



REVENUE OPERATIONS & AI

Variable pay is a risk design when effort is hard to observe

When effort is hidden and output is uncertain, incentive intensity is conditional: separate observability, risk, uncertainty, and wider control.

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MANAGEMENT SUMMARY

Variable pay is often treated as a universal answer to uncertain performance. Ghosh and John test three agency-model predictions across three experiments and report conditional support for flatter wages under specified verifiable-effort conditions and for lower incentive loading when risk-averse agents perform nonverifiable effort as effort-output uncertainty rises. The support varies by experiment. Cravens, Ingram, LaForge, and Young provide the adjacent boundary: incentive compensation is one part of a wider salesforce control system that can include field management. This article turns the evidence into a risk-design card. It does not recommend a commission rate, diagnose a current employer, or claim that flat wages always dominate variable pay.

Keywords: Variable pay · Incentive intensity · Sales compensation · Agency models

Variable pay is a risk design when effort is hard to observe.

The short answer is conditional: the more uncertain the link between effort and output, the less useful it is to treat incentive intensity as an automatic improvement. Ghosh and John test three agency-model predictions across three experiments. Their results support flatter wages under specified verifiable-effort conditions and lower incentive loading when risk-averse agents perform nonverifiable effort as effort-output uncertainty rises, with variation across experiments.

Cravens, Ingram, LaForge, and Young supply the adjacent management boundary. Incentive compensation is one part of a wider salesforce control system. The question is therefore not simply “How much commission should we pay?” It is “What can be observed, what is uncertain, who bears the risk, and which control mix supports the work?”

Why is variable sales pay a risk-sharing contract when rep effort is hard to observe?

Agency-model reasoning becomes vague when its variables are collapsed. Keep them separate:

Table 1 Why is variable sales pay a risk-sharing contract when rep effort is hard to observe?

Variable	Question	Error if it is hidden
Effort observability	Can the relevant effort be verified by the principal?	Hidden effort is treated as measured effort.
Effort-output uncertainty	How predictable is the link from effort to output?	A noisy outcome is treated as a clean signal.
Agent risk	How costly is outcome risk to the person doing the work?	Risk transfer is treated as free.
Incentive loading	How strongly does pay vary with the outcome?	More variation is assumed to create more effort.
Wider control	What field management, information, or coaching exists?	Compensation is asked to do every management job.

Table from this essay. Sources and interpretation are given in the article.

These fields do not calculate a plan. They show what a plan would have to assume.

Figure 1 The variable-pay risk-design card

Risk-design field	Required input	Permitted statement	Stop signal
Effort	Which effort matters, and can it be verified?	"This part of the effort is observed or remains hidden."	Output is used as a substitute for all effort.
Uncertainty	How uncertain is the effort-output link?	"The outcome is a noisy or more predictable signal under this setting."	A noisy outcome is treated as a clean measure.
Agent risk	Who bears outcome risk, and what is known about it?	"The pay rule transfers this declared risk."	Risk aversion is assumed away.
Control alternatives	What coaching, information, supervision, or field management is available?	"Compensation is one part of the control mix."	Pay is used to repair every process problem.
Loading	How strongly does pay vary with the outcome?	"This is the incentive intensity under review."	A higher percentage is presented as universally better.
Evidence	Which study or local test supports the choice?	"The decision is conditional on this evidence."	An experiment becomes a current prescription.

Author's diagnostic framework grounded in Ghosh and John (2000) and Cravens, Ingram, LaForge, and Young (1993). The worksheet is synthetic and does not calculate pay.

What the three experiments test

Ghosh and John test three agency predictions across three experiments. The experiments make the mechanism concrete because they vary conditions that a slogan about variable pay usually hides. Their results link more effort-output uncertainty with less incentive-loaded compensation when agents are risk-averse and effort is not verifiable. The reported support for flat wages under verifiable effort and for reducing incentive loading with more risk-averse agents varies by experiment.

The correct reading is conditional. The studies do not say that a flat wage is always better. They do not say that every salesperson is risk-averse in the same way. They do not say that output uncertainty is the same as effort invisibility. They show why those variables belong in the decision before the pay rule is defended.

An experiment also does not become a current compensation evaluation simply because its prediction sounds intuitive. The unit, task, risk, observability, and outcome in the experiment define the boundary of its evidence.

Observability and uncertainty are different risks

Consider two roles. In the first, the effort is visible and the output is relatively predictable. In the second, the effort includes relationship work, learning, coordination, or long-cycle preparation, while the output is exposed to timing and external conditions. The second role may have both hidden effort and a noisy outcome, but the variables still need separate assessment.

If effort is observable, a manager may have a direct control or coaching signal. If effort is not observable, outcome-based pay can become a proxy. If output is uncertain, the proxy becomes noisier. If the agent bears the uncertainty, incentive loading can transfer risk rather than create useful information.

That is the logic behind the card. It does not predict an individual response. It asks which part of the agency problem a proposed pay change is intended to address.

Compensation is inside a wider control system

Cravens et al. study behavior-based and outcome-based control in 144 sales organizations and treat incentive compensation as one element within wider field management and control. This boundary matters even in an agency-model discussion. A compensation rule cannot provide missing product knowledge, repair a broken territory, clarify authority, or teach a seller how to perform a new activity.

The wider system may include supervision, information, training, territory design, feedback, and outcome measurement. Variable pay can signal a declared result, but the result needs a connection to the work and a review of what the seller can influence.

This is not an argument against incentives. It is an argument for naming the control object. If the real problem is unobserved effort, increasing the pay percentage may be a weak response when the underlying work remains unsupported. If the real problem is a clear, verifiable outcome and an appropriate risk allocation, the pay rule may have a different role. The source evidence cannot choose between those cases without the conditions.

A synthetic compensation-risk review

Imagine a team considering more variable pay for a long-cycle selling role. Before changing the plan, it can record:

- 1 which effort matters and whether it can be verified;
- 2 how long the outcome takes to arrive;
- 3 which external factors affect the output;
- 4 who bears the outcome risk;
- 5 what field management and information already exist;
- 6 how much incentive loading the proposed rule adds;
- 7 what result would show that the rule improved the declared control problem.

The example is synthetic. It does not imply that the role needs a flat wage or a higher commission. It forces the team to distinguish information, risk allocation, and behavior support before selecting a pay signal.

How should enterprise sales compensation balance risk and incentive intensity?

Before revising variable pay, record:

- 1 the task and the effort that matters;

- 2 the observability or verifiability of that effort;
- 3 the uncertainty in the effort-output relationship;
- 4 the outcome, horizon, and external drivers;
- 5 the risk borne by the agent and the principal;
- 6 the wider control alternatives available;
- 7 the incentive base, timing, and loading;
- 8 the source or local test supporting the decision;
- 9 the result that would stop or revise the rule.

This sequence makes the compensation question smaller and more honest. It may show that the problem is pay. It may show that the problem is observability, information, authority, or process. A good design allows those possibilities to remain open.

What this note does not recommend

Ghosh and John do not provide a universal variable-pay rule. Their experimental support varies by condition and experiment. Cravens et al. do not turn the wider control system into a current plan. The article does not estimate an employee's risk aversion or recommend a commission percentage.

The stopping rule is concrete. Do not respond to hidden effort and uncertain output with a larger incentive signal until observability, risk, wider controls, loading, and evidence are written together. If those fields are unknown, the plan can still be changed. The claim that it is a better design is not ready.

The incentive boundary connects to the compensation plan that can reward coverage and salesforce control as a blend.

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END OF ESSAY

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