

## Step 7: Budget

Budgeting of open-ended programs.

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### *Open-Ended Approaches*

To simplify budgeting, many planners use a closed-ended or a tournament approach that sets a fixed budget by awarding a predetermined number of people. While this approach provides predictable results for the accounting department, it fails to profit from the inherent advantage of open-ended programs: the ability to pay for performance. Although an open-ended approach is harder to predict, an open-ended program is more motivational by reaching out to a broader audience and creating a much greater link between program costs and outcomes. A properly structured plan will result in expenses that are in direct proportion to performance. To develop a budget, here are some general guidelines.

#### *First Define Fixed Costs*

Set up the program so fixed costs consist primarily of strategic planning, communications, training, and tracking and administration, and that your rewards and recognition are based on incremental performance generated by participants, customers, channel partners or employees.

You might want to allocate some portion of a project manager's pay to the program as an overhead expense or include allocations for any technical help required for setting up your measurement system, printed communications, Web work, training, meetings, promotional products and performance improvement/incentive company fees. Generally, these expenses account for about 20% of overall program costs. If you've got a closed-ended component to your program (for example, a fixed number of top performers will receive designated awards) then indicate this award pay out as a fixed cost.

### ***Establish Return On Investment Measures***

Return-on-investment measures can help you determine how much to pay out in awards, but companies generally budget top awards to equal about 3% to 5% of a recipient's annual earnings to get attention. Under this scenario, only about 20% of the program's budget has a fixed cost; the rest varies based on performance improvement.

Open-ended programs can be more difficult to budget because how much you spend depends on how much individuals or groups perform, which no one can accurately predict. On the other hand, your budget only goes up if your results go up, and if your program is structured correctly, you won't pay nearly as much for your program if results fall short than you would if they exceed your expectations.

Most other marketing options have a fixed cost no matter what the outcome. Closed-ended programs are easy to budget because you set the predetermined number of winners, but that also may mean you'll pay full freight for your program even if you don't achieve your objectives.

### ***Budget Open-Ended Programs On Best Case Scenarios***

The budget for your open-ended program should be based on a best-case scenario, e.g., performance went up as forecast and a large proportion of your audience achieved some level of incremental performance warranting an award. The following provides a step-by-step guide for best-case scenario budgeting of open-ended programs.

### ***Determine the Award Values Based On Improvement***

Determine what you are going to spend for rewards and recognition based on unit or dollar performance improvement. Many companies allocate 5% to 10% or more of the value of incremental improvement to rewards and recognition because a greater percentage of incremental gains normally fall to the bottom line than your base line of output. (Not only do most companies make more profit on incremental business, but the ability of current employees to function more productively decreases the need for future hires.) This process will enable you to establish an arbitrary cost per unit of improvement.

**Example** -- For the first \$1,000 in incremental performance, a salesperson will get points worth \$50; for the second \$1,000 increment, a salesperson gets an additional \$75 in points.

In this example, you could arbitrarily budget \$60 per \$1,000 in improvement, assuming some people do better than others.

In the case of an office machine service contractor, the first unit improvement in the number of calls successfully completed per week over the company benchmark is worth \$10 in points, the second is worth \$12 and the third is worth \$15. As in the sales scenario, you can safely assume that each unit of increased performance will cost on average \$12, taking into account the influence of top performers on the average.

***Set Up An Award Spreadsheet To Estimate Costs***

Use any spreadsheet program to run your forecast scenarios. This would show your baseline data and new forecasted data multiplied by the award value per unit. This is the simplest way to forecast costs. If you want a more detailed template for cost analysis, set up a spreadsheet showing the same information by person or group so that you can make more granular forecasts based on your estimation of individuals or groups.

***Run “What If” Scenarios***

Using your spreadsheet, run three forecasts: one showing a best-case scenario, another showing a moderate increase in performance and one showing only a small increase in performance. If you’ve done the more detailed template broken out by employee or group of people, you’ll get a much more precise level of forecast.

***Example -- Under the above sales scenario, if sales go up by \$100,000, the program will cost \$6,000 in awards. If they go up by \$50,000, they will cost \$3,000.***

In the example above, the number isn’t precise, but it’s as close as you’ll get in just about any other type of business forecast. Similarly, in the case of an office machine service contractor, if you forecast 50 units of improvement in service calls made, you budget \$600; if you forecast 100 units, it is \$1,200.

***Use The Safest Estimate***

Generally speaking, management wants reliable forecasts and programs with a good cost-benefit ratio. Since the cost of incentive programs should directly relate to performance, at least more so than most other marketing and sales tactics, it pays to err on the high side in terms of costs and—as every budgeter knows—err on the low side in terms of performance improvement.

***Add To Fixed Costs To Get  
The Total***

Take the safest bet on award costs and add it to your fixed costs to come up with your budget.

***Find The Funds***

In the sales and marketing arena, budget dollars come out of general sales and marketing funds and compete with other business development tactics, such as advertising, direct marketing and trade shows for organizational resources. Today, it has become increasingly possible for resellers to get co-op dollars from manufacturers for incentive programs that promote specific products.

Some companies add a small allocation per unit of product sold, especially for channel partner programs. In the human resources area, many companies have budgets for rewards and recognition. However, an incentive program differs from pure recognition in that it intends to drive a specific behavior with a measurable benefit; therefore, it's actually a productivity tool and can be viewed as a potential cost saver, rather than a fixed cost.