

2006 Incentive Compensation Trends

An overview of trends in the Pharmaceutical Industry

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Incentive Compensation Overview:

Over the last five years we have launched hundreds of different sales incentive plans for the pharmaceutical industry. For 2006, we communicated or trained 1 out of every 4 pharmaceutical sales representatives (in the United States) on their incentive compensation plan (24,000 sales representatives out of 92,000 sales representatives). We have witnessed a number of changes in the plans structures, the focus of these plans, and the way in which they are communicated and trained over the past five years. This document outlines a few of the trends that we have observed.

Key Trends:

- Pharmaceutical organizations have increased their use of territory specific goals as the basis for their annual incentive plans – moving away from more general growth goals or other types of plans. This type of plan represented 71% of the IC plan types that we worked with this year.
- However, most organizations still use some type of ranking plan or grid format for new products, products with declining volume, or products that have highly erratic sales and thus cannot be accurately forecasted. We do not see this trend changing in the near future.
- 79% of the plans we worked with gave sales representatives the opportunity for an uncapped earning potential.
- Organizations are moving away from mirrored sales forces and transitioning towards a single sales representative calling on a single physician structure. This impacts IC plans in providing more accountability at a representative level and decreasing the use, or relative weight, of team incentives.
- Our experience indicates that organizations are trying to match their incentive compensation plans with the overall company sales strategy and objectives. This has implications on how individual company's (and even products) reward their sales (i.e., volume, market-share, volume change, market-share change, etc...). We have seen no distinct trends emerge in this area thus far - however, a growing number of plans are exhibiting characteristics that directly tie representative compensation to company successes.
- Communication of annual incentive plans has increased in sophistication and focus as organizations realize that they must actively promote understanding and buy-in from sales representative and front-line managers in order to leverage the significant investment they commit to these plans. The trend has been to move towards year long communication campaigns to try to increase understanding and influence perceptions.

- IC plan training is increasingly being used to motivate the front-line managers as they are viewed as the key linchpin in the comprehension, buy-in, and ultimately the success of the incentive compensation plans. This change includes providing front-line managers with training on how they can use both the annual and short-term compensation programs to motivate their sales representatives.
- More organizations are increasingly using electronic media for both the communication of their plans as well as training delivery. This has led to a decrease in the printing of plan books and training manuals and in turn led to more information being hosted on an intranet or web-based platform.

Insights:

Incentive compensation plans are designed to increase sales representative's motivation and help drive their behavior. The trends that we see in the industry regarding plan structure have been to increase the accountability of sales representatives by providing more specific goals, reducing overlap, and directly tying plans into the company's overall sales objectives. This should have a positive impact on motivation and behavior if implemented in an appropriate manner.

Research on human motivation indicates that IC plans should provide feedback on performance and allow a sales representative to accurately gauge his or her performance level. Ranking plans offer great motivation in that they provide feedback for the representative – not only how they are performing organizationally but also relative to their peers. This feedback allows representatives to make adjustments and modify their behavior¹. However, the recent trend has been to move away from ordinal stack ranking type plans. This means that the impetus is on the sales representative to discern their performance level based against a goal but not necessarily against their peers. Plans that have specific targets or quotas provide a clear indication of a sales representative's performance against company expectations – however, the implications of peer comparison must be more clearly explained and communicated. In doing so, it is possible to create a feeling of self-efficacy can provide a significant increase in satisfaction, work place performance, and motivation².

Another key factor to be addressed is how plan changes are perceived. IC payouts are interpreted based on a sales representative's belief in the perceived fairness, accuracy, and the relative effort put forth by other representatives. This basis for comparison is made regardless of how the plan is designed. Often this aspect is misconstrued by sales representatives and does not provide an accurate assessment of their performance. This is particularly true in territory specific plan structures. Our interviews with representatives in companies that were moving towards this type of plan showed an increase level of anxiety, fear, and misunderstanding of how these goals would impact them. Research by

World at Work³ shows that the greatest gap in communication of IC plans is how sales representatives can “win” with their plan. We believe that this is particularly vital in instances where plans are changing or that the sales force has trepidation regarding the plan.

When plans do not change (or certain aspects of plans such as a particular drugs IC structure) it is important to communicate why it didn't change. In those instances where a relative rank structure is kept in place we recommend explaining the rationale (specifically addressing the uncertainty involved) and how a rank plan is the most effective structure for the representative given all the variables surrounding the particular sales force, its products, and the customer base.

Increased accountability in organizations also leads to plan structures that have less team orientation and more individual features. Again, this shift must be communicated effectively to counter any negative perceptions. The key here is to enhance the link to a company's values (i.e., fairness, pay for performance) and show how individual plans can increase the opportunity and earnings of a sales representative. Individual accountability can lead to fairer and more significant individual rewards

We see an increased focus on how these plans are implemented in the field. The need is not just in creating the right plan structure but also in how that plan is rolled out to the field. We have observed a significant shift in the last five years in relation to the sophistication and focus of this aspect. Sales force automation has been a significant part of this shift. Sales representatives now often have high-speed internet access, real-time pay calculators, and electronic access to sales reports on a daily basis. While this trend seems to indicate less of a role for front-line managers, we argue that their role is more strategic and thus far more significant.

This is also true in the communication and training of the plans. While the technology is available for sales representatives to undertake their own on-line training of your incentive compensation rules and structure, we see a greater need to have manager involvement. This involvement provides clear indication of the level of commitment by the organization, it personalizes the focus, it provides a sounding board for questions, it enhances the ability to influence the field's perceptions of the plan, and is a key link between the IC plan and sales planning and expectations. The trend away from print communications and live training has limited this involvement by managers which we feel has had a negative impact on how well IC plans are understood and act as motivating influencers.

Conclusion:

Our work has shown a number of trends are reshaping the industry in a positive manner. With incentive compensation typically accounting for between 30% and 40% of a sales representative's pay³ - it is vital to ensure that this investment is leveraged and the plans implemented effectively. While these trends are seen as a positive influence in helping organizations succeed in an ever more competitive market environment, it is vital that these changes are implemented effectively across the organization. To be successful, even more time and effort must be invested up-front on how plan structures will be perceived by the field, how they will be cascaded out across the organization, what is the best way to communicate these changes, and how can an organization effectively train people on how to get the most out of the new plans.

References:

¹ Stajovic, A. D., & Luthans, F. (2001). Differential effects of incentive motivators on work performance. *Academy of Management Journal*, 11, 580-591.

² Bandura, A., (1997). *Self-efficacy: the exercise of control*. New York: W.H. Freeman and Company.

³ World at Work. (2005). *Key sales incentive plan practices: a survey of World at Work members*. Scottsdale, AZ. World at Work