CASE STOCKMANN

Driving organization performance through analytics and incentive experimentation

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Key takeaways

- Organization performance drivers are key inputs to improve business outcomes through people
- Experimentation coupled with rigorous analytics facilitates learning and helps drive the right actions
- Impactful experiments do not require state-of-the-art HR systems, but thoughtful design and active listening
- Right incentives can substantially change workforce behaviors and contribute to organization performance
- Commissions outperformed team-based incentives by 18% in terms of improved sales performance

In summary

What. Reinforce business turnaround and support new strategy through people

Why. Top-line performance needs to improve across the board

How. Analytics and experimentation to inform sales incentive redesign

Stockmann in brief

Stockmann, established in 1862, is a Finnish listed company engaged in the retail trade. It has about 47 000 shareholders and about 7 000 employees. The Group's revenue in 2017 was EUR 1 055.9 million.

Stockmann's operating structure is devided in three divisions – Stockmann Retail, Real Estate and Lindex.

stockmanngroup.com

The retail sector has gone through rough years. Disruptive competitors, online business models and changing consumer habits have rocked department stores both in the U.S. and Europe. Stockmann, an iconic up-market department store chain operating in Finland and the Baltics, has not been spared. In late 2016 revenue in the critical Finnish Retail business was still in a 10% decline compared to last year. With large losses, the previous years were no better.

Against this grim backdrop and with a clear sense of urgency, Stockmann HR leadership and the OnWork team sat down in November 2016 to think of ways to reinforce turnaround and support a new corporate strategy through people. The top priority was clear: to drive top-line growth we had to understand how human capital and people practices impact sales performance. Without such systemic clarity any people interventions would be guesswork. The analytic journey kicked-off quickly as we gathered HR, sales performance, and store traffic data (see "Data" for details). Another priority was a new incentive plan for key personnel and management. It was designed concurrent to the analytic workstream.

Journey

We started with organization performance analytics: the objective was to understand how various human capital attributes like age, gender and even language skills, and factors such as full/part-time status, drive hourly sales performance at the individual-level. This helped us understand sales "success profiles": characteristics conducive to high or low performance. The most important performance driver was the tenure effect: how much Stockmann experience contributed to sales. It blends both how well an organization can retain its top talent, and how an individual's own performance develops over time. Tenure effect is important to understand as it impacts so many facets of people strategy.

After running a series of statistical models, a key storyline emerged. First, key performance drivers all indicated people mattered a great deal. Human capital and people practices explained sales performance variation. Second, despite many high-caliber individuals an across-the-board performance improvement was needed.

Data

- HR, sales (Point-of-Sales), and foot traffic data merged together for the analysis
- In total 250.000+ person-day observations from January 2016 to September 2017
- Average hourly sales performance reported daily for every sales employee
- Cosmetics, Fashion and Home sales groups included, Food excluded
- All six department stores in Finland included, Baltics excluded

Third, Stockmann had to get better at retaining the right talent. Competitors poached top people literally from the shop floor, a previously-held intuition the modeling confirmed. Fourth, the existing team-based incentive plan did not differentiate pay enough. In short, the preconditions to become more entrepreneurial and customer focused – a key piece of the new strategy – were not fully met on the people side.

Analytic insights clearly reinforced the case for a sales incentive plan redesign. It would not be a panacea but an important first step. But what type of plan would move the needle? We gleaned public information of incentive practices from Nordic retail sector and U.S. luxury department stores. Nordic "benchmarks" – at least those we were able to gather – were helpful in showing what *not* to do. Caution and conservatism in these examples would be antithetical to the objective of reinforcing business turnaround.

Bloomingdales, Nordstrom and the like revealed more attractive practices. Here, sales incentive plans are individual-based and yield higher pay differentiation. In theory at least, such plans drive performance and retention of top performers. These insights from U.S. luxury department stores were ideal starting points for experimentation. Nonetheless, what works in context A might fail in B; theory and practice sometimes disagree.

Experiment

To find the right solution for Stockmann, we chose to run an experiment in its Finnish department stores. A controlled experiment, if designed, implemented and analyzed properly, would provide much more robust input for decision making than any "industry best-practice." The objective was to understand how a commission-type plan based exclusively on individual sales would contribute to hourly sales performance compared to the existing team-based incentive.

Around 200 front-line sales employees from Cosmetics, Home and Fashion were assigned in a commission-based plan while the rest of around 800 formed a control group (see "Analytics" for details). In practice we wanted to know how sales performance of the commissioned relative to team-incentivized employees changed after the introduction of commissions.

The commission was uncapped and radically improved earning opportunities. High-performers could double their base salary, and "stars" had a chance to earn even more. High earning opportunities are typical in U.S. department stores: at Nordstrom the best sales associates earn six-figures through commissions[1]. To the best of our knowledge the earning opportunities in the experiment were unheard of in the Finnish retail context. It also turned the traditional incentive model – where earning opportunities grow with hierarchy – totally upside down. Relatively speaking, commissioned front-line workers had access to more variable pay than top management.

We tested two slightly different variations of the commission model, coined "standard" and "threshold". Both were designed to reward above-average performers, and provided roughly similar average earning opportunities. "Standard" was a more U.S.-type plan with higher seasonal earnings variation and hence more employee-side risk. "Threshold" provided better "insurance" against seasonal volatility and retained more management control.

The key point of the experiment was to see how changes in incentives impact sales performance independent of the dozens of other changes taking place simultaneously. This is especially critical in retail where everything from weather to campaigns can impact business substantially.

[1] Frey, Christine. Nordstrom salesman's million-dollar secret is in his treasured client list. Seattle PI March 26, 2004.

A task-force spanning sales personnel, human resources, business control and two external consultants (the author is one of the two consultants) was assembled in early 2017 to design the experiment slated for a mid-March launch. With the short timeframe agility was a must. Although the baseline experiment design was solid, we knew it was far from perfect. For instance, product returns were deducted from the receiving sales person's commissions. This was not ideal, but the design was nonetheless good enough to get started. We solicited qualitative feedback from sales employees and made some changes on-the-fly. Front-line listening turned out to be invaluable.

Outcomes

Incentives impact organization performance through two distinct channels: behavior and selection. Behavior captures the direct impact as individuals simply put in more effort and focus on their work. This direct impact does not account for any change in the workforce composition.

Selection effect results from individuals moving in, out and within the workforce. In short, it reflects the asymmetric impact incentives have on workforce composition and, resultantly, performance. Strong incentives should motivate high-performers to join or stay, and low-performers to leave. It's important to distinguish the two channels conceptually and analytically. For instance, behavioral effects can kick-in immediately while selection effects might take more time. Another example: selection effects are reinforced if ambitious outside job candidates have knowledge about the incentive plan. Without awareness, their impact is limited. In sum, to make the most of the two channels, quite different HR and leadership actions are needed.

The evidence from the first six months (Q2/Q3 2017) showed that commission-based incentives improved sales performance at Stockmann considerably. Sales per hour was up 18% on average compared to the team incentives group. This is the behavioral effect: the same individuals performed much better under commissions than team-incentives.

The behavioral effects kicked-in immediately. In one store sales performance improved 18% among the commissioned the week it was introduced compared to the previous week. Performance among the team-incentivized increased 4%. The 14% gap could not be attributed to campaigns, seasonality, or any other known factors. Further, the previous year did not show such changes during those weeks, for these employees, in this store. In sum, the evidence that commissions *caused* better performance is robust.

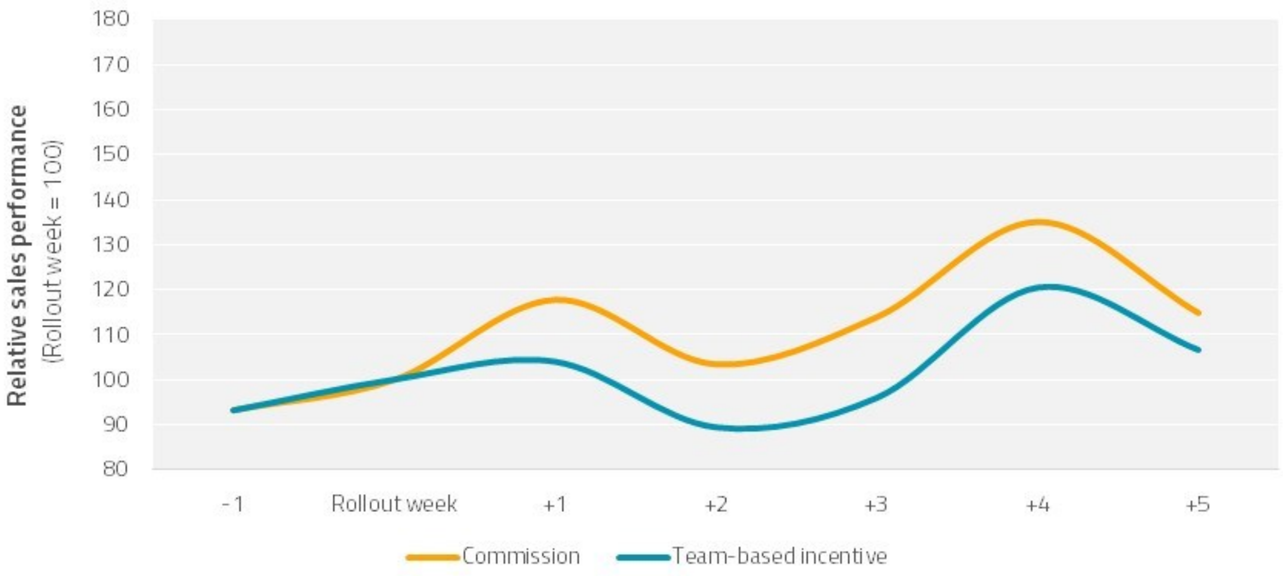
The improvements differed somewhat between stores and sales groups. Some products are simply more suitable for commissions. Also, organizational climate

Analytics

- The experiment started in March 2017. The analysis period ran until September 2017. The experiment ended in November 2017.
- Two to three sales groups from each store, around 200 people in total, were assigned to the commission plan ("treatment group") while 800 remained in the team-incentive plan ("control group"). Assignment was not fully random, but employees could not self-select to the treatment group.
- Statistical modeling based on OLS and fixed effects estimation. Unobserved time-invariant heterogeneity was controlled through store and person fixed effects. Year, week, and day of week included as controls to adjust for seasonality.
- Dependent variable was average hourly sales performance
- Models were updated bi-monthly to track progress
- "Crazy Days" campaign periods were omitted from the analysis as commissions were temporarily disabled
- Helsinki flagship store started the experiment one week later than others, a minor benefit for estimation
- Tapiola store was excluded from the main analysis as it moved to another building and operating model (centralized counters and split sales roles) on March 2017, concurrent with the experiment rollout

Commissions had immediate impact on sales performance

Sales performance in a select store in weeks before and after the rollout



seemed to alter the impacts of commissions. It tended to have smaller impacts in areas with organizational climate issues. Context matters.

We can't say much definitively about selection effects yet. Still, anecdotal evidence of turnover patterns suggests they are positive. This should further improve sales performance over time. Moreover, given that some employees were able to drastically improve their earnings – more than double their base pay – we would expect the commission plan to materially impact long-term career incentives. The top sales persons were incentivized to stay in shop floor roles rather than pursue managerial positions. Also, some already self-selected to other jobs within Stockmann.

The total impact on sales performance, the sum of behavioral and selection effects, is likely to exceed 20%. In fact, the figures from Stockmann are strikingly close to evidence from an experiment in Bloomingdale's New York flagship store in 1989[2]. They reported a 22% sales increase in men's accessory department following the introduction of commission. Together, the results strongly suggest that proper incentives can markedly improve top- and bottom-line outcomes in retail. Remarkably, both examples are from a unionized context.

Learning

As far as sales performance is concerned, the hard numbers speak for themselves. Individual-based commissions outperformed team-based incentives by a large margin. On top of that, there were other lessons learned from the experiment.

First, qualitative front-line feedback indicated that commissions hindered collaboration, led to unethical behavior (e.g. passing on returns, poaching customers, avoiding non-incentivized support tasks) and could hence negatively impact customer experience. Second, another critical input was that sales roles were not aligned with the commission plan: commissioned employees should focus exclusively on sales so that other activities would not suffer. Third, shift allocation felt unfair in some cases. Fourth, mechanisms to enhance collaboration and team spirit were deemed necessary. Lastly, sales employees could not track their performance in real-time but only retroactively. These were serious concerns that had to be worked on. Notwithstanding, performance improved markedly despite these issues.

We also received positive front-line feedback, ranging from enhanced fairness to better focus and engagement. Sales leaders indicated that commission helped with people and performance management, fostering a more candid dialogue with employees.

[2] Barmash, Isadore. Bloomingdale's to Pay Commissions on Sales . The New York Times July 6, 1989.

Insights to actions in 14 months

11/2016	12/2016-3/2017	3/2017	4-8/2017	9/2017	10/2017-1/2018
Kick-off Learn organization performance drivers	**Think** Design a controlled experiment	**Go** Roll-out the experiment	**Listen** Gather feedback and adjust	**Evaluate** Analyze impact of the experiment	**Act** Design the full-scale rollout

Actions

The experiment ended successfully in November 2017. Its success led management to greenlight the new incentive plan for implementation on February 1st, 2018. About a year separated the idea to experiment with a radically different incentive scheme and its full-scale rollout. Commission were extended to all Stockmann's Finland employees in designated sales roles. Their incentive opportunities are now more in tune with U.S. rather than Finnish peers – and radically depart from local competition. If this does not help Stockmann attract and retain top sales talent, then probably nothing will. To ensure full alignment, supporting roles and sales leader incentive plans were also redesigned.

The experiment yielded important lessons that shaped the final design. "Threshold" model proved to be easier to communicate, implement and maintain. Product returns, a major source of complaints, are handled more smartly. Technology to enable sales personnel to track performance in almost real-time was developed. Sales roles were split and redesigned for better clarity and performance measurement, and centralized counters were implemented. The commission plan's earning opportunity was fine-tuned to reflect the new roles. Evidence from the Tapiola store, which moved to centralized counters and split roles concurrent with the experiment rollout, suggests that such sweeping changes to sales organizations and processes take time to translate to higher performance. Ultimately, though, they pay off. In short, through experimentation the final design was built on a much firmer ground.

Analytic insights and experimentation clearly led to action. And a big action at that. The changes are bound to shape Stockmann's culture and customer experience for years to come.

Conclusions

We conclude with a few key points. First, organization performance analytics help get a grasp of the people side of business. The right facts are necessary, but not sufficient for sound decision making. Second, controlled experiments are a powerful management approach. This is especially true in retail, where experiments are easier to ramp-up given the fast-paced nature of business. Yet other sectors can benefit too. Third, incentive design clearly matters and can make a big difference in business performance. Rather than sticking to "industry best practices" or "local market practice" as is often the case, it makes sense to experiment with different and even unconventional alternatives to find the optimal match for given circumstances. Lastly, as the Stockmann case demonstrates, high-impact experiments do not require state-of-the-art systems, massive up-front investments, or fancy HR tech. Instead thoughtful design, active front-line listening and open-minded leadership are absolute must. And perhaps that sense of urgency.

About the author

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Tatu Westling drives analytics business as a partner at OnWork. He has experience of cutting edge people and organization performance analytics engagements from leading Nordic and U.S. firms. Tatu is based in Helsinki, Finland. He is M.Soc.Sc. (Econ) from University of Helsinki and working on his economics PhD thesis.

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