MX Business Strategies for Medical Technology Executives

Balancing Incentive Compensation Plans

For medtech companies, a good incentive plan can mean higher sales and a more motivated sales force—but only if it allows for effective territory alignment.

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Many executives of medical technology companies count on incentive compensation plans to align their sales representatives' goals with the goals of the company, but this oftentimes isn't the result. Some very common types of incentive plans, when coupled with poorly balanced sales territories, can actually hinder a medtech company's ability to maximize sales. Faced with today's consolidating healthcare marketplace as well as a proliferation of competitive products, medical technology executives cannot afford to have their sales incentive plans work against them.

This article explores how incentive compensation plans can backfire, and explains how medical technology executives can determine whether such a phenomenon is at work at their company (see sidebar, page 85). The article also discusses what medtech executives can do to maximize company sales while maintaining high morale and income for their sales representatives.

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The Different Types of Incentive Plans

The fundamental reason for the existence of incentive plans is to ensure that a company's sales representatives have the motivation necessary to meet the company's sales goals. Three basic incentive-plan structures have evolved to accomplish this end, each using a different definition of a sales rep's performance as the basis for making incentive payments (see Table I). All three types of incentive plans—and various derivatives of them—work effectively as sales motivational tools in the medical technology industry.

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In commission-based plans, incentive payouts are calculated as a percentage of the sales revenue or profit associated with each sale (or transaction). In some cases commissions are the only form of payment to a sales representative, while in others commissions are paid as an incentive in addition to a base salary. Commission-based plans make great sense during the launch of new medical technology products, or when cost control is critical. During new product introductions, commission payments are typically based on sales volume, profit, or market share. As such, commissions directly link sales-rep motivation—and pay—to the successful launch of the new product in their territory. When cost control is important, pure commission-based plans (i.e., those consisting of no base salary) allow management to pay only when a sale is made. Such plan structures are typical in small medical device, diagnostic, and medical supply companies that cannot afford the cost and risk associated with sales-force salaries. Because of their simplicity, commission-based systems are widely used.

In goal-based plans, sales-rep performance is measured first by comparing an actual result with a predetermined goal. The incentive payout is then calculated based on the level of goal achievement. Goal-based plans allow companies to set clear expectations with the sales force. As opposed to commission-based plans, which simply ask reps

When to Redesign

There are several indications that a company's territory alignment or its incentive plan may be working against it. Any of the following conditions should suggest to medtech executives that it's time to revisit the alignment of their sales territories.

Vastly different market shares from one territory to the next, particularly if the high-market-share territories have low overall sales volume. High-potential territories typically have lower market share than low-potential territories. If high-market-share territories also have low sales, it is an indication that potential in the company's sales territories is not balanced.

Vacant territories top sales-performance charts. This may be due to the fact that the vacant territories have huge potential and loyal customers. If the previous sales rep for that territory was earning large commissions because of the large sales base, that rep was probably overpaid, and the territory is probably too big.

A long time has elapsed since the last realignment of territories. If this is true, chances are the company's markets have shifted. The dynamic and consolidating nature of the medtech industry's customers (hospitals, alternate sites, integrated delivery networks, laboratory locations) ensures that target markets do shift over time. Territory alignments should adapt to these shifts.

The product portfolio has changed significantly since the last territory realignment. Many medtech manufacturers get a significant portion of their revenues from products less than three years old. If the company has not realigned (or at least reevaluated) the geographic deployment of its territories recently, it is likely the territories are not designed to optimize market penetration for the company's current portfolio. This is particularly true if the company's new products address needs in different markets than its mature products do.

	Commission-Based Plan	Goal-Based Plan	Relative-Performance Plan
General description	Incentive compensation is calculated as a percentage of sales or profit.	Incentive compensation is a function of goal achievement.	Incentive compensation is determined by ranking sales reps based on certain criteria.
Incentive-plan example	Incentive or commission is equal to 5% of sales.	Incentive payout starts at 90% of goal; $2000 is paid for each percentage point of goal achievement from 90 to 110%; $2500 is paid for each percentage point of goal achievement above 110%.	Ranking is determined by sales percentage growth. If there are 60 reps in the sales force, the rep with the highest growth receives $50,000 in incentive compensation, the second receives $49,000, and so on. The 10 lowest-ranking reps do not receive an incentive payout.

Table I. The three fundamental incentive-plan structures. Each plan uses a different definition of the sales rep's performance as the basis for incentive compensation. Source: ZS Associates (Evanston, IL).

Imbalanced Workloads

Workload imbalance exists in the sales forces of many medical device, diagnostic, and medical supply companies. The figure below shows the estimated workload for a medical sales force with 185 territories. The account workload in each territory has been calculated and indexed on the vertical axis.

The territories have been sorted from highest to lowest workload, and each territory is plotted as a point along the curved line on the graph. The "average territory" line on the graph represents the annual workload capacity of one salesperson. The territory with the highest workload on the graph has more than twice the workload of the average territory. Conversely, the territory with the lowest workload has less than 40% of the workload of the average territory. More than 50% of the territories have workloads that deviate by more than 15% from the average.

Alignment imbalances like those shown in the figure are typical. Such imbalance leads to suboptimal sales results.

Workload imbalance in medical sales territories leads to suboptimal sales results. Source: ZS Associates (Evanston, IL).

to sell more, goal-based plans specifically tell reps how much more to sell. Such plans allow management some control over how sales reps allocate their efforts across various products or customer segments by giving them a goal for each product or set of customers. While goal-based plans are also widely used among medtech manufacturers, they are more difficult to administer, primarily because goals must be set and assigned to each representative.

In relative-performance plans, a sales representative's incentive pay depends on his or her performance according to a prespecified criterion (for example, sales volume) as compared with the rep's colleagues. The most common relative-performance plan is one that pays the sales reps based on a ranking system. Relative-performance, or ranking, plans allow companies to control their incentive payout, because the amount of money that will be paid for each position in the ranking grid is determined when the plan is developed. As such, relative-performance plans are also easy to administer. Ranking systems can also encourage a competitive atmosphere among the sales reps, if such an atmosphere is desired.

While each type of incentive plan has its place in helping to drive sales strategy, a decision about which type of plan to use should not be made in isolation. Executives of medical technology companies should consider situational factors such as environment and market conditions and other sales-management decisions before choosing which of these plans to adopt. One important factor that medtech executives should pay special attention to is their company's territory alignment.

The Importance of Balanced Sales Territories

A company's territory alignment reflects how it has assigned coverage responsibility for its products and customers to its representatives. In most medical technology companies, territory alignments are geographic. That is, each sales rep has a piece of geography assigned to them. The salesperson is responsible for all current and potential customers within that geographical region.

Studies conducted across hundreds of medtech companies have proven the importance of a balanced territory alignment (see sidebar, above). A balanced territory alignment means that each territory has approximately the same level of workload and market potential. The following situations show how medtech companies with unbalanced territories are essentially leaving money on the table for their competitors.

- Salespeople in territories with too much workload or potential are

Figure 1. Territory sales potential ranks among the primary indicators of sales performance.[1]

not able to cover all their customers and prospects effectively. Valuable accounts are often underserved by sales reps who have limited time to get to them. The reps focus on the very best accounts in the territory, leaving many valuable accounts ignored or underserved.

- In low-potential territories, sales reps have to spend time scouring through unproductive accounts just to keep their heads above water.
- Many hospital and alternate-site accounts that are not being covered in high-workload territories are significantly more valuable than some accounts that are overcovered in low-workload territories.

By realigning territories, good accounts from high-workload territories can be reassigned to salespeople that have excess capacity. The result is an increase in productivity that leads directly to higher sales and profits.

Studies performed using sales figures from hundreds of medical device, diagnostic, and medical supply companies show that balancing territories can lead to a 2–7% increase in sales.[2] While the percentages seem small, the figures are usually quite significant when converted to dollar equivalents. It is also worth noting that reaping the benefits of territory realignment requires no additional financial investment in the sales force.

When Incentives and Unbalanced Territories Collide

When a company has an unbalanced territory alignment and a volume-based incentive plan (such as those found in commission-based and ranking plans), chances are that the company's sales representatives are being rewarded based on the

Warning Signs

Many signals of potential alignment or incentive issues take the form of comments from sales reps and medtech customers. Company leaders should be attuned to such remarks that might indicate some realignment is necessary.

- **"How am I going to win the sales contest if you take away my most valuable accounts?"** Such a quote is likely to come from a sales rep in a disproportionately high-potential territory who is paid and measured on sales volume.
- **"Other reps are overpaid," or "I'm not making enough money."** Comments like these from sales reps indicate that territories in a heavily commissioned sales force may be out of balance.
- **"I'm working harder than anyone. I can't possibly handle more accounts."** This comment could come from a sales rep whose territory is geographically too big. The rep is probably spending most of his or her time traveling and little time selling. Conversely, under a market-share-based compensation plan, the same comment could actually signal a territory that is too small.
- **"Where is my sales rep?"** If you're hearing this from customers in certain territories, chances are good that those territories are too big.
- **"Is all this attention I'm getting showing up in my price?" or "Didn't I just see you?"** Comments like these from customers indicate that territories may be too small.

Figure 2. The percentage of unbalanced medical sales territories before and after territory-realignment initiatives. Source: ZS Associates (Evanston, IL).

nature of their underlying territory rather than on their performance. Such situations run completely contrary to the fundamental tenet that sales incentives should reward a sales rep's performance.

Studies in the medical technology industry show that sales volume in any given territory is highly correlated with the potential of that territory (see Figure 1). In fact, territory sales potential is a much better indicator of sales performance than any factor related to the sales rep. The greater the potential of a territory, the higher the sales volume (and the higher the sales rep's incentive payments). Territories with less potential tend to have lower sales volumes. Rather than reward sales reps simply on the volume of sales that they are able to generate, a better approach would be to base the reward on the volume of sales generated as a function of the potential of the rep's assigned territory.

Besides leaving performance unrewarded in unbalanced territories, a volume-based incentive plan can also stymie a company's ability to reap the benefits of realigning sales territories. Volume-based incentive plans encourage medtech sales reps to want more accounts than they can cover effectively. More accounts mean more opportunities to build sales. Sales reps in large territories will understandably fight a realignment that shrinks their territory. They know that realignment will hit them in the wallet via the incentive plan.

In contrast, incentive plans based on market share encourage sales reps to want fewer accounts than they realistically could manage. With fewer accounts, sales reps can penetrate the accounts in their territory more deeply and drive out competition.[3] Reps in these situations will fight any addition of accounts to their territory, claiming that they are already too busy and can't handle any additional work (see sidebar, page 88).

Such resistance from a company's sales force can cause its top management to retreat from territory-realigning efforts. Leaving territory alignments alone frequently calms fears of sales-force turnover or mutiny among the troops. But in doing so, medtech company leaders leave market opportunities unaddressed and their existing customers inappropriately covered. Figure 2 shows the percentage of unbalanced medical sales territories before and after territory-realignment initiatives. The bars on the left show that high-leverage incentive plans (typical of many commission-based plans) make it difficult to balance sales territories. Incentive plans with lower leverage, on the other hand, have significantly fewer unbalanced territories and therefore offer better coverage of the market.

A Balancing Act

Clearly, the benefits of a good territory alignment are significant enough to pursue, particularly in today's challenging healthcare marketplace. But how can the discrepancy between effective territory alignment and a good incentive plan be resolved?

Perhaps the easiest way for medtech executives to resolve the discord is to make a fundamental change to the incentive plan at the same time that a new territory alignment is being implemented. The following changes have worked well for many medtech companies.

Pay Commission on Sales Growth, Not Total Sales. By paying commissions on sales growth, medtech executives will shift the sales reps' focus from the size of base sales in their assigned territory to the amount of potential in that territory. If a company's territory realignment has balanced potential across territories, executives should be able to convince sales reps of their ability to earn significant commissions, provided they grow their business. Even without a realignment of territories, paying commissions based on growth rather than on total sales may be valuable in its own right. Such plans more closely link the sales reps' pay with their company's growth objectives.

Create a Transition Incentive Plan. After territory realignment, medtech executives should consider creating a short-term incentive plan that pays sales reps a residual incentive based on sales in their old territory, in addition to regular incentive payments for sales in their new territory. While such plans can be complex to administer, they can help ease sales reps' fears about losing credit for upcoming sales that they have in the pipeline. Such plans can also help ensure a smooth transition of customers from one sales rep to the next.

Adjust Salaries. If commissions

are paid as an incentive in addition to salary, medtech executives may be able to make up for commissions lost or gained due to a territory realignment by adjusting their sales reps' salaries. Such an approach requires appropriate salary bands to accommodate any adjustments and assumes that any discrepancies in salary that would be created can be justified.

Provide Conditional Earnings Guarantees Linked to Specific Performance Metrics. Under this approach, the commission-based incentive plan is kept after territory alignment changes are made. For those reps whose territories have been dramatically reduced (lowering their expected commissions), conditional earnings guarantees are put in place to ensure that the reps make at least as much as they earned in the previous year. These guarantees are intended to make up for the lost commissions associated with a smaller territory, but are conditional on the rep meeting certain performance benchmarks. Typical benchmarks include market-share targets, customer-satisfaction targets, and activity targets linked to helping junior reps. It is important that the guarantees are conditional. Without the conditions, offering an earnings guarantee removes any incentive for the rep to work hard to grow sales.

Change to a Goal-Based Incentive Plan. Goal-based incentive plans give company leaders maximum flexibility to realign territories, since goals can be easily adjusted to reflect any changes in territory sales and potential created by realignment. By moving to a goal-based plan while simultaneously implementing a new territory alignment, medtech executives break the direct link between the existing base of sales in a territory and the sales reps' pay. Under such a plan, leaders of medtech companies need to demonstrate to sales reps that they have a chance to earn significant incentive pay (to replace their commissions) if they hit or exceed their goals.

Align Over Time. Sales-force turnover presents the opportunity to change territory alignments over time without significantly affecting existing sales reps' earnings. Large vacant territories can be split, or portions of them given to surrounding representatives who could use more accounts. Small vacant territories can be completely absorbed by surrounding territories. Realigning an entire sales force using such an opportunistic approach will take a long time to accomplish, particularly if the company's sales force has low turnover rates. However, this approach can help to ensure the sales force's buy-in to the changes and improved sales-force morale.

Communicate Clearly. Regardless of the approach taken to implement new alignments and compensation plans, the sales force should be clearly told by senior management why the changes are taking place, and what benefits will be realized by both the organization and the sales force. It is particularly important that first-line sales managers understand the strategy and rationale for change, since they are the people likely to receive most of the questions from the sales reps.

Involve the Field in Key Decisions. Participation builds buy-in. By involving first-line sales managers and sales reps in decisions about compensation and alignment changes, medtech company leaders can improve organizational commitment tremendously. The goal is to make these individuals key messengers in the company's communication strategy. If changes are orchestrated and mandated by management alone, company executives can expect resistance from the field.

Conclusion

In the medical technology industry, the benefits of well-designed sales territories are significant in terms of enabling proper customer coverage and driving sales results. But existing incentive compensation plans may hinder the ability of medtech executives to make the necessary territory-alignment changes. Leaders of medtech companies should keep in mind that recognizing a territory-alignment issue and being creative in addressing the compensation implications associated with a major realignment can lead to higher sales for the company as well as a more motivated sales force.

References

1. A Zoltners, P Sinha, and G Zoltners, *The Complete Guide to Accelerating Sales Force Performance* (New York: American Management Association, 2001), 343.
2. Zoltners, p 136.
3. Zoltners, p 144.

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