ROI INCENTIVE PROGRAMS

A Case Study for Channel Sales Success

i-Myth

Advancing the science of incentive performance management

EXECUTIVE SUMMARY

A Fortune 500 manufacturer and distributor were faced with the challenge of motivating their Master Resellers to increase sales and marketshare in each of their key sales territories. The company had used various forms of incentives in the past with some success and many repeat winners, but was facing formidable new challenges due to a recently reduced budget for incentives and an increase in competition in the marketplace. Company objectives for a new incentive initiative were as follows:

- Increase revenues by not less than 20% over the previous year
- Increase VAR marketshare in all territories to a minimum of 30%
- Increase net operating income by not less than 10% of revenue

An in-depth analysis of the internal and external environment in which the company operates was conducted. Based on this analysis, the objectives, rules and rewards were put in place for an ROI Incentive Program.

Over a period of nine months, the following program results were achieved:

- Total revenues increased by **32%**
- Marketshare increased in nine of twelve markets, in excess of **30%**
- Net operating Income increased to **19%** of revenue

The non-financial results included:

- 30% of the Master Reseller reward participants were first-time reward earners
- Program participant surveys yielded 87.3% “excellent” ratings
- Turnover of key Master Resellers decreased by 2% from the previous year

The incentive program yielded the following Return on Investment (ROI):

Total Incremental Improvement:	*$ 3,934,700*
Total Incremental Costs:	*$ 3,186,900*
***Total ROI**:*	***$ 747,800***

(To determine the Return on Investment for this program, all additional incremental revenue and costs were calculated, including increased operational costs and incentive program costs.)

The complete details, including additional results gained outside of the original goals, are documented below.

BACKGROUND

Company Overview

The company is a United States based Fortune 500 Corporation that manufactures and distributes computer hardware through a channel distribution model. Master Resellers are utilized by the company to manage sales territories, and to sell in a highly competitive market to Value Added Resellers (VARs). The company sells their products in countries around the world, with a heavy concentration in the United States, Europe and Asia/Pacific markets.

Situation Analysis

During the past two years the company has used various forms of incentive programs to motivate Master Resellers to increase sales and marketshare in each of their 12 key sales territories. In the most recent sales year, the company experienced a high degree of competition from several new competitors who have entered the market. The entry of these competitors has created a new pricing environment for the company. While they once controlled much of the market for their products, they now were experiencing pricing pressures from their customers. Value Added Reseller inventories were at a record high. The success of previous incentive sales programs, which focused on increasing sales to VAR's, created a situation where the VAR's loaded up on product and now they found it was still sitting in their warehouses. VAR Resellers were asking for reductions in both price and terms in order to eliminate aging inventories. Competitors were waiting at the door to fill any new inventory orders required, at a lower price than the company had been asking.

Company Objective

The company recognizes the value of providing incentive programs to their sales team in order to drive new sales and increase marketshare. However, budgets for these programs are being reduced as the company is forced to react to the new competitive forces in the marketplace. The company intends to continue with a sales incentive program, albeit with a reduced budget (25% less than last year). The company objectives are as follows:

- Increase revenues by 20% over the previous year
- Increase marketshare in all territories to a minimum of 30%
- Maintain total operating income at not less than 10% of revenue

SOLUTION

The first step was to complete an independent analysis of both the internal and external environment in which the company operates. This analysis included an impact study of the company financial statements immediately following an incentive program. The internal analysis revealed that in the years when the company operated sales incentive programs, sales did increase. There was not, however, any indication that it was the incentive program that caused the sales increase. Budgets for these programs were established based on the anticipated sales increase and the estimated number of qualifying Master Resellers. These estimates were based on the Master Resellers who had qualified for sales incentives in the previous years.

Further analysis indicated that the company grew in areas other than sales. Analysis of the company's balance sheet indicated a substantial growth in both inventory levels and outstanding accounts receivable. A review of the incentive reward participants also indicated a high degree of repeat reward participants.

The external environment analysis indicated that the industry environment would continue to face new competitors entering the marketplace. Pricing pressure would be an added factor as new products were released. Economic indicators, both domestically and abroad, were forecasted to be within the same range as the immediate year. Employment, especially in the US market, was under tremendous pressure, as companies were using stock options; cash bonuses and cars as incentives to lure qualified employees.

<u>Program Design</u>

An incentive program was designed that included both the Master Resellers and the Value Added Resellers. A review was completed of each Master Reseller with regard to individual expectations as it related to marketshare availability, product knowledge, length of time with the company, and length of time in the sales territory. Revenue enhancement objectives for these Master Resellers were established based on a reasonable expectation of achievement.

Program design also included the VAR's, both existing and those who were still in the prospect stage with the company. Objectives for the VAR's were established based on their current inventory levels, past purchasing patterns and payment terms. Each VAR objective was established with a reasonable expectation of achievement.

The rules structure developed provided the company an opportunity to exceed their revenue related objectives.

Incentive Program Objectives

Based on an in-depth assessment of the competitive marketplace, it is estimated that:

- Revenues could be increased by 25% to 45%
- Net operating income could be increased by 15% to 21% of revenue
- A marketshare increase of not less than 30% in not less than 60% (or 7) of the 12 markets
- VAR marketshare would be maintained at not less than 30% in a minimum of 12 (out of 29) markets

Incentive Rewards

Incentive rewards were selected based on the demographic profile of both the Target Master Reseller and VAR audience. This profile considered the economic factors of each of these individuals, and the type of incentive reward that would provide the highest perceived value to them. Target Master Resellers were motivated to achieve program objectives by earning a spot in the company "Top Gun" reward category. These select groups of individuals were treated to a real-life Top Gun Flight School experience, complete with a flight in an F-16 aircraft. VAR's that met incentive objectives, along with their guests, were treated to a spectacular 8 day/7 night stay at an exclusive Caribbean Resort. For the full week, this select group had the resort to themselves, where they enjoyed all of the amenities of the "Life of the Rich and Famous".

Best Practice Rules Structure

The incentive rules structure was designed to drive the revenue objectives of the company and to provide enhanced benefits not originally recognized by the company. Rules included rewards for:

- Sales of specific products made within the first two weeks of the program
- Total sales achieved over the course of the program in excess of stated objective
- Points to VAR's for JIT inventory purchases
- Points to VAR's for the purchase of specific products
- Points to Master Resellers for new VAR acquisitions

RESULTS

- **Total revenues increased by 12% over the desired 20% increase**
- **The company increased marketshare in 9 of 12 markets to a level in excess of 30%.**
- **Net Operating Income increased to 9% of revenue over the desired 10%**

ADDITIONAL RESULTS
Beyond Original Scope of Goals

As is often the case, the analysis conducted at the beginning of the program revealed a number of issues that were not anticipated when the company sponsoring the program set goals for the program. The analysis indicated that the past sales incentive programs had actually created several issues for the sponsoring company.

These issues surfaced and, while outside the original scope of work, were investigated and incentive rules developed to resolve them. Each of these issues is identified below, along with their potential impact, the incentive program rules designed to create change, and the results which were achieved during the program's implementation.

Issue: Excess Inventory

Products sold as a result of previous incentive programs were still sitting at Value Added Reseller locations. Sales numbers for the immediate two sales quarters following the sales incentive program showed a drastic reduction in unit sales to VAR's.

Impact
Inventory that remained unsold created the added cost of carrying that inventory in stock.

Inventory Age projected for the company:	44.8 days
Normal for the industry:	40.0 days

Best Practice Rules Structure
VAR's with existing levels of inventory were assigned a point value for each product line of inventory. Points were awarded based on the number of units sold and bonus points were provided for those sold within the first two weeks of the program.

Results
VAR inventory levels decreased and inventory aging days improved from 44.8 days to 40.2 days.

Issue: Excess Borrowing Costs

Accounts receivable dollars and days-to-collect grew during the time period of previous sales incentive programs. Borrowing costs for accounts receivable financing grew as a direct result.

Impact
Increases in outstanding Accounts Receivable caused higher interest costs, as much of these receivables were financed through a lending source. Increases in the number of days it took to collect invoices put a strain on cash flow and caused further increases in interest expense as funds were borrowed to meet daily operating costs.

Accounts Receivable Projected:	17% of revenue
Industry Standard:	15% of revenue
Accounts Receivable Collection Days Projected:	61 days
Industry Standard:	57 days

Best Practice Rules Structure
Points were allocated for VAR's that paid invoices within 55 days. Master Resellers were allocated points for new VAR relationships that paid within 45 days.

Results
Accounts Receivable decreased to 15% of revenue and days outstanding improved to 54 days.

SUMMARY OF RESULTS

The company initiated a monthly monitoring of the program results as the program operated. This allowed both the company and the TBG incentive team to monitor changes in the overall behavior of the internal and external environment of the company as the program unfolded. By tracking these changes and adapting the rules structure to meet any unforeseen changes, plus or minus, an accurate measure was achieved of the incentive program's impact on the company.

The financial results created, expressed as incremental above the projected company plan, specifically created by the ROI Incentive Program included:

- Incremental increase in revenue of 12%
- Incremental decrease in SG&A Expenses of 5%
- Incremental increase in net operating income of 9%
- Incremental decrease in outstanding Accounts Receivable of $42,500.00
- Incremental decrease in Accounts Receivable collection by 7 days
- Incremental decrease inventory valuation of $38,300.00
- Incremental increase in inventory aging of 4.6 days

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