



## A New Framework for Incentive Management

### Executive Summary

Incentive management systems are complex applications that help auto manufacturers plan and launch multiple marketing campaigns targeted at dealers at the regional, national and international levels. Using configurable rules, an incentive management system enables auto makers to offer discounts that help generate demand for select vehicles. This white paper lists various elements of an incentive management system and discusses how these components interact with each other. The overall incentive management framework described here can provide useful inputs to auto manufacturers that are planning to establish or enhance an incentive management system. It draws upon industry standard practices and highlights various regulatory and compliance issues that must be considered while conceptualizing an incentive management solution.

### Incentives Primer

Auto manufacturers offer various kinds of incentives targeted at customers or dealers to keep vehicles moving in their value chain. The overall incentive amount per vehicle that a manufacturer can offer depends on various factors. A mix of historical data, inventory levels, market elasticity of demand and product pricing helps manufacturers determine the optimal level of incentives.<sup>1</sup>

Dealer incentives can be cash-based or non-cash-based. Cash-based incentives generally cover dealer holdbacks and vehicle discounts.

- **Dealer holdback:** This is a percentage of either the MSRP (Manufacturer Suggested Retail Price) or invoice price of a new vehicle (depending on the manufacturer) that is repaid to the dealer by the manufacturer. The holdback is designed to supplement the dealer's cash flow and indirectly reduce "variable sales expenses" by artificially elevating the dealership's paper cost. Manufacturers such as Ford, General Motors and Chrysler generally offer dealers a holdback equaling 3% of the total sticker price of the car.<sup>2</sup>
- **Cash incentives:** Manufacturers use various marketing campaigns valid for a fixed time-frame. If the dealers sell cars that are eligible under a given campaign, then they are paid an incentive for each car sold. Manufacturers also set up dealer targets that, if exceeded, can result in the dealer receiving higher discounts per vehicle.<sup>3</sup>

Years ago, dealers purchased vehicles at some discount (15% to 17.5%) from the manufacturer.<sup>3</sup> The margin that each dealer made was dependent on its ability to negotiate a price with the end customer. Now, incentives have become the key source of income for dealers, and these incentives are contingent on the achievement of sales targets. As dealer incentives have become a key enabler for auto sales, it is imperative for any auto manufacturer to have control over the incentives outflow associated with its marketing campaigns.

To manage incentives accurately, auto makers need a robust incentive management system (IMS). An IMS can improve the accuracy of claims/payouts and enhance the effectiveness of campaigns.

### Typical Incentive Management Models

Organizations can follow various models for calculating incentives and making payments to dealers. Primarily, there are two different models used by organizations:

- Model 1: Dealer receives incentive through the claims settlement process.** In this model, dealers are responsible for the submission and tracking of claims (see Figure 1). If they have a query related to the claim/status, they can raise it online. The manufacturer's accounting system receives various claims and sends back confirmation to the dealers about the claims. It also provides dealers with regular updates about the status of the claims as they flow through the accounts payable process.

### Incentive Payout: Claims Settlement Process

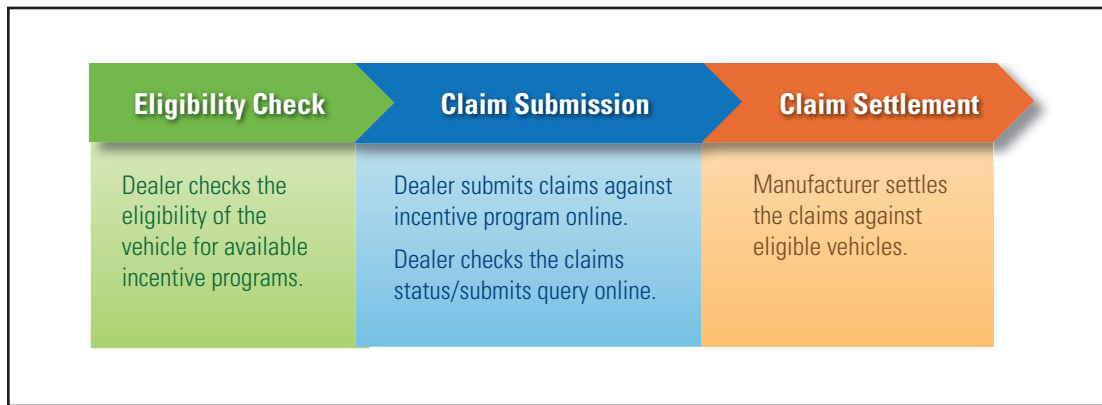


Figure 1

- Model 2: Manufacturer determines the eligible vehicles and releases payments for dealers associated with the vehicles.** In this model, the manufacturer checks the details of the vehicles in the supply chain and identifies those vehicles that are eligible for incentives (see Figure 2). The incentives against these vehicles are then calculated based on the rules defined during the campaign launch. The payment information is sent to the accounting team, which makes payments to the dealers. The dealer also receives regular updates about the payments already made and the pending payments.

### Incentive Payout Calculation & Settlement

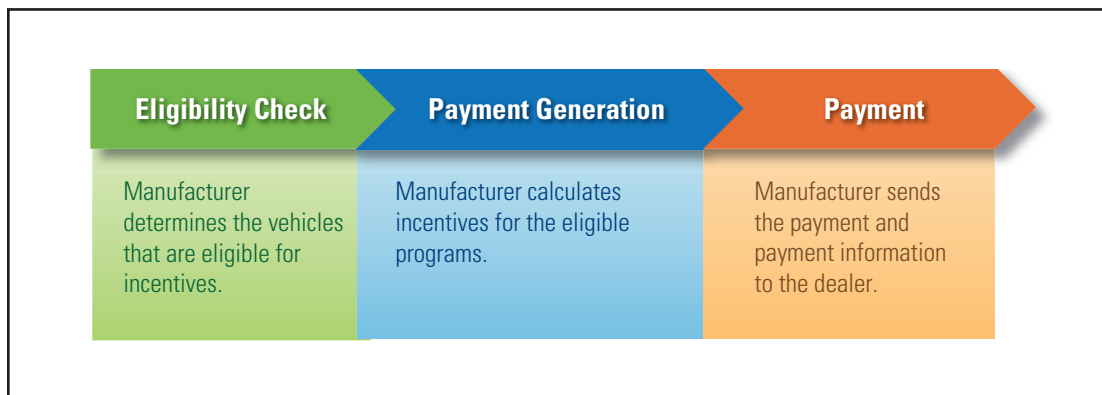


Figure 2

The incentive provided by the manufacturer to the dealer is generally not advertised.<sup>4</sup> However, there are Web sites that provide information about dealer incentives to customers, such as Edmunds.com, cars.com and others.

### Key IMS Drivers

Over the years, incentive management systems have become necessary for auto manufacturers. Some of the functions IMS systems fulfill include the following:

#### Enable launch of marketing campaigns

Incentive management systems provide manufacturers the ability to configure various kinds of campaigns and control the incentive outflow associated with them. The U.S., Japan and many European countries have introduced large-scale scrappage programs during the global recession that began in 2008<sup>5</sup> as an economic stimulus to increase market demand in the industrial sector. As many of these programs have ended, manufacturers will have to plan their marketing campaigns to prevent sales from declining while remaining profitable at the same time. Recent recalls<sup>6</sup> of vehicles by various manufacturers have only necessitated the need for new campaigns, to prevent a further sales decline.

#### Support launch of new vehicle models

The prolonged global recession is causing manufacturers to rethink their product portfolios. As a manufacturer develops and launches new models into the market, a well-designed and executed incentive management system can enable it to configure its marketing campaigns, as well as calcu-

late the incentives to be paid to each dealer based on vehicles sold.

#### Prevent revenue leakage

When multiple campaigns are running, it is possible that a given vehicle is eligible under more than one campaign. Hence, net incentive outflow can be more than what the organization may have anticipated. By using an IMS, it is possible to cap the level of incentive on a given vehicle. IMS helps in accurate calculation of incentives based on pre-set rules, thereby ensuring that only the right level of incentives is paid to dealers.

#### Achieve regulatory compliance

Incentives outflow from the organization can add up to several billions of dollars per year. As these are financial transactions, auto makers need clear workflow processes with checks and controls to ensure Sarbanes Oxley (SOX) regulatory compliance.<sup>7</sup> Incentive management systems are typically SOX-compliant applications that provide checks and approvals for the launch of a marketing campaign or release of payments.

### Cognizant Incentive Management System Framework

Over the years, we have worked with leading automotive manufacturers in the incentive management area, enabling them to optimize their incentive spend, stimulate sales and improve process efficiencies and control. Based on our industry knowledge and experience in the incentive management area, we have developed a framework that helps auto manufacturers either enhance or set up a new incentive management system (see Figure 3).

## Enabling IMS

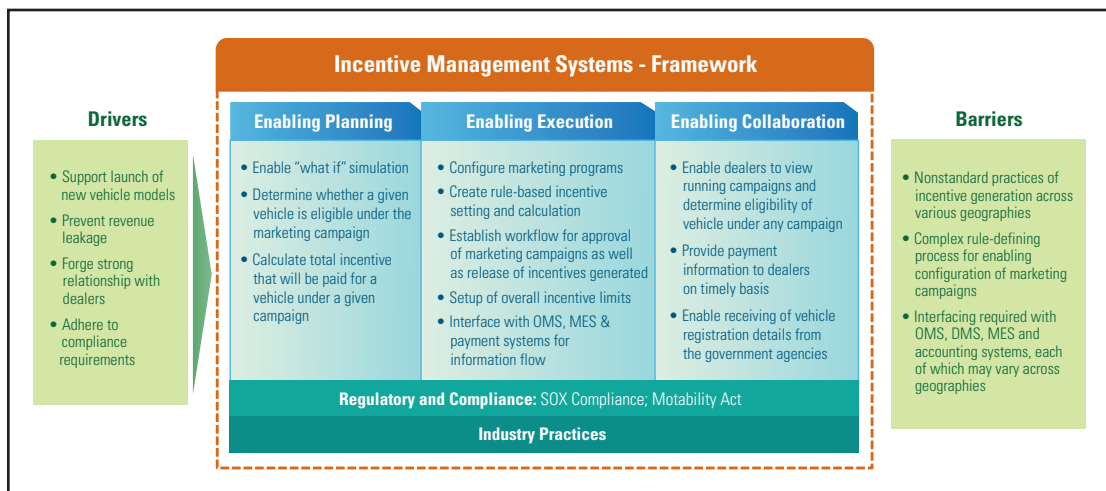


Figure 3

This framework outlines various components, as well as key barriers and enablers of an incentive management system. It is based on the industry practice of a manufacturer determining the eligible vehicle and generating incentives for dealers (see Figure 2 on page 2).

#### Enabling Planning

A planning module is required to carry out a financial assessment of any given marketing campaign. Typically, these are simulation tools with the ability to carry out a “what-if” analysis. Business rules engines available in the market have these features built into them. They can determine which vehicles will be eligible if the campaign is launched and also calculate the incentive outflow associated with it. The simulation results can lead a manufacturer to apply a maximum incentive cap or make adjustments to the incentive level and scope of the campaign. Thus, IMS can add great value in the planning of a marketing campaign.

As dealer incentives have become a key enabler for auto sales, it is imperative for any auto manufacturer to have control over the incentives outflow associated with its marketing campaigns.

#### Enabling Execution

This module deals primarily with the configuration of the marketing campaign based on multiple conditions that must be approved to roll it out. By setting up a rule-based incentives offering, manufacturers can motivate dealers to push harder to sell select vehicle models.

- **Configuring marketing campaigns:** IMS should allow campaigns to be configured based on multiple parameters like vehicle, vehicle model, geography, retail date of vehicle, etc. It should also provide flexibility to adjust incentive levels based on various conditions. Sample scenarios include:
  - If dealers achieve sales targets or exceed them for a given period, then higher discounts on each eligible vehicle are provided.
  - If a dealer orders or sells select vehicle models within a given time period or geography, then a higher discount on each eligible vehicle is offered.

The execution of the campaigns is facilitated by the rules engine (third party or custom), which is one of the key components of the IMS. Already, a number of third-party business rules engines are

available as COTS (commercially off the shelf), which can execute the defined rules in run time.

- **Workflow for the launch of campaigns:** An incentive management system should enable a workflow for launching and executing any marketing campaign to help organizations remain SOX compliant.<sup>7</sup> A huge cash outflow associated with the marketing campaigns is at stake, so it is necessary that checks and controls are applied to the process of dealer payments. As a best practice, both the marketing and finance teams should get involved in campaign approval, as well as payment release.

If the existing process does not contain adequate checks and balances for incentive generation and approval, these roles will have to be defined and the key resources must be identified for performing each of these roles.

- **Interfacing with other systems:** Incentive management systems need inputs from the vehicle order system (dealer, customer, vehicle make and model, etc.), the manufacturing system (order status and other detail), as well as accounting systems (vehicle prices and other information).

#### Enabling Collaboration

- **Collaborating with dealers:** Dealers need provisions for confirming whether a given vehicle sold by them will be eligible for a discount under a given campaign. IMS should have a provision for providing this information to the dealers online. Dealers also need information about the payments that have been released by the manufacturers against the vehicles. Standard reports can also be provided to the dealers in a timely manner. Some dealers also require an interface with the incentive system for receiving information in their dealer management system.
- **Collaborating with vehicle registration authorities:** Incentive management systems should interface with the registration body of the government for receiving vehicle registration details. This can help dealers, as they would not have to complete the task of getting vehicles registered.

#### Compliance and Regulatory Issues

- **Sarbanes Oxley compliance:** As per section 404 of the SOX Act, “Issuers are required to publish information in their annual reports concerning the scope and adequacy of the internal control structure and procedures for

financial reporting. This statement shall also assess the effectiveness of such internal controls and procedures.”

As incentive management systems result in a significant amount of cash outflow from organizations, they must comply with the SOX Act. These systems must have sufficient business and system control over the entire process, from campaign launch, to configuration in the system, to payment release to dealers.

- **Other regulatory issues:** There are various other regulatory acts that need to be considered to ensure the solution addresses all requirements. An example is the Motability Act<sup>8</sup> in the UK, which helps people with disabilities acquire a vehicle. The disability allowance that is paid to the customer by the government is directed toward the payment of the lease amount of the vehicle. Customers obtain vehicle leases at substantial discounts.

### Key Barriers for the Incentive Management System

- **Non-standard practices of incentive generation across various geographies:** The recent spurt in merger and acquisition activities in the automobile industry following the recent financial meltdown has created a situation where newly formed entities must rationalize differing processes for incentive generation across all business units/geographies. To implement one single incentive management system that can address the unique requirements of each region requires complex rules defining process and careful designing of the system.
- **Non-standard systems across geographies:** Incentive systems require inputs to the order management system, vehicle information system and various other systems. The incentives are generally paid to dealers through the accounting system. Integrating all these applications into one cohesive unit requires careful planning and a degree of standardization across

geographies. If the organization has not standardized its processes and systems, implementation of an IMS can become cost prohibitive.

### How Cognizant’s Framework Helps

Our framework can aid in performing a high-level assessment of a manufacturer’s incentive management system to unearth improvement opportunities across planning, execution and collaboration areas. It can also help auto manufacturers understand the key benefits that can be realized by implementing an incentive management system, as well as the potential barriers in adopting this solution. For example, we have leveraged this framework in an engagement with one of the world’s largest U.S.-based automotive manufacturers. We have been able to provide significant improvements to the efficiency and transparency of its incentive management process. Also, the engagement created a greater level of collaboration with dealers, which resulted in a reduction in payment-related queries from dealers.

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### Where the Rubber Meets the Road

Incentive management helps auto manufacturers push vehicles out of their inventory. By improving the accuracy of claims/payouts, preventing revenue leakage and enhancing campaign effectiveness, incentive management systems play a vital role for automobile manufacturers. Incentive management systems can also enforce the checks and balances required by the manufacturer to achieve compliance with government regulations. Our incentive management framework can be of great value in enhancing an existing incentive management system or helping an automaker create a new system.

## Footnotes

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- <sup>5</sup> Wikipedia, [http://en.wikipedia.org/wiki/Scrappage\\_program](http://en.wikipedia.org/wiki/Scrappage_program)
- <sup>6</sup> <http://www.dft.gov.uk/vosa/apps/recalls/searches/search.asp>
- <sup>7</sup> Sarbanes-Oxley Act, Section 404, <http://www.soxlaw.com/s404.htm>
- <sup>8</sup> "How the Car Scheme Works," Motability, <http://www.motabilitycarscheme.co.uk/main.cfm?type=CHSW>

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Tim Gutowski, "Explaining Dealer Incentives," cars.com, <http://www.cars.com/go/advice/Story.jsp?section=inc&subject=incent&story=incDealer>

## About the Author

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## 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 over 50 global delivery centers and more than 100,000 employees as of December 1, 2010, we combine a unique global delivery model infused with 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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