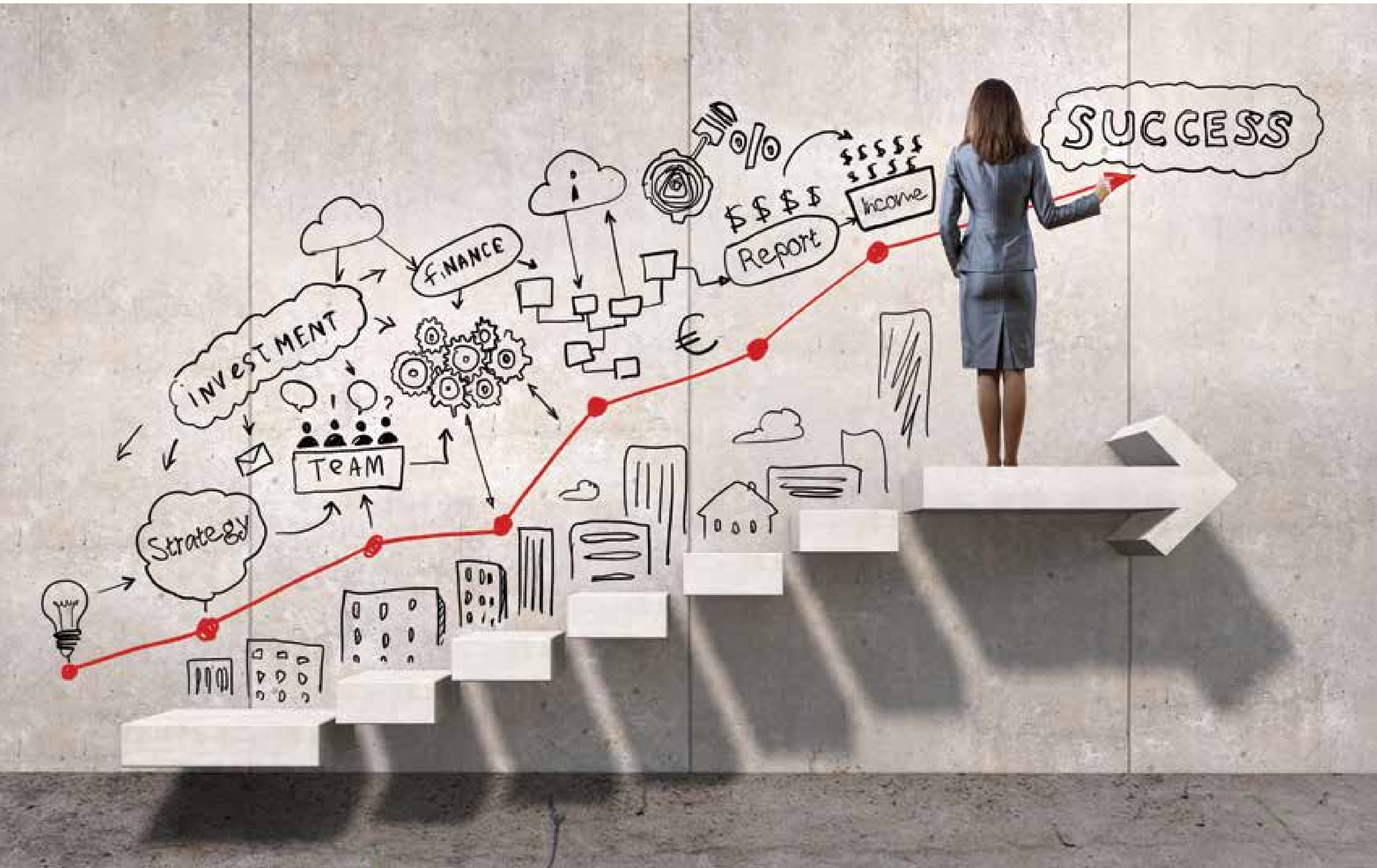


A Roadmap to Success:
Five Guiding Principles to Incentive Compensation Planning

KMK

KMK Consulting, Inc.

Driving informed business decisions with data services and business intelligence solutions

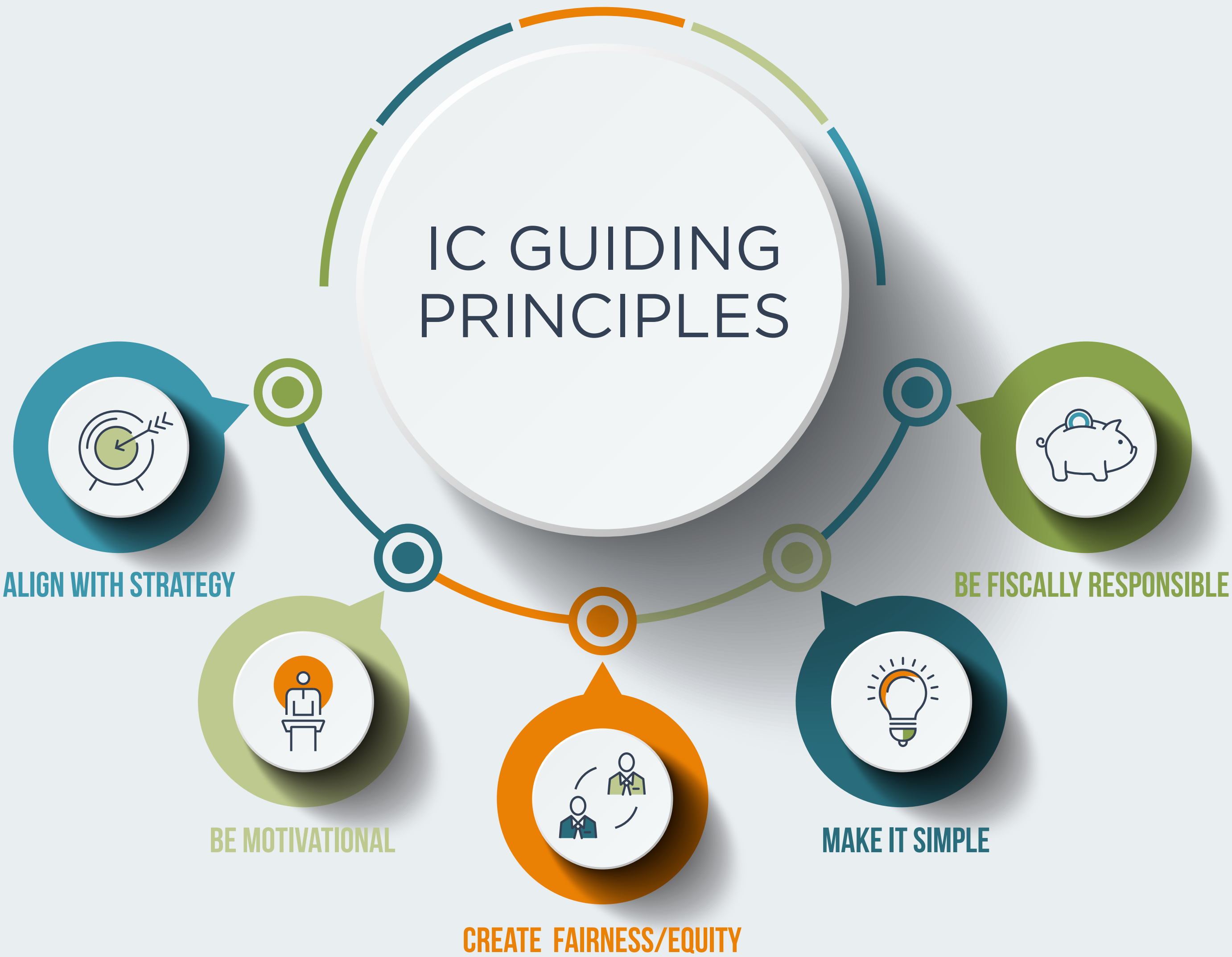
Introduction

Attracting and retaining productive and satisfied sales representatives is paramount to the success of any commercialization effort. Likewise, the sales force incentive plan (IC Plan) is critical to achieving these goals. When properly designed, the IC Plan is an investment that promotes exceptional behavior and motivates sales reps to exceed expectations. In addition, it leads to greater rep satisfaction, encourages company loyalty, and serves to attract talent to the company.

There are many types of IC Plans. Generally these plans can be categorized by four broad groups.

- **Individual Goal-Based Plans –** used for both launch and post-launch brands, these plans provide unique quotas for each sales representative based on historical analogs and/or performance. The reps' payout is frequently determined by their % of goal attainment. The payout curve can be adjusted over time based on the product life cycle. If done well and communicated clearly, this type of plan can be fair and motivational.
- **Commission-Based Plans** – most commonly used with launch products or in low volume situations such as medical devices and rare diseases. The rep payout is based on a flat amount paid per units, Rx, or dollar amount attained. This type of plan can be very easy to understand and simple to communicate.
- **Forced / Relative Rank Plans** – based on either an absolute or relative ranking of territories. The ranking can be national or within segments, and may be done on one or multiple metrics. Typical metrics include measurement of product/market volume and/or share. Segments are typically defined by managed care analogues or other market factors. This plan is sometimes chosen when there is a lack of confidence in product growth predictability since it can be independent of company forecast.
- **Management by Objective (MBO) Type Plans** – generally based on more qualitative metrics "objectives," such as field activity, customer satisfaction, compliance, and training. This type of plan is often used when there is a lack of ability to track quantitative data.

Each general type of plan has positives and negatives. What drives the formulation of a successful plan for one organization and/or product may be far different for another. In some cases, a product may best benefit from utilizing multiple plan types. For example, 80% weight may be placed on individual goals and 20% weight on key MBOs.



There are guiding principles that are key to a successful IC plan and can help determine what IC plan type, or combination of plan types, will be best for a given product. Five optimal guiding principles to use in developing effective IC plans are *(as shown above)*:

1. Align With Strategy
2. Be Motivational
3. Create Fairness and Equity
4. Make It Simple
5. Be Fiscally Responsible

While all of these principles are important, finding a plan strong in all of them can be a significant challenge. In reality, there will be trade-offs with any plan. For example, some simple plans may not create fairness or equity, or some very motivational plans may not be fiscally responsible. Understanding and communicating the relative importance of each of these five principles, in light of both the company objectives and specific product lifecycle and needs, is critical to creating both a successful plan as well as executive, manager, and representative "buy-in."

Principle 1: Align with Strategy

Aligning with company or brand strategy

Every organization and brand carries a strategy for commercialization success to which an incentive plan should be aligned. These strategies can vary significantly based on brand characteristics and requirements; the brand's position in its life cycle, market or policy situations; and the list goes on. Strategic alignment becomes even more complex when one factors in the need to carry multiple brands within the sales team, each with its own goal. In addition, some brands have goals adjusted during different time periods, further complicating planning.

As brands evolve from their launch stage to maturity, the plan strategy may be shifted from achieving great initial adoption and market penetration during launch, to achieving higher revenue and profitability in later brand cycles. An IC Plan taking these position shifts into account might consider shifting the IC measurement from sales units to sales profit. Doing so will automatically help shift the focus of the field force towards targets representing higher margins.

Making sure that the IC plan is in sync with strategic goals may be complicated due to these shifting priorities; however, it is critical to brand and organizational success, as well as the rep's overall sense of satisfaction.

Defining "right" performance

The plan needs to define what the "right" performance is in order to ensure that the "right" performers are the ones getting a strong payout. The "right" performers are those who are driving the business toward the established goals. One wants to avoid situations where a consistently high payout territory is not meeting brand or company objectives while a high performing territory (based on brand / company objectives) receives low payouts.

Example of Mis-alignment Between the IC Plan and Company/Brand Strategy:

Product X is theee years into launch and is considered a "successful" brand. However, while still growing in volume, profit has started to decline. On closer examination of the source of business, the highly profitable cash and commercial channels have started to decline in volume. However, the lower Medicare and Medicaid channels are continuing to grow rapidly.

A primary management objective is to grow Product X profits. The current IC plan is based on a quota structure and pays based on total Rx quotas. The Bronx, NY territory is actually declining in Product X profit, but is being paid well based on Rx growth (high Medicare growth). However, the Fort Worth, TX territory is growing in Product X profit, but is paid only moderately well due to small Rx growth even with a strong movement toward more profitable channels.

In this case, representatives are motivated to push toward the business that is the easiest to grow irrespective of value to the company. In addition, they will shy away from offices that have a concentration of patients who are in more difficult-to-move channels, even if these channels are more profitable.

Principle 2: Be Motivational

Driving intended positive behaviors

Every IC Plan, no matter how well thought out or off-the-cuff, has one thing in common – in impacting pay, it also drives emotions and behaviors. However, the type of emotions and behaviors (which can be positive or negative) that are driven will vary for every plan. In order to develop a plan that will drive intended positive behaviors, it is critical to first identify the desired company and brand positive behaviors. For example, a desired compliance behavior may be to only promote a given product for patients over 18 years of age. Paying for all Rxs written by all physicians (including pediatricians) may motivate representatives to promote a product for use with under-aged patients, potentially resulting in legal fines and penalties.

Other identifiable potential positive behaviors may include collaboration with team members and open sharing of best practices. Also, avoidance of cannibalization of a secondary product in the portfolio and a balanced portfolio effort may be important in cases of multiple products in the bag. The plan needs to be motivational and also drive that motivation toward all desired outcomes and behaviors.

Strong links between individual payout and individual performance

Some IC plans may have a strong link between national payout and national performance, yet not differentiate well between individuals who are driving the brand and company objectives versus those who are not. When this is recognized by the sales reps, it can result in regrettable turnover and poor retention.

Example of Lack of Payout/Performance Linkage at an Individual Territory Level:

Product A is a new launch product and the company chose to put a very high weight on national performance to encourage team collaboration. A small weight was placed on some MBO measurements.

The national payout was very closely linked with national performance. However a downside consequence was significant among the individuals who brought in the highest volume. Upon closer inspection, most of these individuals went to a competitor who was launching a new competing product using a commission IC plan, and their former territory results ended up with the lowest volume.

Appropriate Range in Payout Spread

Even when a plan differentiates well between individual performance, the amount of spread in the payouts is also important to motivate and drive performance. Spread can be either too narrow or too wide. Too narrow of a spread can result in high performers being demotivated to work hard, as they feel that hard work does not pay much more than moderate work. Conversely, too large a spread can result in a high percentage of zero or very low payouts and significant turnover and training costs.

"Low risk" in plan-induced payout swings between periods

An example of a payout swing is where a sales rep gets a great payout (e.g. 200%) in one period but a very poor payout (e.g. 50%) in the following period or vice versa, otherwise known as the "Hero to Zero" or "Zero to Hero" phenomena.

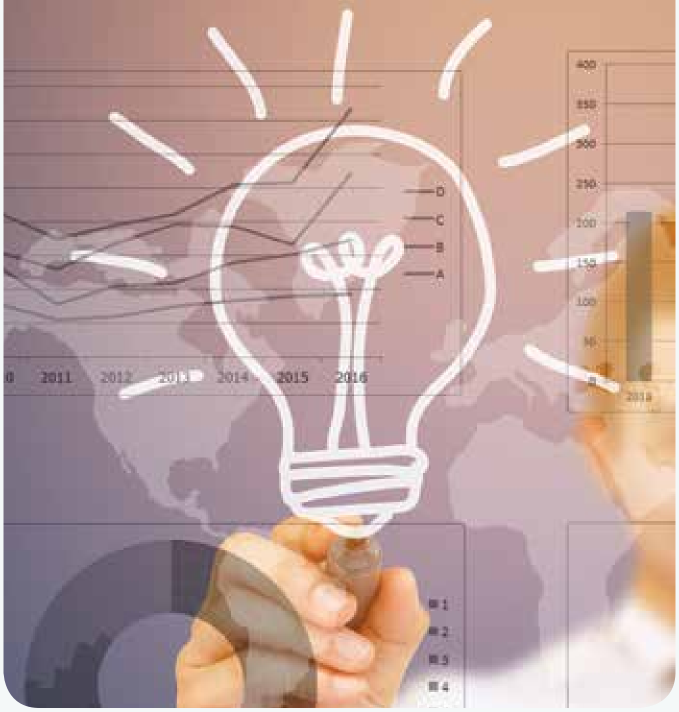
In general, there are two main causes for payout swings. The first is induced by change in individual actual performance. This is what a good IC plan should drive, where compensation is based on a strong link between performance and payout and sales reps are highly motivated to achieve beyond prior periods.

The second cause for payout swings is plan-induced, where individual performance continues per the prior period, but payout changes vastly between periods purely due to the nuances in plan design itself. This is the type of undesired payout swing to be avoided. Plans that induce a payout swing penalize employees for prior growth over a longer period, resulting in poor morale, lackluster performance, and regrettable turnover.

There are "reward for growth" approaches to goal setting that can avoid this type of issue.

Example of Plan-Induced Payout Swing:

Plan-induced payout swing is a fairly common issue for both Trending and Fair-Share Goal approaches. A Fair-Share approach requires every territory to grow at the same rate across the nation, say 10%, regardless of prior performance. Reps that had grown their business by 25% previously, might very much struggle to continue this pattern to reach even the required 10% growth off that much higher base. They therefore become a "Plan-Induced Hero to Zero" and miss a good payout. A rep who previously declined by 30% can easily earn a strong payout in the coming quarter by showing growth at 10% over the prior quarter's significant decline. This practice actually penalizes for growth and can encourages reps to "play with the system" by holding off their best effort.



Principle 3: Create Fairness / Equity

Equal Earning Opportunity (Unbiased Plan)

Territories are not the same. They can vary in product potential, market share, managed care, or accessibility. When territory differences are not accounted for in an IC plan, payout variability may have more to do with territory dynamics than with individual performance. This is often referred to as a biased plan or "unfair" plan. Establishing fair or equitable territory goals is a complex matter.

Plan biases often result in general plan mistrust and distraction from selling. There are analytical approaches that can be used to test any plan for potential biases and to create an unbiased plan.

It may not be enough to have a plan that is fair and equitable. If it is perceived by the field as unfair, there is still a problem. Therefore, it is critical to also proactively communicate to the field in a way they can understand and believe in the inherent fairness of the plan. There are analytical and visual approaches that can be used to ensure this sales force understanding. A proactive approach to both illustrate and communicate fairness and equity will create confidence in the plan. Reactive approaches often result in a large number of field inquiries.

Principle 4: Make It Simple

Simple to understand

Highly motivational, successful IC Plans often require some complexity to drive better sales performance. However, there is a difference between good and bad complexity. Good complexity can achieve additional goals such as fairness, while still being communicated clearly. Bad complexity detracts from the plan's effectiveness and makes it difficult to understand. Any complexity in plan design should not be difficult to communicate. The goal is to put in place a plan that results in optimum sales performance. This requires sales force buy-in, which comes from sales rep understanding. Use of charts and diagrams can help facilitate this.

Transparency

To ensure comprehension, one must also overcome the lack of trust that can exist between the sales force and management. Reps in the field today are often given a single number representing the goal they need to hit. Many times the whole process of IC operation is akin to a black box for them, generating mistrust and fostering poor morale.

If one maintains a high level of transparency in IC Plan design and processing, reps will find the plan to have higher credibility. They, in turn, will have greater motivation and job satisfaction. This transparency should extend beyond the IC methodology to also cover performance measurement, crediting, and payout calculation. Visual comparison to national, regional, and district performance creates additional transparency. A clearly visualized and easy-to-follow performance dashboard report goes a long way in providing transparency. When ued together with video training materials and Q&A sessions, rep understanding improves. Better transparency of a well-designed IC Plan enables reps to focus on driving business growth. Lack of transparency often results in rep time spent on conducting data analytics and validation.

Example of Managed Care and Access Plan Bias:

For Product A, the Pacific Northwest, Minnesota, and New England have very challenging managed care policies and poor access compared to other areas of the country. Since the current IC plan does not take into account managed care or access differences, these areas have consistently underperformed. There has also been a large amount of turnover in these areas.

Principle 5: Fiscally Responsible

Consistency between corporate performance, sales results, and IC payouts

A good IC Plan should not only have a strong link between individual payout and actual individual performance, it needs to be strongly aligned with corporate performance. When payout is closely linked with overall corporate performance, it drives accountability for financial outcome within the field. Sales reps clearly understand that if the corporation misses its goal, their IC payout could be affected.

Payout predictability

Payout predictability and its measurement rely heavily on the accounting designation of incentive compensation as an investment or as an expense. Each corporation has it accounting principles to follow, and understanding how each designation can impact the overall sales performance is an important consideration in developing an IC Plan.

- **Investment-Based IC plans** – Thinking of incentive compensation as an investment can lead to the best sales performance and highest rep satisfaction, as these plans reward the right behavior. Although there can be a bit less payout predictability, these plans offer a well-calculated risk in that predictive tools can be used to get a fairly accurate prediction of results. The challenge of cash management can be minimized, and results enhanced, by using simulation models.

- **Expense-Based IC plans** – When incentive compensation is treated as an expense, the norm is to favor plans with great payout predictability, such as the MBO or forced/relative rank incentive compensation approaches where payouts are often fixed regardless of overall performance. Top ranked performers always receive the greatest payout, while bottom performers get the least. With this plan, even if the team completely misses the national goal or performs greatly beyond its goal, the total payout is often completely fixed and predictable. In doing this, one trades off more predictable cash management for a plan with a lower fairness quotient and a poor link between sales and corporate performance. Although expectations may be for this plan to induce some level of internal competition, it more often leads to poor morale and underperformance.

In Conclusion

While it may be easy to find an IC plan strong in one specific principle, finding an IC plan strong on all five guiding principles is challenging and tradeoffs are necessary. One may need to balance creating a more complex plan to achieve better fairness. In order to develop the IC Plan best suited to meet strategic needs, companies need to address how important each of these five principles is for specific brands and then determine the balance and emphasis across all dimensions.

KMK has the expertise in IC planning to shepherd you through the process using these five guiding principles. We partner with you to establish your concerns and understand your perspectives up front, to best assist in the planning process. Companies unsure of which plan to follow can rely on KMK's IC specialists to facilitate live planning sessions with sales operations and senior leadership. These sessions ensure that everyone lands on the same page and is onboard for implementation and success.

About KMK Consulting, Inc.

KMK Consulting Inc. is a full-service consulting firm specializing in commercial operations support to the life science industry. For more than 17 years and now with more than 100 full-time employees in the US, KMK provides analytical support to clients on-site, as a project, or as SaaS that helps drive business decisions and improve sales operations efficiency and effectiveness. We offer Sales Force Effectiveness (SFE) services, software for Incentive Compensation and sales reporting, as well as primary market research. From product pre-launch to launch and growth and maturity, KMK helps guide and support your sales force requirements and goals.

Our expertise includes:

- Incentive Compensation —
  - Plan Design & Administration
  - Goal Setting
  - Reporting
- Forecasting
- Targeting, Alignment, Call Planning
- Sales Force Sizing
- Ongoing Analytical Support
- Primary Market Research

KMK

KMK Consulting, Inc.

23 Headquarters Plaza,
North Tower, 7th Floor
Morristown, NJ 07960

info@kmkconsultinginc.com
Phone: 973-536-0700
FAX: 973-536-0702