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Compensation: Time to Switch from Cost-Cutting Back to Compensation Strategy?

As we are almost mid-way into 2009, is it time to switch gears from survival mode to planning for an eventual upturn with our compensation strategies? Maybe it's time to look ahead.

by **Marie Brinkman and David Knopping**

While the global recession grinds on, there are now "glimmers of hope" and signs of an uptick. At least, in many cases, the downward pace has decreased: the rate of decline in orders, profits and job losses is slowing. Although this recession is deemed to be the most severe since World War II – with the global economy now expected to shrink by 1.3 per cent in 2009 – a slow recovery is still anticipated to take hold next year. While GDP is forecasted to decline in all the advanced economies, it is still expected to grow by 4.8 per cent in developing Asia as a group – with China at 6.5 per cent GDP and India at 4.5 per cent in the lead. (*International Monetary Fund, World Economic Outlook, April 2009*).

In light of recent indicators, how are companies coping with the current economic environment, and just as importantly, preparing for the future and eventual turnaround?

HR/compensation strategies reacting to the downturn

Navigating the downturn has produced a variety of HR survival strategies. These range from financial "triage," with rapid and dramatic across-the-board cost reductions that include pay cuts, significant reductions in work schedules, and/or major layoffs by companies hardest hit and least able to withstand a sharp decline in business. For companies less severely affected by a drop off in business or those with the financial ability to endure the decline, "surgical," or selective strategies to pare back have been adopted. These may include a hiring or salary freeze, limited bonuses, and/or a reduced work schedule. For the fortunate companies with a more recession-proof business model and a strong balance sheet, it may be an opportune time for acquisitions and the selective hiring of key talent. Additionally, by pausing from the hiring frenzy of recent years, it means the opportunity to enhance employee selection processes and career development and performance management programs. For many companies, particularly in the fast growth markets, it's the chance for a "resetting of employee expectations" to be more attuned with a more realistic growth mode.

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Employment outlook

In grappling with compensation strategy in this economy, the first question to answer may be: how stable is the employment picture for 2009? Radford's *Quarterly Summary of Industry Trends* report shows that about 40 per cent of high-technology companies anticipate workforce reductions in 2009 overall, with about half of those reducing staff levels by less than five per cent and the other half by more than five per cent. Another 40 per cent of companies expect to maintain current staffing levels, while about 20 per cent actually anticipate growth in the workforce, even if only selectively. Most of the global hiring will occur in China and India with 20-25 per cent of surveyed companies anticipating adding staff in these locations, even if only modestly. Only a small percentage of companies (nine to 11 per cent) anticipate increasing the size of their workforce in Japan and Singapore – economies harder hit by the downturn.

Salary trends – More variation in the market

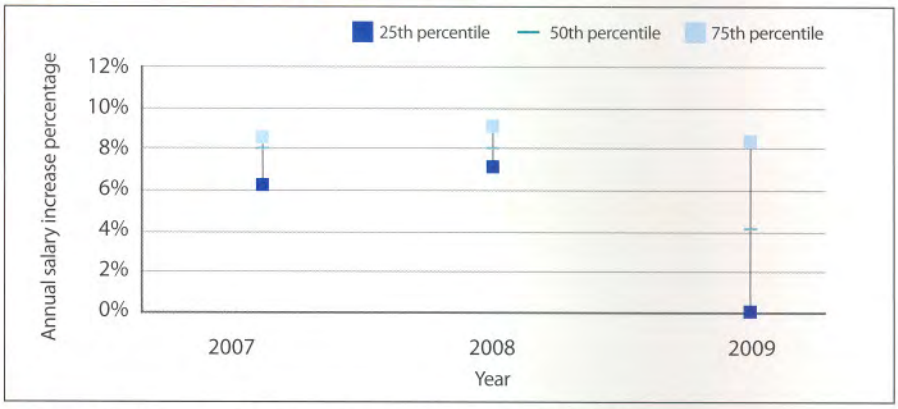
Unlike recent years, when virtually every high-technology multinational company provided salary increases to employees globally and double digit increase percentages were common in rapid growth markets, the picture now is quite different. There is more variation in practice because the economy is not affecting every company in the same way. Typically, in the past, companies

Table 1 Planned changes to size of workforce – 2009

Country	Per cent of global companies Changing staffing levels in these countries		
	Decreasing	No change	Increasing
China	29%	51%	20%
India	26%	49%	25%
Japan	32%	59%	9%
Singapore	32%	58%	11%

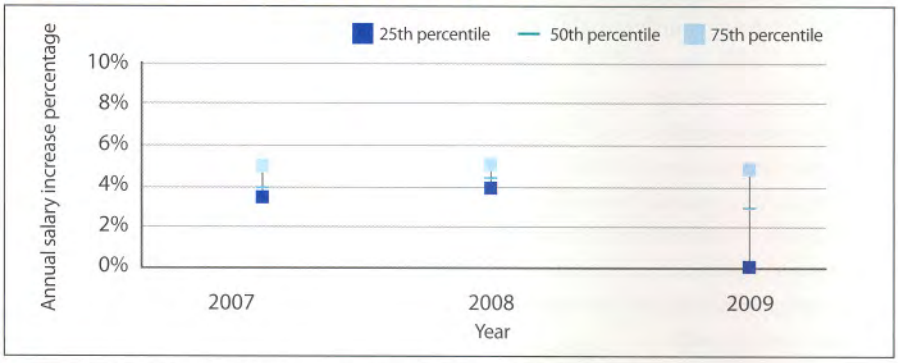
Source: Radford International Semi-Annual Summary of Industry Trends, March 2009

Table 2 Overall annual salary increase – China



Source: Radford International Semi-Annual Summary of Industry Trends, March 2009

Table 3 Overall annual salary increase – Hong Kong



Source: Radford International Semi-Annual Summary of Industry Trends, March 2009

would rely almost exclusively on general market pay data, narrowly benchmarking against the median of market salary increase forecasts to develop their pay strategy. Now, however, given so much economic turmoil, there is a great deal more variation in market practices. Trends in market pay levels will range from decreases in pay (due to pay cuts), to no movement in pay levels (due to a pay freeze), to modest increases, and finally, to relatively generous salary increases for key positions or key sectors by those fewer companies that can still compete aggressively for talent.

Table 2 and Table 3 illustrate the mid-market range of annual overall salary increase percentages for 2007, 2008 and 2009. The "mid-market range" is defined as the middle 50 per cent of the market (i.e., salary increases falling between the 25th and 75th percentile of the market). As charts demonstrate, there is significantly more variation in the mid-market range in 2009 compared to prior years.

This means that HR and compensation professionals need to carefully evaluate their company's growth prospects and cost constraints, as well as opportunity costs, when determining what level of salary increase, if any, is right for their company for the remainder of 2009 and in planning for 2010. Careful selection of peer companies and industry sectors helps in interpreting the variance in the market, providing a more nuanced view of compensation trends. Balancing "market trends" with what your company can afford and its long-term viability is essential.

For HR and compensation

Table 4 Senior finance position "When is pay the same?" calculator

China				Hong Kong			
Current salary market 50th percentile	Annual salary growth	Number of years	Future salary	Current salary market 50th percentile	Annual salary growth	Number of years	Future salary
USD 100,000	8%	9.25	USD 203,700	USD 155,000	3%	9.25	USD 203,700

■ *Source: Radford International Survey, October 2008*

professionals involved in workforce planning with a need to forecast relative labor costs across countries, it is helpful to determine the "cross over" point (i.e., when market pay levels will be the same for a given job in different countries based on current salary increase trends). For example, Table 4 shows the pay level for a senior finance management position in China compared to that in Hong Kong (both translated to US dollars) and the number of years until their pay would be the same, given certain assumptions about market trends. Together with information about the supply and demand for talent in each labor market and other economic and business metrics, this may be helpful in forecasting staffing requirements and associated costs across countries.

Incentive plans – Acting as an automatic stabilizer

In times of economic turmoil, a properly designed incentive plan acts as an automatic cost stabilizer, paying out when company performance meets expectations, and not paying out when performance (and financial ability) is lacking. According to a recent Radford survey *Managing Compensation in a Downturn Economy*, most incentive plans are doing just what they were designed to do, with approximately 70 per cent of multinational high-technology and life sciences companies expecting to pay either no bonuses or lower bonuses in 2009 than in 2008, reflecting this year's extremely challenging business climate.

Although this is beneficial from an overall company cost standpoint, it presents a difficult message to many employees who are working harder than ever and have been used to earning good bonuses in recent years. Many companies are taking advantage of the current environment, when rapid hiring and other HR initiatives are not the top priorities, to re-set expectations and clearly communicate the goals and structure of their incentive program. This helps employees to better understand the concept of variable pay, which in good times, many had come to see as a guarantee. It also helps them understand how their contribution, performance and bonus payout is connected to the overall company performance. Additionally, it is important, particularly in a multinational company, that employees clearly understand what portion of their incentive is tied to the performance of their company as a whole versus their geographic region, country and/or business unit, and/or their own individual performance.

Recognizing that forecasting performance and setting incentive plan goals are particularly challenging this year, some companies have made modifications to their incentive plan design, although these changes are in the minority: some have changed the performance measurement period to be more frequent, while other companies have re-oriented their goals to compare performance relative to peer companies. However, a more likely scenario is that companies are making highly selective awards, such as project team bonuses or special incentives, for top performers to recognize and reward superior efforts, and outcomes that rise above the challenges of today's economy.

Conclusion

In terms of the work of HR and compensation professionals, this year has been marked less by compensation strategy and more by dramatic and necessary cost cutting *reactions*. As we look toward the latter part of the year, and beyond to 2010, it may be time to take measure of where the market has landed, and plan your best strategy accordingly. HR

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