A Rough Guide to Incentive Program Budgeting

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At the highest level, incentive program budgets are factored according to the number of participants, the duration of the program and the value to the company of anticipated results (both tangible and intangible). Tax features as well. This rough guide offers a point of departure for calculating realistic budget projections.

Projecting value
As a general rule, total expenditure on your program should be proportionate to the value generated by improved performance. Sales-related program budgets may be roughly calculated according to these incentive industry guidelines:

- Total Sales: 0,5% – 3,5%
- Incremental sales: 5% – 15%
- Anticipated gross profit: 10% – 18%
- Anticipated incremental gross profit: 15 – 35%

Non-sales related programs require more critical financial analysis to determine measures. In some circumstances, payroll costs offer a quantifiable base. For example, determining productivity lost to absenteeism or production downtime is a fairly straightforward calculation that may be used to structure performance improvement goals.

Projecting costs
Program costs can be roughly separated into two categories:

- Research and set-up, program launch, communications, training and administration
- Awards (merchandise and/or travel)

While administrative and promotional costs may be somewhat flexible, awards costs are typically fixed or variable according to closed-end or open-end program design.

Closed-ended programs are designed around a specified budget or a percentage, for example, a percent-of-anticipated savings or percent-of-anticipated profits. The obvious benefit to a closed-ended program is that you can forecast your maximum costs. Determine how much you are prepared to put into the rewards element of your program, and then divide that by the number of participants. The result will guide the investment required for program design.

Open-ended programs are a bit more difficult to budget for, since by design they encourage limitless performance. The higher the participant performance, the higher the payouts, but the upside is that payouts happen as individuals or teams hit their goals and produce higher profits. These programs encourage cooperation over competition and produce the greatest number of winners across a range of performance levels. Open-ended programs represent a bigger financial investment, but are funded by incremental growth and profit.
Incentive Program Budget Breakdown

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Program design and set-up</td>
<td>3.5% – 5%</td>
</tr>
<tr>
<td>Behavioural drivers</td>
<td>70% – 85%</td>
</tr>
<tr>
<td>• Launch</td>
<td></td>
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<tr>
<td>• Communications</td>
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<tr>
<td>• Motivational rewards</td>
<td></td>
</tr>
<tr>
<td>Program management and implementation</td>
<td>10% – 18%</td>
</tr>
<tr>
<td>Recoveries</td>
<td>1% – 2%</td>
</tr>
</tbody>
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Percentages may vary according to program specifics, but use this as a rough guide to constructing a program budget.

Motivational Rewards

Rewards represent a significant portion of budget, so it’s important to get the mix right. Will a range of merchandise motivate performance or will nothing less than a luxury cruise suit your crowd? From both a program cost and performance effectiveness point-of-view, it’s important to strike the right balance between effort and reward.

In 1963 American workplace and behavioural psychologist John Stacey Adams developed *Adams Equity Theory*. His motivational theory suggests that individuals will modify behaviour in order to strike a fair balance between what they put into their work (time, skill, loyalty) and what they get out of their work (pay, respect, recognition). Adams refers to these factors as *inputs* and *outputs*. Further, the individual’s measure of fairness is determined by their perceptions of what others around them are receiving.

Adams’ theory is built on the belief that people become demotivated when they feel that inputs are greater than outputs. Interestingly, imbalance in the opposite direction is equally disruptive and being overly compensated may induce feelings of guilt.

How much is enough?

Participant expectations may be gauged according to behavioural theory and budgeted according to a percentage of employee compensation. Plan to offer rewards that represent 5% – 15% of an individual’s annual salary. It’s a good idea to periodically perform this ‘sanity check’ throughout the budgeting process. The guideline applies to all incentive budgeting methodologies.

- Short term programs (less than 12 months) designed for quick results generally require a higher percentage payout
- Long-term incentive programs (more than 12 months) should offer participants an earning potential of at least the value of a 13th cheque over a 12-month period – but probably more
- Recognition programs will work at 60% of a 13th cheque, but only if the program is supported by a good communications strategy
- Administrative workforce programs require not less than 5% of annual salary
- Sales force programs generally require between 8.33% – 15% of annual salary

About tax

Budgeting for tax seems an obvious detail, but the full implications on the total cost of a program are frequently overlooked. It’s important to get your accounting and tax people involved early in the budgeting stage.

Incentives normally accrue in respect of “services rendered” by one party to another, and are therefore taxable. The person liable to collect and pay the tax to SARS depends on whether the participants involved in the incentive scheme are your employees or not.

Programs for staff that are not employed by you

If you are a car manufacturer, for example, you might want to offer an incentive program to
employees of your (independent) dealerships around the country – a classic channel partner program. Because the participants are not your employees, the onus is on the individuals concerned to declare the value to SARS and pay the relevant tax.

Programs for staff employed by you
If, however, you’re running an incentive program for your own employees, then your company will need to put aside the appropriate tax on the points allocated to employees and remit this to SARS. The before and after tax details get included on their IRP 5 under fringe benefits. As you’ve paid the PAYE, your employees receive their benefit after tax, with no fuss or bother.

Also, for employee programs, the employer is obliged to pay “deemed VAT” on points redeemed (not recoverable from SARS), at a rate slightly lower than standard VAT – so you must budget for employees’ tax as well as deemed VAT.

Company tax and deductions
Your payments to an incentive company may be deducted for tax purposes in the normal way. Payment consists of two components: the cost of running the program, and the cost of the rewards (i.e. merchandise or travel). If you are a registered VAT vendor and are entitled to VAT input credits, the normal rules apply regarding payments to the incentive company.

Art, science and lateral thinking
Incentive program budgeting, like incentive program design, is both a science and an art. There is no one-size-fits all budget template with hard and fast rules for all circumstances. And because incentives are all about motivating people, budget management takes a bit of lateral thinking and on-going adjustment as the program evolves.