

White
Paper

How scenario modeling can improve compensation effectiveness

**Watson
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Reducing errors and gaining efficiencies in sales compensation processes are “table stakes” when it comes to choosing a sales performance management (SPM) system. Companies are increasingly revisiting how their sales people are incented to perform. As a result, it is quickly becoming a business imperative that organizations truly understand the potential costs, risks and implications of various plan design alternatives that are being contemplated.

Drivers and challenges

Compensation plan design changes are often addressed as part of the annual planning process, or even mid-year if there are course corrections required. Drivers of change could include new products, corporate mergers or even a realization that the existing compensation design is not driving the expected behavior.

With legacy incentive compensation systems, often Excel-based, it has been difficult for sales compensation staff to get a handle on the full implications of various changes that are being considered. There are just too many variables, plus legacy tools do not deal well with large volumes of multi-period data, often residing in disparate systems. As a result, robust “what-if” analysis has often just been ignored.

Performing scenario modeling within a sales performance management system means that compensation teams can perform their analysis in the context of past sales data and historical compensation levels. Plus, SPM systems can leverage reporting and analytics which have been designed specifically for this task.

What are compensation teams hoping to find out?

Often, sales leaders task their compensation analysts with a mandate to see what happens if they tweak the commission rates, calculation logic, reporting hierarchies, territory assignments or sales levels within a compensation plan.

Most often, the two big outputs that are looked at are total cost of compensation and what’s referred to as displacement analysis. Displacement analysis aims to identify the winners and losers on the sales team under the respective scenarios; in other words, the people that are most impacted by the changes. With sales staff retention as one of the key focus areas, sales leaders are wary of changing plan designs if it is going to have a negative impact on their top producers. Better to do this analysis first.

Scenario modeling in IBM

With IBM, an existing compensation plan is used as the base case for a scenario. When a new scenario is created, a copy of the various calculations, tables, imports and reports is placed inside a “scenario component”. The compensation analyst can then:

- Drill into the component that contains the item(s) being considered for change.
- Alter the desired data and logic.
- Calculate the scenario.
- Compare scenario results to each other (and the base case) in a report.

Once the compensation analyst has created the scenarios, they review the findings with their management and decide if further tweaks are warranted. Once there is acceptance, the analyst can easily promote the scenario to active status within the compensation model.

An example

It is September and the sales leadership team is starting to make plans for the following year's compensation plan rollout. Some new products are coming from marketing, and there is a feeling that the current year's quota levels were too easy. In addition, reporting hierarchies need changing and the sales VP is considering shifting the mix from base salary to variable commissions. What will be the impact on the total compensation spend? Which sales reps and sales managers will be most impacted? Which approach is most equitable?

Obviously, the sales compensation team needs some technology to make an informed decision and have confidence in the plan that gets rolled out. The compensation analyst takes the year-to-date results and projects out to the end of the year. This is the base case. He then creates a "scenario component." Within the scenario component, payee hierarchies are shifted and commission tables and calculations altered. The resulting side-by-side comparison reports are reviewed with sales management and the process is repeated until there is satisfaction that the outcome is optimal.

Sales performance management

A true sales performance management solution goes beyond commission calculations by giving the tools and information to improve the effectiveness of their sales compensation programs.

Beyond scenario modeling, SPM solutions address the problem that legacy incentive compensation systems are slow, rigid and error prone. IBM SPM solutions automate and accelerate the core SPM processes — incentive compensation, territory management, quota planning and roster management. With IBM, organizations dramatically reduce sales administration costs, but also improve the overall sales compensation effectiveness with tools such as scenario modeling.

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