payout is slightly less correlated with new contract sales under the new plan vs. the current plan

SCENARIO 1 —WHAT WERE THE EFFECTS OF THE CHANGES?

Does the new plan differentiate more on the basis of retention?

- Yes it does…



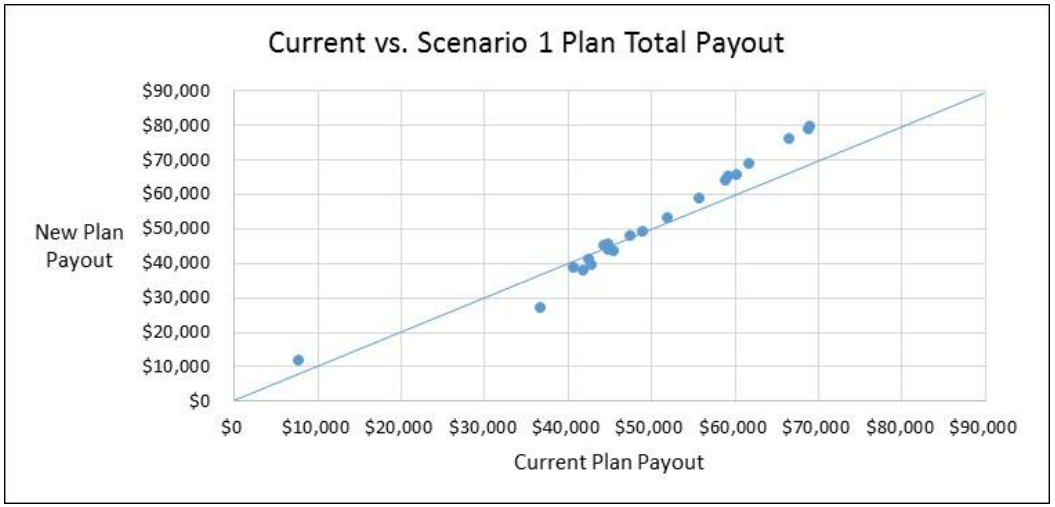
Retention Payout by Percentile

Percentile	Current Plan	Sc 1 Plan
90th	$52,500	$55,000
Median	$35,000	$27,500
10th	$23,333	$13,750

SCENARIO 1 —WHAT WERE THE EFFECTS OF THE CHANGES?

Does the new plan differentiate total payout more?

- Yes it does…



- But dispersion remains low:

Payout by Percentile

Percentile	Current Plan		Scenario 1 Plan	
	Payout	% of Median	Payout	% of Median
90th	$66,590	140%	$76,135	158%
Median	$47,457	100%	$48,060	100%
10th	$40,713	86%	$37,700	78%

Is total cost about the same?

- Yes

Total IC Payout

	Current Plan	Sc 1 Plan
Cost	$1,040,413	$1,081,995
Cost/current	100%	104%

Are we okay with who the winners and losers are?

- Top 5 gainers

Name	Difference
Denis Summer	$10,750
Lorrie Ping	$10,000
Myrna Dicken	$9,545
Renea Rowland	$7,080
Janna Mulloy	$5,870

- Biggest losers

Name	Difference
Benito Buchholz	($1,863)
Vance Chevalier	($2,018)
Kevin Pohl	($3,223)
Samuel Angle	($4,100)
Freida Dudley	($9,662)

Summary of learnings from *What-If analysis* on proposed plan changes

- The new plan does offer more incentive for new sales than the current plan
- The new plan does differentiate more on the basis of retention performance
- The new plan does differentiate total payout more

- …But it could do more in all of those things
  - I.e., the plan is still too risk averse

- *So the company decides to consider further changes...*

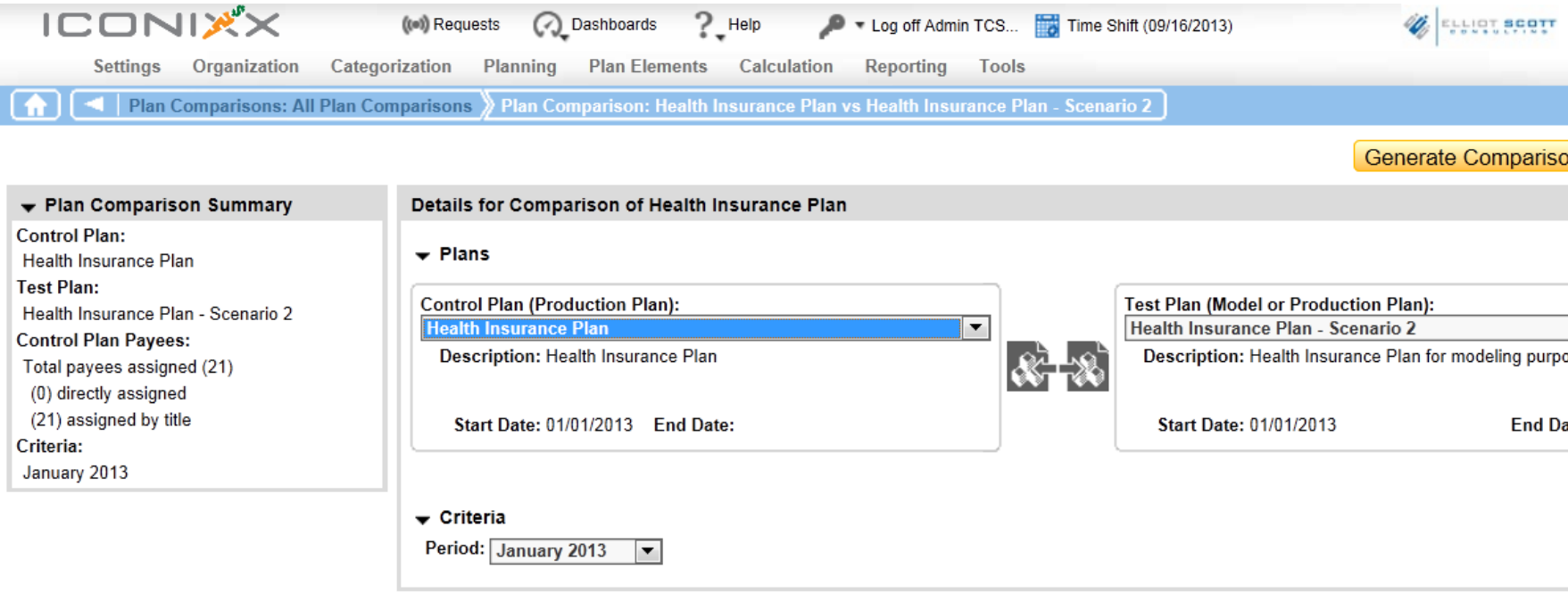
To increase the riskiness and motivational impact of the plan, the company decides to consider the following further changes:

- Instead of paying 50% of target incentive at the new retention threshold of 75%, pay only 25%
  - More downside risk for low retention performance

- Instead of paying 200% of target incentive at 95% retention (excellence performance), pay 225%, and in addition remove the cap so there is incremental reward for improved retention all the way up to the maximum possible retention of 100%
  - More upside potential on the retention measure

- Add a second commission rate of $20 per contract that applies to all contracts over the annual quota of 1500 contracts
  - More upside
  - Greater reward for exceeding new contract quota

SCENARIO 2 — RUNNING A PLAN COMPARISION IN ICONIXX



SCENARIO 2 — RUNNING A PLAN COMPARISION IN ICONIXX

Details for Comparison Results of Health Insurance Plan

Control Plan (Production Plan):
Health Insurance Plan

Test Plan (Model or Production Plan):
Health Insurance Plan - Scenario 2

Cost Comparison

Category	Control Plan	Change	Test Plan
Cost per $1000.00	$568.50	$68.16 ▲	$636.66
Cost per Payee	$49,543.49	$5,939.61 ▲	$55,483.10

Payout Comparison

Category	Control Plan	Change	Test Plan
Average Payout	$47,291.51	$5,669.63 ▲	$52,961.14
High Payout	$69,000.00	$35,562.50 ▲	$104,562.50

SCENARIO 2 — RUNNING A PLAN COMPARISION IN ICONIXX

Payee Comparison

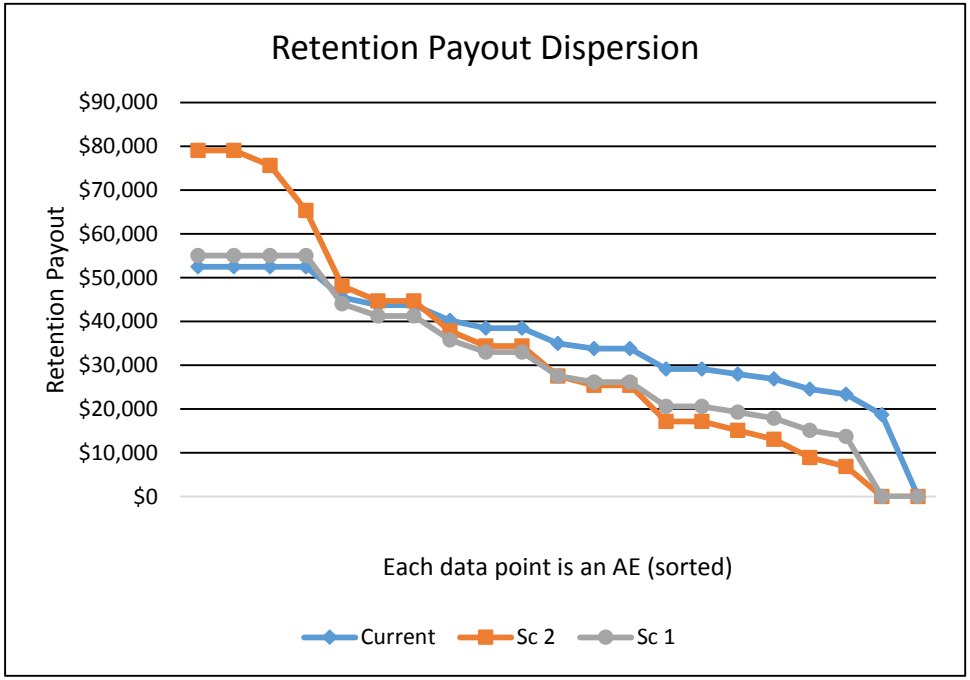
Payee Name	Control Plan	Change	Test Plan
Alexandra D Hayashi	$44,860.00	($2,702.50)	$42,157.50
Benito A Buchholz	$45,523.33	($2,550.83)	$42,972.50
Darwin K Burkett	$7,830.00	$3,915.00	$11,745.00
Denis M Summer	$69,000.00	$35,562.50	$104,562.50
Elinore J Greenhaw	$58,920.00	$9,335.00	$68,255.00
Freida P Dudley	$36,676.67	($8,156.67)	$28,520.00
Janna P Mulloy	$59,240.00	$16,182.50	$75,422.50
Kenneth A Rhodes	$0.00	$0.00	$0.00
Kevin R Pohl	$42,803.33	($3,910.83)	$38,892.50
Loretta N Belmont	$51,870.00	$2,560.00	$54,430.00
Lorrie O Ping	$68,750.00	$18,437.50	$87,187.50
Manuel Q Merrit	$42,580.00	($5,585.00)	$36,995.00
Myrna I Dicken	$66,590.00	$33,607.50	$100,197.50
Portia F Domenico	$49,000.00	$3,562.50	$52,562.50
Renea S Rowland	$61,660.00	$27,705.00	$89,365.00
Samuel G Angle	$41,800.00	($4,100.00)	$37,700.00
Shelby G Rumery	$47,456.67	($1,189.17)	$46,267.50
Shelley H Ranieri	$44,796.67	($3,849.17)	$40,947.50
Sherril E Brassell	$60,180.00	$9,992.50	$70,172.50
Spencer C Bradeen	$55,790.00	$5,665.00	$61,455.00
Vance L Chevalier	$40,713.33	($6,830.83)	$33,882.50
Willy B Matula	$44,373.33	($2,918.33)	$41,455.00

Export options: CSV | Excel | XML | PDF

SCENARIO 2—WHAT WERE THE EFFECTS OF THE CHANGES?

Does the new plan differentiate more on the basis of retention performance?

- Yes, both on the upside and the downside



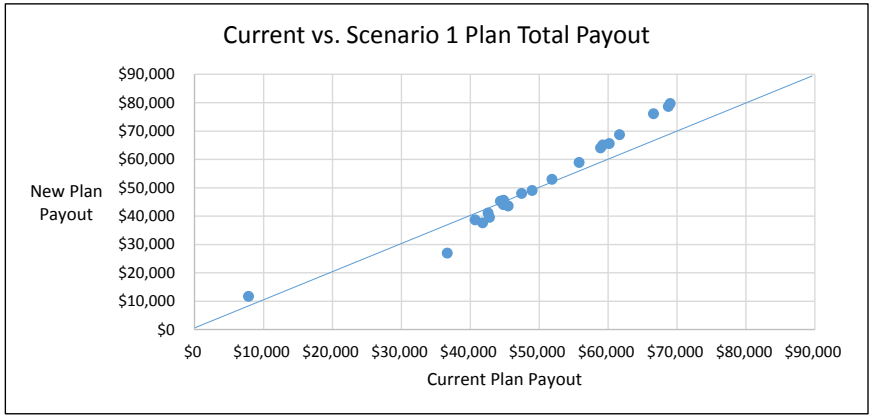
Retention Payout by Percentile

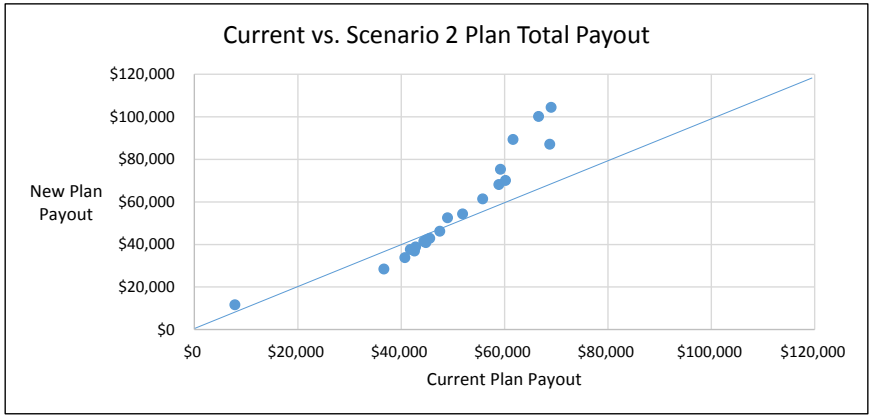
Percentile	Current Plan	Sc 1 Plan	Sc2 Plan
90th	$52,500	$55,000	$75,625
Median	$35,000	$27,500	$27,500
10th	$23,333	$13,750	$6,875

SCENARIO 2—WHAT WERE THE EFFECTS OF THE CHANGES?

Does the new plan differentiate more on the basis of total payout?

- Yes. There is much more differentiation, particularly on the upside





Payout by Percentile

Percentile	Current Plan		Scenario 1 Plan		Scenario 2 Plan	
	Payout	% of Median	Payout	% of Median	Payout	% of Median
90th	$66,590	140%	$76,135	158%	$89,365	193%
Median	$47,457	100%	$48,060	100%	$46,268	100%
10th	$40,713	86%	$37,700	78%	$33,883	73%

SCENARIO 2—WHAT WERE THE EFFECTS OF THE CHANGES?

Is the cost still about the same?

- No. The second scenario is 12% costlier (at last year's performance levels)

Total IC Payout

	Current Plan	Sc 1 Plan	Sc 2 Plan
Cost	$1,040,413	$1,081,995	$1,165,145
Cost/current	100%	104%	112%

- It turns out the increased upside on the retention measure is responsible for most of the cost increase
  - The increased above-target commission rate on new contracts does increase the cost but not as much

SCENARIO 2—WHAT WERE THE EFFECTS OF THE CHANGES?

And how will the cost change under different performance scenarios?

- If overall retention is 3% higher than last year, and new sales are 20% higher…

Total IC Payout

	Current Plan	Sc 1 Plan	Sc 2 Plan
Cost	$1,190,396	$1,267,594	$1,416,741
Cost/current	100%	106%	119%
Cost/100%	114%	117%	122%

- And if overall retention is 3% lower than last year and new sales are 20% lower…

Total IC Payout

	Current Plan	Sc 1 Plan	Sc 2 Plan
Cost	$896,847	$882,646	$902,303
Cost/current	100%	98%	101%
Cost/100%	86%	82%	77%

- Conclusion: The second scenario is costlier than the current plan in each scenario, but the cost is more sensitive to overall performance

CONCLUSIONS

- SPM tools can test multiple *What-If* scenarios
  - Avoids various unforeseen effects
- Look beyond overall cost change
- Make sure the historical or test data you are using is valid
- Take the time to think through all scenarios

Questions and Discussion

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Our presenters answer questions from the webinar audience.

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Comparing old and new plans

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Please clarify how you compare costs between old and new compensation plans.

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Modeling projected costs iteratively

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Is it possible to see cost impacts in real time when inputting projected performance changes?

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Collaborating on cost impact decisions

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Who within the firm should be involved in decisions that impact compensation costs?

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Is modeling different for sales managers?

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Are costing and modeling issues different for sales management positions?

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Limitations of modeling

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What limitations exist in modeling plan changes that are important for management to be aware of?

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