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Monitoring and Incentives in Sales Organizations: An Agency-Theoretic Perspective

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Abstract

Our primary objective in this paper is to analyze a framework that simultaneously examines the role of *both* monitoring and incentives in the design of sales force control systems. Previous research has focused exclusively on the role of incentives in directing salesforce effort.

We build on the structure provided by the past work and analyze an agency-theoretic model in which a salesperson generates wealth for the firm by expending effort across two dimensions, namely, internal and external. We assume that effort in the internal dimension can be monitored relatively cheaply whereas effort in the external dimension can be monitored only at infinite cost. We then analyze the following two scenarios: (i) a pure incentives world wherein both effort dimensions are governed through the use of incentive pay, and (ii) a monitoring and incentives world wherein the internal dimension is monitored and the external dimension is governed through the use of incentive pay. In addition to modeling the notion of partial monitoring in this manner, we also explicitly allow the firm to choose the level of risk aversion desired in its salesperson. Of course, salespeople who are relatively risk-tolerant command higher reservation wages; consequently, such salespeople are likely to be valuable only to those firms that emphasize incentive pay in their control systems.

Our analysis across the two scenarios helps us to demonstrate the implications and value of introducing monitoring into the control structure. Specifically, we find that monitoring allows the firm to decrease the weight placed on incentives and hire a relatively risk-averse salesperson from the salesforce labor market. These actions, in turn, permit the firm to reduce the risk premium and the reservation wage

offered to the salesperson. In direct contrast to these monetary savings, however, we find that an adverse side effect of monitoring is that it induces salespeople to overemphasize the effort devoted to the monitored dimension while underemphasizing the effort devoted to the nonmonitored dimension. This adverse effect of monitoring notwithstanding, we find that the overall benefit of increased monitoring is that it allows the firm to *lower* the amount of total compensation paid to the salesperson. These analytical findings are consistent with the prescriptions found in the popular business press where it is often stated that compensation plans that emphasize incentive pay are characterized by independence in managing activities (lack of monitoring) as well as high income potential. These findings are also consistent with the popular wisdom that incentive-laden compensation plans are generally more appropriate for individuals who are risk takers and entrepreneurial in nature.

We also delineate the conditions where monitoring can improve on the profits obtained in a pure incentives world. Specifically, we find that monitoring can prove to be most valuable when the importance of internal activities is high and the level of incentives is low. Finally, we conclude by conducting a sensitivity analysis to examine the robustness of our results to the specifications we utilize in our modeling efforts.

Overall, we view the main contribution of our research efforts as one of explicitly delineating the tradeoffs associated with the use of monitoring and incentives in the design of salesforce control systems. As such, our paper should be of interest to academics and practitioners interested in the design of salesforce control systems.

(Monitoring; Salesforce Compensation; Salesforce Control; Agency-Theory)