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Using "What-If" Scenarios For Predictive Planning

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Introduction

Business is fluid. Trends come and go, fortunes mount and fade and companies are often forced to change accordingly. It can be a daunting prospect, changing the business model, or adjusting lesser aspects of operations—especially when you have a plan in place, but don't ultimately known how it may turn out.

But that uncertainty can be effectively removed when using "what-if" analysis to calculate and forecast exactly how those tweaks will affect the business. This especially comes in handy when planning changes to a compensation plan because of the number of variables involved: plan design, individual performance, territory definitions, quotas and sales force being among the most notable.

How will payout be affected? What about the dispersion of payout? These are some of the most important questions to answer before rolling out any changes—and easily addressed when using what-if analysis. Doing so will enable you to plan more strategically, budget more effectively and mitigate any unintended consequences.

How does it work?

The what-if analysis is essentially a comparison model. It works by taking your historical data, calculating the existing incentive compensation plan and arriving at benchmark results; then it takes a modified version of the incentive compensation plan to compute the forecasted results. If the benefits of the new plan design outweigh those of the old—you've got the go-ahead to incorporate. But if it's the other way around, you can go back and continue to retool until you get the desired results.

The best part is it's a planning exercise: Nothing is set hard and fast, allowing you go back and make it work.

To make the comparison through what-if analysis, you change the myriad variables that dictate outcomes: pay mix, performance measures, crediting rules, timing of credit, territory definitions, quotas, payout curve and caps or decelerators.

Using all the variables and tools at your disposal will help to refine the plan to ready it for implementation.

Doing so results in changes to overall payout and compensation costs—which will either increase or decrease—and reveal whether participation and payout dispersion will be optimized. It recognizes any windfalls, determines if pay is correlated to the right measures and ensures the right individuals will benefit from the modified structure.

Once the formulas have been computed and you have two sets of comparable data, examine where the deviations lie. Is payout greater or less than expected? More or less dispersed than imagined? What exceptions exist?

Using all the variables and tools at your disposal will help to refine the plan to ready it for implementation.

Beware the pitfalls

What-ifs are critical to projecting the feasibility and success of a plan, and they do so efficiently. But sometimes, there are still actions to take outside merely switching variables here and there—or else the scenarios envisioned may not come to fruition.

There are four common pitfalls. The first is not appreciating the fact historical data might not be relevant. As was set out, businesses change, and sometimes, using historic data that is sure to be outdated as your business performance shifts—for better or worse, or just becomes different—will affect your outcomes. The remedy to this is simply, modify a copy of the historical data to get a clearer picture of how the compensation structure change will perform in the future.

Another is using estimation data as the modified data because the initiative is still in its infancy stages. Now, there's nothing wrong with using estimation, but companies often dream big and distort the picture with unrealistic data. Keep your estimations ambitious, but also grounded in reality.

Basing your strategy off just one scenario won't bring the results you want.

There's no such thing as one-and-done in what-if analyses. And basing your strategy off just one scenario won't bring the results you want. There are a multitude of factors to consider, all of them interconnected, and it behooves you to imagine each scenario possible using the analysis—you don't want to corner yourself with just one run-through.

Finally, there are the problems that occur when one rushes to conclusions when, say, payouts change—and subsequently err in identifying the responsible factor. If even off in the slightest, changing the wrong variable can tank a scenario. To rectify this, do the due diligence; examine all the relevant data and individual payouts. The what-if analysis is a planning tool, so use it to its fullest extent to make sure your own plan will work.

An example

Let's take an account executive role, someone who is responsible for selling new contracts as well as the retention of existing ones, and assume there are 22 of them on a team. The goals of the compensation plan the company desires is to drive new sales, increase payout differentiation on the retention measure and keeping costs unchanged.

The changes envisioned are:

- Increasing commission rate from $10 per member to $15
- Decreasing target incentive on retention from $35,000 to $27,500

- Making the retention payout curve steeper by
  - Moving the retention threshold from 70 percent to 75 percent; and
  - Paying 200 percent of target incentive at 95 percent retention, instead of 150 percent

Under the current conditions, 71 percent of total payout was dedicated to retention, while only 29 percent went to new contracts. But just as the company wanted, the new structure puts 41 percent of payout toward new contracts, reducing retention's share to 59 percent.

Further examination reinforces just how essential it is to dive into the data and not take it at face value.

Indeed new contracts are being rewarded, but is it driving them more? Surprisingly so, the correlation between new contracts and and total payout decreased by 1 percent to 28 percent under the new plan. This further examination reinforces just how essential it is to dive into the data and not take it at face value.

Now, on to payout differentiation. Retention payout according to the existing plan paid $52,500 to the 90th percentile, $35,000 to the median and $23,333 to the 10th percentile. The object is to increase that differentiation—reward high performers and pay less to low performers—and that comes through in the new system. The 90th percentile is paid $55,000, median gets $27,500 and the 10th percentile is paid $13,750.

But the ultimate question is will cost be unimpacted. Total incentive compensation payout according to the standing structure totaled $1,040,413; under the new scenario, that cost would mildly increase to 104 percent of the current cost to $1,081,995, meaning that cost would relatively remain the same.

So the result is a new structure that satisfies most of the objectives set out in the initial plan—driving new sales (though not directly), rewarding high performers and maintaining cost. Still, this plan can be tweaked more—as it is slightly risk averse—allowing the company to visualize new and exciting scenarios.

Why not to what-if?

Sales performance management solutions are integral to shaping new initiatives in compensation—with their use and benefit particularly shining through in the planning stages of such rollouts.

The tools are at your disposal, the keys to the future success of your new compensation plan—and in a more broad sense, your business—lie in utilizing the what-if analysis to its greatest extent. That means tweaking variables, running scenario after scenario and judging their fit, even if you feel comfortable after just a couple spins.

Without proper preparation and planning in such endeavors, the outcomes may be murky, and even worse, to your detriment. But by using what-if analyses, you'll know what to expect and how things will shape out exactly as you planned. Just always be constantly aware of those pitfalls, and most of all—have fun with it.

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