A Look Inside Incentive Compensation: Pharma Leaders Discuss Changes, Challenges, Choices

"We are faced with the challenge of delivering innovative compensation design that also reduces cost of operations."

That statement, from a compensation director at a major pharmaceutical company, sums up the critical business objective at many pharmaceutical companies. Their sales operations group and compensation directors are challenged with designing incentives to motivate sales to greater results while simultaneously delivering more administrative efficiencies and lower costs.

To better understand the impact of this objective, marketRx, a Cognizant company, recently held in-depth, one-on-one conversations with compensation directors at 20 leading pharmaceutical firms ranging in size from small to large. Some participants were clients; others were not. While exchanging ideas and discussing key issues, they spoke candidly about the changes their industry is undergoing; the challenges change is creating; and the choices they are making to turn today's compensation challenges into opportunities (see methodology, page 6).

In this paper, we present an overview of thoughts and ideas that emerged from these discussions in hopes of stimulating an industry peer-level dialogue about the critical factors influencing incentive compensation programs.

Most Influential Trends

The Changing Selling Model

- Regulatory issues, access constraints and increased influence of other marketing mix channels challenge value proposition of sales representatives
- Compensation plans must be flexible to accomodate tomorrow's fundamental changes, while balancing between simplicity and equity
- Industry practice on ratio of base vs. performance pay might change, and increased consolidation will lead to fewer large incentive payouts

For compensation directors the overarching goal remains designing fair and motivating incentive compensation plans that align with business goals. Yet to be effective these plans, and processes and systems underlying them, must have foundations flexible enough to accommodate the clearly evident evolution in industry sales channels and practices.

That evolution is most obvious in questions industry professionals raise about the effectiveness of sales representative efforts in the face of access constraints, regulatory issues and other market forces, see Figure 1:

The IC Conundrum

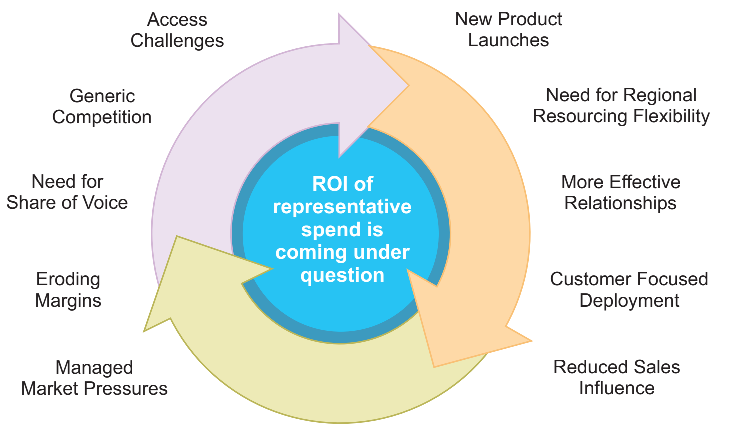

FIGURE 1

- Evolving market dynamics, federal and state regulatory actions, and demands on physician time are directly affecting how sales representatives may sell. In some states and regions, directors noted that physician access remains an issue, and this limits the number of visits their representatives can make. In addition, more physicians are opting to block access to their prescription-writing data, eliminating a source of sales intelligence. Similarly, in certain states, current or proposed regulations completely block physician level data.

- Other marketing-mix channels like DTC, speakers at professional conferences, KOLs and journal spend clearly are influencing sales in certain therapeutic areas, and these channels are finding increased adoption among physicians. That then calls into question how much influence individual sales representatives have over prescriptions, and how to separate their influence from that of the other channels in the promotion mix. Such factors are leading to a perceptible decline in the return on investment in representative selling.

- The fact that the sales representative model is arguably less effective, yet still necessary, makes compensation design increasingly difficult. The industry is seeing a struggle with the appropriate composition of the pay mix (base pay to incentives ratio), with current consolidation and cost control moving the needle towards reduced incentives. Further, they expect legal and regulatory compliance requirements to eventually stifle their ability to create innovative compensation incentives. Further it is noteworthy that in certain deployment designs, like mirrors, pods or differential resourcing, it becomes difficult to measure impact attributable to an individual.

Increasing Compensation Complexity

- Plan changes will continue to occur with greater frequency
- Quota-based compensation plans will see increased adoption
- Plans will require increasing complexity to be fair and effective, presenting hurdles for effective communication of plans to participants

Given the macro environment, including ongoing acquisition and right sizing, the industry can expect to see still-higher velocity of changes to compensation plans with pressure to swiftly adapt them to changing market realities as they emerge.

Directors say they are likely to require specialized treatment in the base plan to account for regional market, regulatory and compliance issues. They are emphatic that a single simple design will not fit their entire sales organization, and this poses a threat to harmony in plan design across sales divisions.

They are especially concerned about creating fair compensation plans that will help them retain and reward their best representatives, yet reflect the power of new influencers.

- To that end, the directors were very positive about the merits of quota-based compensation plans. They note such plans score well on fairness measures and are more motivating. At the same time, they voiced concerns about volatile or inadequate brand forecasts. In our extensive experience with plan design templates, we see adoption swinging from quotas to forced rank based design in extended 5-7 year cycles. At this point we see a renewed surge in quotas based designs.

- Directors say while rank-based plans promote competitive behavior, and are implemented with a lower total cost, and have other advantages, such as a fully divided compensation pool with no overflow and a simple design, these plans will likely face decreased adoption due to increased managed care influence and access issues, particularly in companies whose products face diverse market environments.

- Directors also see current compensation systems (including installed on-premises solutions or home-grown systems) becoming increasingly obsolete in the face of new complex requirements.

Regardless of the plan design that is in line with their compensation philosophy, plans necessarily will tend to be more complicated in order to introduce more equity and fairness. This trend is in conflict with the need for plans to be simple, for sales representatives to understand and be motivated by. A well-designed plan clearly should accommodate many variables, such as product lifecycle, market, selling model, access and environmental constraints. All of these variables today have become increasingly complex.

The added challenge for the industry is that while market structure and conditions require more complex plans to account for such variables, these now must be implemented within tighter budgets and cost constraints.

Obstacles to Overcome

In addition to the powerful trends affecting compensation strategies, there are equally potent industry and internal obstacles that compensation directors must overcome or navigate around if they are to create incentive compensation plans that lead to increased sales at lower costs, see Figure 2.

Data Dramas

- **Availability and accuracy of sales data does not always and consistently meet planning and payout requirements**
- **Adequate managed care consideration for IC needs remains elusive**
- **Contingency planning is on the rise**

Obstacles to Overcome

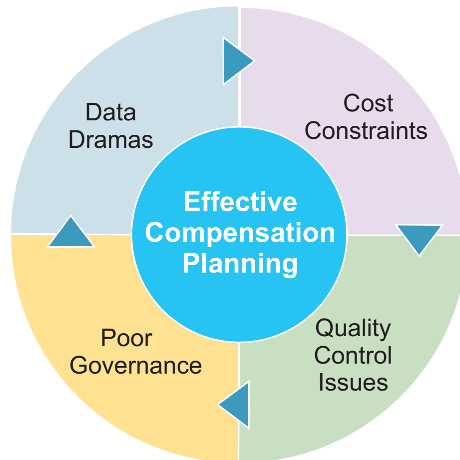

FIGURE 2

Compensation directors repeatedly cited issues relating to the availability and accuracy of syndicated prescription sales data. These are the key sources of incentive compensation planning data, yet directors say they lack confidence in the validity of the data supplied:

- There continues to be concern about whether the data is accurate and consistent. The directors emphasized their need for strong, validated data, particularly at regional/territorial levels.

- Valid data will be an increasingly important requirement because directors expect plans and quotas to be altered mid-cycle, more frequently than in the past. Compensation groups are under increasing pressure to avoid situations in which sales representatives are paid on the basis of inaccurate data.

- To this end, directors expect to retain in-house validation teams, even if they outsource other compensation functions.

Managed care as related to compensation plans remains problematic. The industry does not have standard practices yet to resolve how to address the impact of managed care on sales representatives' results. The lack of readily available data considered trustworthy for compensation is a main factor behind this challenge, leading some firms to adopt a feedback process for cleansing such data.

Given the inherent issues in their planning data, compensation directors are increasing contingency planning, and are making such planning more formal. They are widening the scope of contingency planning from natural disasters to now include items like sales data pervasive adjustments or managed care win/loss adjustments. However, we duly note that only organizations with mature IC governance processes will be able to adequately execute their contingency plans when needed.

Cost Constraints

- **Outsourcing models are gaining adoption, as they continue to improve quality at lower costs with increased ROI on spend**
- **Variable cost models will increase**
- **Cost control measures lead to tougher vendor product scrutiny, demands for transparent pricing**

Within firms, sales and marketing operations is under pressure to justify their results versus their headcounts. To accomplish this, many are considering variable cost models to augment staff at peak loads, and outsourcing of key processes, including IC.

- The variable cost models especially would affect staffing. Some positions might be eliminated or reduced, with temporary staff brought in for capacity only at peak times, such as at product launches, year end or quota setting periods.

- Many directors say they will shift from using in-house teams to some form of an outsourcing model, not simply to reduce costs but also to gain technology and process advantages, and industry best practice advantages vendors bring. As other internal support departments, such as information technology and information systems management come under cost pressure, directors expect them to be less likely to have the resources required to manage increasingly varied and complex incentive compensation plans.

- Functions that continue to be outsourced include plan design, quota setting and refinement, administration and payout. Some compensation directors suggested they could outsource some of these processes (sometimes with multiple vendors) and retain others in-house, though they are concerned about multiple vendors' ability to integrate data in such scenarios.

  Others would prefer fully outsourced operations, while at the other end of the spectrum, some directors still prefer to work with an on-premises solution behind their own firewall. Some directors are intrigued by the on-demand and Software as a Service (SaaS) models, in which their vendor would host an incentives management solution that employees could access over the Web, see Figure 3.

- With compensation teams coming under increasing pressure to reduce cycle times from plan design to production, industry professionals today want to be able to access the system for modeling, what-if analytics or ad hoc reports when they choose, but prefer to have the vendor manage administration functions.

With rising cost constraints, we see the industry moving into a phase where there will be increased focused on managing the predictability of outsourced program costs. Compensation directors will be investing in upfront due diligence to understand vendor

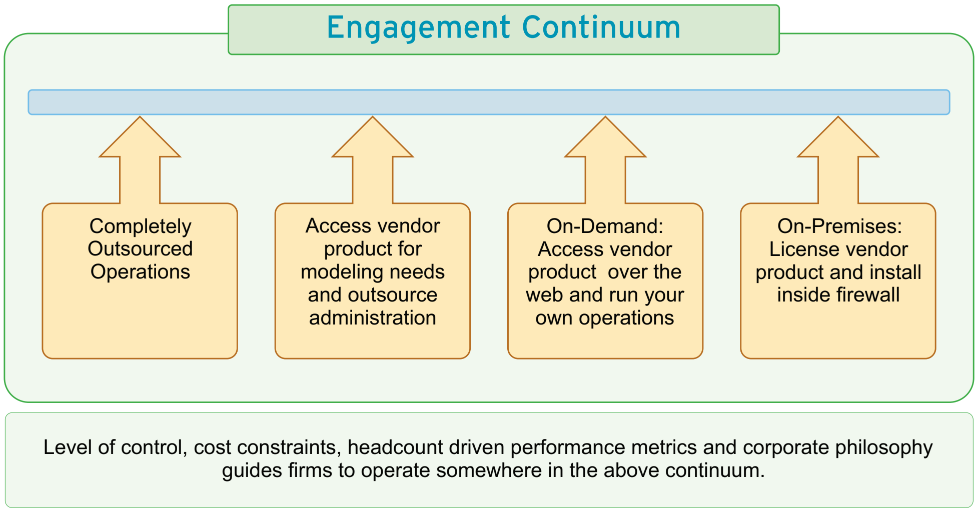

FIGURE 3

capabilities, and product flexibility to handle plan changes, implementation and hidden fees, while their sourcing group will demand more price transparency.

IC Governance

- **Governance of IC, award and recognition programs has not fully matured**

In spite of the importance of this key element, directors across the board maintain that governance remains elusive and poor, with business units continuing to exert inordinate influence on plan designs and SPIFs/contests. Further, the industry does not have a platform or forum to share and reference best practices to assist IC teams and to standardize deliverables. Directors contend this standardization would reduce costs and streamline vendor offerings.

Directors also complained about the extensive time staff spent on field investigations, citing this as one of the prime areas in which to introduce governance.

Quality Control

- **Vendor quality control must improve**

Given the complexity they expect their plans to contain, directors insist their vendors must do more to "get it right the first time." They point out that many well established vendors nonetheless have continuing quality control issues, and directors are impatient for this to be resolved.

Their major point of pain occurs when vendors incorrectly apply business rules or data overrides that lead to inaccurate payouts to the field, or do not fully account for organization or participant changes. Such errors can lead to time- and effort-wasting shadow accounting, create mistrust and hurt morale. Incorrect rules applications also create additional costs as errors are discovered and investigated, leading to a re-run of payouts and reports.

Given that directors expect to adjust sales force deployment and structures, as well as alter plans and goals more frequently, they are concerned about vendors' ability to support such flexibility. The directors need and expect vendors to accurately simulate and administer mid-cycle changes and updates. Such support will be critical to the directors' ability to manage plans successfully, to increase motivation and sales while reducing costs.

Join the Discussion

Would you like to hear more from these discussions about the trends and challenges reshaping incentive compensation in our industry? Cognizant marketRx is creating a variety of forums in which you can connect with peers to share insights and ideas.

To us, such efforts are an integral part of our role as a trusted advisor to our clients as well as a provider of a full spectrum of incentive compensation services, from design analytics to quota-setting to incentives administration.

To learn about how you can participate in these and similar industry conversations to gain valuable, practical information, please contact Nik Jasuja, project manager of our Cognizanti eCommunity, at *cognizanti@cognizant.com* or (201) 916-7643.

We look forward to hearing from you.

Methodology

Cognizant's marketRx is grateful to the compensation directors who participated in this study. We held a series of discussions with 20 compensation directors from large, medium and small pharmaceutical and biotech firms, with the objective of validating and discovering key current and emerging trends that are shaping our industry. While being guided by a structure, the one-on-one interviews were held in an informal setting with open questions to stimulate free exchange of ideas. Views from any particular director have been kept confidential, and this paper interweaves Cognizant marketRx viewpoints with those of these leading industry professionals.

About marketRx, a Cognizant company

Cognizant's marketRx combines analytics, technology and market research to provide solutions that enable our customers to improve returns on their sales and marketing investments. We deliver measurable and actionable results that significantly improve the performance of product portfolios and sales forces.

Our Incentive Compensation practice is focused on meeting needs of Life Sciences companies with our proven capabilities in plan design analytics, quota setting and incentives administration. Leveraging our global delivery platform, we have managed IC programs, including plan and quota design, for large, medium and small pharmaceutical firms, with relentless focus on improving the ROI on their incentives spend.

At the heart of our practice is iComp®, a Web-based incentives lifecycle management system, with integrated workflows supporting modeling and simulations, quota setting and refinement, objectives setting, and administration of incentive plans and SPIFs.

Our customers gain exceptional value from lower and predictable total cost of ownership, ISO 9001 certified quality processes, significantly reduced implementation and production cycles, fast response to changes, SOX compliance, and completely secure Web access to reports.

About Cognizant's Life Science Practice

Cognizant's Life Sciences Practice partners with 27 of the top 30 global pharmaceutical/biotech organizations in addition to serving companies in the medical devices, CRO and life sciences product sectors. Cognizant's passion is in our focus to help life sciences organizations navigate today's dynamic healthcare environment by delivering high value business-enabled solutions through our business process outsourcing and information technology solution offerings.

About Cognizant

Cognizant (NASDAQ: CTSH) is a leading provider of information technology, consulting and business process outsourcing services. Cognizant's single-minded passion is to dedicate our global technology and innovation know-how, our industry expertise and worldwide resources to working together with clients to make their businesses stronger. With more than 40 global delivery centers and approximately 59,500 employees as of September 30, 2008, we combine a unique onsite/offshore delivery model infused by a distinct culture of customer satisfaction. A member of the NASDAQ-100 Index and S&P 500 Index, Cognizant is a Forbes Global 2000 company and a member of the Fortune 1000 and is ranked among the top information technology companies in BusinessWeek's Hot Growth and Top 50 Performers listings.

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