

Enterprise Incentive Management – A Primer

Overview:

Implementing an Enterprise Incentive Management (EIM) system successfully requires surmounting various unique problems that are typical of this business area. This document attempts to address the process of implementing and the challenges that should be addressed as part of the process. The audience for this document is the project team and the project manager entrusted with the successful execution of the EIM software implementation.

State of EIM

Sales Commission plans are complex in nature and require sophisticated systems to faithfully provide the results of these plans. Automating Sales Commission business processes is a challenging issue for most companies. Robust, flexible, easy-to-use software has been a long time coming to this field. The difficulty in this business area and the in implementing software is due to many reasons.

Uniqueness of Companies

Sales Compensation plans tend to be unique by industry. The Banking Industry's compensations plans are based on business features such as Financial Accounts, Deposits and Loans, whereas the Retail Industry plans are based on Stores and Product Sales. Every industry tends to have its own set of requirements for this business process. But there are no rules or regulations governing how these plans should work even within an industry. This results in each company literally creating their own compensation plan that in many cases are very dissimilar to other companies in their industry. This requires a very broad based system to cover all the different kinds of compensation plans that may be built.

Complexity

In addition to the variation between different companies, there maybe a lot of variation within a company as well. EIM covers a lot of different compensation plans, typically segregated into Sales Compensation, Executive Compensation, Variable Pay Plans, Channel Incentive Compensation, etc. These types of compensation affect different participants, pays for different kinds of performance, using different methods of payments. Even within a particular area such as Sales, compensation plans maybe very different from employee to employee, incenting for different performances in many

different ways. There are also different sub processes within the administration process of Sales Commission plans, such as Territory management, Goal Setting, Allocation and crediting, Calculation and Payout determination. Given all these varying needs the product to solve them will necessarily need to be very complex.

Change

Most Sales Commission plans are designed to address only a single fiscal year. Almost every year, there is an initiative to readdress the Sales Commission plans for the next fiscal year. This makes for a lot of change in the business process and in the systems every year. In addition, due to business conditions the business may revise various aspects of the Sales Commission plans such as Quotas, Incentives, etc; the organization itself maybe realigned and affect the incentive plans. This area typically has more than the usual impact of change every year.

Integration

Sales Commission software may calculate payouts based on many different kinds of performance such as Revenue, Gross Profit, Contracts signing, Project Mile Stones, Customer Satisfaction, Invoicing, Bill Payments, etc. The data for this performance may come from many different systems from Supply Chain, Order Management, AR, AP, etc. Participants may come from HR systems, CRM systems or from external firms, as in the case for channel salespeople. The output of the compensation data may be updated to Payroll, GL, Accounts Payable, etc. Data may need to be converted and evaluated for processing on a daily basis and may need to be retained for a number of years. The process of moving data in and out Sales Commission system and the setup and testing required to verify the quality, could be a significant undertaking.

Volume

Some EIM plans can be paying incentives by individual order lines, because of product-based commissions. Larger firms can have hundreds of thousands of order lines per day. These individual order lines may affect the payout of many participants. By the time all the credits for these order lines are provided and the compensation has been calculated, the volume of transactions handled by the system could have exploded to millions of transactions. Global firms may need to be able to process their plans separately by global regions. Software needs to be very robust to be able to handle these volumes in a reasonable time period.

State of Software

To address all the issues listed above requires a very robust, flexible and stable software system. The system has to be a rule-based system, such that any customer requirement can be easily be setup in the system without having to reengineer it. Most software is still not at a level where they fully meet these needs.

CellarStone is very aware of the kind of problems the typical company will face as they try to automate this business area. CellarStone is also familiar with the capabilities of various vendors in this area and can help you navigate through the implementation of the products.

Sales Commission Implementation Issues

Implementing a Sales Commission solution is a complex task for most organizations and there are many pitfalls to watch out for. Under the State of EIM, we discussed many of the characteristics of the Sales Commission function which contributes to many of these issues. We discuss some of those issues here.

Plan Documentation

The entire logic of compensation processing is typically captured in the 3 to 10 page document that is the compensation plan. These documents are constructed for participant readability and do not adequately capture all the special conditions required to properly pay Incentives. The actual requirements of an EIM system are typically buried in the brains of the compensation administrators and the code of the existing system. It will take some effort to appropriately analyze all three sources to create the functional requirements necessary for any new system.

Exception Processing

Given the nature of the plans and the difficulty of modifying existing systems, a tremendous off-system processing happens in this business area. Actions such as late orders, order adjustments, new hire and terminations, territory realignments trigger manual changes in everything from Quotas, commissions, credits, bonuses, etc. It would be important to interview the business partners in detail about all of these exceptions and construct appropriate requirements so that these actions can be automated.

Adjustments

Adjustments can be processed in the system directly from source data (order adjustments) or can be effected within the Sales Commission system (credit given to the wrong

participant). Adjustments may be used to affect credits, rollup credits, split credits, quota attainment, commissions, bonuses, prior period payments, draws and many components of the a Sales Commission system. Adjustments may need to understand and affect multiple transactions within the system (recredit all lines for an invoice) or all transactions for a participant. Adjustments are an important and complex area of EIM systems and it would be important to document these requirements clearly and check that vendor systems support those requirements.

Effective Dating

Processes within the Sales Commission system are strongly driven by the date in which data changes occur. For example, the start date of an employee can drive the transactions for which the employee is eligible for. Another example would be the specific date of a transaction credit: this could determine the commission rate the employee received for the transaction based on when it occurred during a plan year. Plans can change during the year and they old and new plan may need to be maintained in the system for recalculation purposes. Territories maybe reorganized and the old and new organizations may need to be maintained as well. The underlying architecture necessary to support all of these changes is called “effective dating”. Additional system logic will be required to take advantage of effective dating for proper calculations but the underlying effective date structure would be a key requirement. Vendor systems should be carefully reviewed for these requirements.

Territory Management

Some variations of a Sales Commission such as Channel compensation may require territory management functionality. The ability to add, move, consolidate, various territories would be a necessary functionality in that case. Territories are grouped to create organizational structures and undergo occasional reorganizations. Territory historical information will be necessary to process commission properly. In some compensation plans territories direct allocation of transactions to associated participants and the territories may need to contain built-in logic to properly direct the transactions. Sometimes territories may be ill-defined and not automatable (everything north of Hwy 92), but rules can be based on area codes, zip codes, products, types of customers, etc.

Goal Setting

Quota and Goal setting are key parts of certain a Sales Commission business processes. The facility to set goals, change them during the plan period, prorate goals as necessary are key features. Ability to set goals and push them down the organization or to rollup bottom-level goals will be required for the more sizable organizations. More difficult are requirements to have goal setting drive a workflow process. When goals are changed

during the year, there needs to be a process of approvals for the associated managers and the participants prior to activating the goals.

Allocation and Crediting

The determination of which transactions belong to which territories/participants is an important part of the compensation process. In some situations (e.g. 3rd party sales), this may not be automatable. Issues such as quality of data (customer name spelled correctly) become important factors in this process. The ability to flexibly set up allocation rules for transactions is a critical requirement for EIM systems. Rules to determine if other participants split the credits or how the credit is to be rolled up to higher levels of organizations are also required in the system. For organizations with large transaction volumes, with order level allocation and crediting requirements, getting this portion of the business process automated could be the lion's share of the work involved.

Participant Changes

When a participant is hired, terminated, changes jobs or any other change in the relationship with the company, the Sales Commission system needs to keep track of these changes to properly attribute transactions, calculate payments and determine actual payouts. Based on the change, different plans may need to automatically be assigned to the participant. There may be special kinds of changes such as "Leave of Absence" that may require specialized processing. Sales Commission systems need to have the ability to flexibly specify processes based on these changes.

Retroactive Changes

Most companies process Incentives on a fiscal period basis which is typically monthly within a plan duration of a year. Some compensation is based on attainment performance against goals and rises as attainment increases. Typically by the end of the year, the compensation rate is much higher than in the beginning of the year. If there was a reason to adjust the transactions from the earlier part of the year (large deal got canceled or there was understatement of a transaction's sales), then all the subsequent transactions may need to recalculate the compensation rates to be completely accurate. But periods have been processed and closed and compensation checks have been cut, so complete restatement will cause issues. Many companies ignore this and handle any such past changes by means of exception processing and manual adjustments. But for the companies where proper recalculation and payments are critical, the Sales Commission system needs to provide a robust and complex Retro change processing functionality. A controlled scenario demo should demonstrate this functionality from vendors.

Multiple year processing

For some companies to set calendars that cross multiple years and have transactions affect payments in multiple years, maybe important requirements. Data needs to be retained necessarily for such calculations. Such multi-year processing should be configurable for the individual customers' needs.

Global Processing

For global firms, multiple currency processing is a significant need. The logic used in handling currency processing needs to be matched against the customer's requirements. Ability to calculate payments for a transaction in one currency but make payouts in the participant's currency needs to be available. In addition, given the typical volumes and time zone changes, the system should allow processing of calculations by parts of the company organization.

Maintainability

Given the complex nature of the application, it is very common for applications to build in all the necessary logic into the application. But all of the logic in the application should be configurable in essence, since no plans seem to be alike. A solid rule-based architecture allows a tremendous amount of flexibility to the application. Almost no change to the system should require coding changes to the base system.

Ease of Use

When asking for flexibility and maintainability the cost paid is one of ease of use. As challenging as having high flexibility and high ease of use, together is, it is still important to look for ease of use since the business expects to go through constant change. Even if a rule-based system is used, a good front-end that hides the complexity will be necessary.

Volume and Processing

Larger companies may process millions of transactions through their Sales Commission system. These transactions need to be allocated, credited, split, rolled up and paid out against. The number of additional records could explode from a base set of transactions. Additionally processing may need to happen every day and in some cases, reprocessing of prior periods may be necessary. Ability to handle large volumes in a reasonable period of time with a reasonable hardware configuration would be important. Customers need to draw out their expectations in this area and verify vendor supplied benchmarks to make sure the processing will fit their needs.

Sales Commission Benefits

Most Sales Commission systems within organizations are either unwieldy excel based structures or legacy applications that are rigid and brittle and require a lot of upkeep. Upgrading to a robust, flexible enterprise class application automatically provides many benefits. A well crafted application implemented with clear analysis and understanding of the business's needs will provide many benefits. The EIM systems can provide measurable return on investment.

In a survey by Synogy, Inc. respondents indicated the following estimated benefits if they could improve management of their plans-

- 3.5% increase in company revenues
- 2.7% improvement in margins
- 6.0% reduction in employee turnover
- 5.9% reduction in administrative and IT costs
- 6.2% reduction in over payments

Source: *Synogy 1999 Compensation Conference Survey Results*

Gartner estimated the hard ROI on improvement of payment accuracy through the reduction or elimination of overpayments to be –

Hard Dollar ROI Calculation Example: Improved Payment Accuracy

Revenue year/salesperson	\$2 million
No. of sales people	750
System costs for 750 payees (example)	
License	450
Implementation/training	675
First maintenance @ 18%	81
Total system cost	\$1,206
Average target income	120
Salary/incentive — 50/50	
Salary	60
Incentive	60
Performance = 110%	
Accelerators at 10%	20
Total incentive comp	80
Current overpayment error rate 3%	2.4
Reduced to 1%	0.8
Net improvement per salesperson	1.6
Net improvement for sales org.	\$1,200

ROI = 12 Months

Source: *Gartner Research Note 8 November 2001*

In addition there are many other benefits expected from a good EIM system implementation:

Alignment

Incentive plan is more directly linked to the way executives and employees manage the business. It properly and accurately reflects product groupings, customer segmentation, sales channels, geographic regions, organization structure and reporting relationships. The business logic for calculating compensation plans is accurately and legible modeled in the system.

Trust

Due to transparent and clear communication of the data and the calculations used, more trust is engendered in the system by the payees. This allows freeing up of key resources to focus on business objectives.

Change and Maintenance

Constant change such as payee change, reorganizations, product line change, competitive change, etc can be more easily reflected in the system and allow the organization to respond quicker. The necessary change in compensation plans at the end of the year as well as the large changes such as mergers and acquisitions can be done with less effort and much faster.

Communication

Clear and more frequent communication of plan calculations and results allows the building of trust and elimination of 'shadow accounting'. More frequent communication allows payee to respond to market conditions and their own performance much faster. Troubleshooting of incentive calculation is quicker and simpler.

Productivity

Due to transparent, immediate communication and ability to easily identify and resolve compensation problems, payees are spared from spending a significant time in

administrative activities such as reconciling or ‘shadow accounting’. This allows the payees to spend more of their time on achieving their and the corporation’s objectives. Comp administrators and IT end up spending a tremendously less amount of time in maintaining the software, data, adjustments and reconciliation of issues.

Turnover

A good clear compensation administration should reduce payee turnover and consequently reduce hiring costs.

Conclusion:

There are significant and unique challenges in implementing Enterprise Incentive Management applications, due to both the business issues and capabilities of software. Due diligence has to be applied un understanding the business needs and matching it to the software choice being made. A successful implementation can provide compelling benefits to the organization.

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