



ZS ASSOCIATES

SALES & MARKETING INSIGHTS

ZS Interview: Making Room for Incentive Compensation ROI

Participant: Stephen Redden

Early in their careers, executives are taught the importance of measuring return on investment. Knowing ROI is essential to measure the effectiveness of R&D, capital expenditures, advertising and many other aspects of running a business.

So why not measure ROI for the sales force? More specifically, why not measure the ROI of your sales force's incentive compensation?

Knowing the return on your incentive compensation can go a long way to maximizing incremental sales. Yet the difficulties in measuring ROI on sales compensation have held some executives back from doing so.

Stephen Redden, a ZS Principal based in Evanston, Ill., who leads ZS's sales compensation practice, talked about why it's important sales executives consider ROI for incentive compensation.

About the Expert

Stephen Redden,
Principal

ZS Associates,
Evanston, Ill.

Stephen is the Managing Principal of ZS's Incentive Compensation practice. He has helped develop innovative compensation plan designs and goal-setting approaches that are in widespread use today.



Why is it important to measure return on investment for incentive compensation?

STEPHEN REDDEN: Compensation design is both art and science, but traditionally it's been treated more like an art and less like a science. A typical company spends millions of dollars on incentive compensation, and it helps executives if they view incentive compensation as an investment, as driving motivation and ultimately sales, rather than thinking of it as a cost.

There's a lot of ways you can invest \$10 million in your sales force. For example, you can give \$10 million to the top rep, or have a system in which everyone can earn incentive compensation. Just how do you spend that money? Answering that question is the basis for ROI for incentive comp.

Now in the last few years, we've had a poor economy, though we've seen signs of a recovery. In a downturn, you want to do more with less—you need to take those few dollars you have and invest them in a way that gives you the biggest bang for your buck. In an upturn, investing in your sales force allows you to recruit the best talent and put them to work in the fastest-growing market segments. ROI analysis helps you do both of these.

Do executives think about investment in their sales forces in terms of return?

STEPHEN: Not necessarily. This is the art and the science of it. The art is the typical rules of thumb that apply to incentive comp, which sales leaders have learned from years of experience. Some of these rules of thumb are perfectly well founded. You could do all the science in the world, and realize that this rule of thumb is proven empirically.

But in other cases, you can absolutely bring science to bear—the science is when you apply predictive modeling. A lot of companies just learn from the past, rather than modeling and predicting the future. Even highly seasoned execs can make better-informed decisions.

But how can they actually measure ROI? Is it even feasible?

STEPHEN: The ability to truly measure ROI on sales comp is the big problem we're trying to solve. A lot of it boils down to this: Let's say you make a change in your sales compensation, and sales go up. Can you truly attribute that to the change? Is the market getting stronger, or competitors getting weaker?

Given that, there are approaches like conjoint studies that are helping us answer the questions involved in ROI in sales compensation. How much harder will they work with a different sales compensation plan? If reps knew they could earn \$1 million, would it change how they work?

Should different industries approach this differently?

STEPHEN: ROI is relevant for all industries, but it's particularly important in industries in which the salesperson has a significant impact on the final sale. Take the insurance business. Some insurance salespeople are 100% commission-based, and a good salesperson can make a huge difference. Insurance companies are always looking for ways to increase motivation, which in turn should increase sales. The incentive plan is important to get a good return on your investment.

That brings up something else: There are many ways to measure the return on investment, in addition to increased sales. For example, retaining top salespeople minimizes the costs for hiring and training, not to mention helping protect the business they manage.

How much is there to other measures of ROI?

STEPHEN: There is a lot. In some industries, salespeople basically "own" the account or customer. Incentives are a big reason that they stay with a company or move to a different one. You're not just risking churn, but losing salespeople who can take an entire customer base to the competition. You can model and estimate how much it's going to cost if you don't maintain these top salespeople. For instance, clients will follow a good financial planner from one firm to another. That gives the planner a lot of control, so knowing this helps you calculate how much to invest to retain the salesperson.

In many industries, it's common to have a commission-style plan; you eat what you kill. But some reach a point where their book of business grows to the size where they don't care to grow anymore—they have an annuity business, so why work harder? Sales executives need to decide how much to invest in these situations to foster growth.

What can compensation managers do in a situation like this?

STEPHEN: The incentive plan can be designed in a way that focuses the sales force on the appropriate customers, products and activities that lead to better sales. If two-thirds of the sales force's incentive plan is based on new business and one-third on existing business, it dictates the type of business they will go after.

Do random events affect incentive compensation?

STEPHEN: They do, but a good incentive compensation plan will minimize the effects of random events.

At a publishing company we advised, one particular rep had a low goal due to an anomaly in the data. One day, he picked up the phone, and a business ordered an advertisement for a "double truck," which was an enormous order that

came out of the blue. Because of that single order, the rep received 700% of his monthly target bonus, and went out and bought a Porsche—all because of one random call. And yet this person didn't meet his goal for the entire year! You can imagine what this did for the morale of the rest of the sales team.

You don't want to decouple what sales reps can control and what they get paid. When that happens, the return on your investment drops significantly.

What's most important to remember when evaluating incentive compensation ROI?

STEPHEN: It's important to establish a connection between performance and sales force rewards. Performing predictive analytics on sales compensation plans and quota setting plays a big role in helping companies make well-informed decisions. But there's more to it than analytics; it's important for companies to ensure that the sales force understands the sales compensation plans through training and good communication. All the analytics in the world won't help if the sales force doesn't recognize how their efforts will lead to increased rewards.

So there needs to be direct linkage between what salespeople do and what they get paid. The more direct that linkage is—and as long as the reward is something the rep values—the better the return on your investment.

About ZS Associates

ZS Associates is one of the largest global firms focused on sales and marketing effectiveness. ZS combines deep expertise with rigorous, fact-based analysis to deliver management, business operations and technology consulting to help companies improve performance and results.

With 20 offices around the world, ZS Associates has worked with more than 700 companies in 70 countries across consumer products, energy, high-tech, insurance, medical products and services, pharmaceuticals and other industries. Founded in 1983, ZS comprises multiple affiliated legal entities. Find more at zsassociates.com.

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