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## The Impact of Economic Uncertainty on Reward Programs: A Global Research Study Conducted by Hay Group

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### Executive summary

With the downturn in the economy, organizations around the world are becoming more and more concerned about the impact on their business. In response to the downturn, organizations are cutting costs and reconsidering the value and expense of many programs, including their staffing levels and cost of their reward programs. As organizations review these programs and consider changes, benchmarking is a key component in helping organizations make these decisions. Hay Group recently conducted a global research study in order to assist organizations in understanding the extent to which companies have altered or are considering altering their reward programs.

While not all regions, countries and industries are impacted equally, many organizations are feeling at least some effects of the downturn. A total of 2,589 organizations from 91 countries across six continents participated in this study, demonstrating that the effects of the downturn are being felt worldwide. In fact, in terms of the participant base, this is the most comprehensive study of this subject that is available. Data collected include organizational changes to base salary increases, variable pay programs, and long-term incentives as well as planned changes to other reward-related programs (such as overtime, use of contractors, benefit plans, car programs, and training and development).

### Summary of global study findings

- **Business results.** When Hay Group conducted a similar study in March 2008, only 12 percent of organizations expected their business results to be significantly worse than targeted levels. However, eight months later, that number has jumped to 31 percent. Only 62 percent of organizations indicate that business results are expected to be close to targeted levels in 2008. Some industries are faring better than others:
  - Nineteen percent of oil and gas companies reporting that business results will be significantly better than targeted levels.
  - In contrast, 63 percent of retailers are expecting poor results due to reduced consumer spending and a tightened credit market.
  - Africa and the Middle East seem to have been hit the least with only nine percent of African companies and 12 percent of Middle Eastern companies reporting business results significantly below target.
- **Base salaries.** Sixty-five percent of participating organizations are making changes or considering changes to their previously established base salary increase budgets for 2009.
  - Of those organizations, 58 percent are decreasing their budgets and 24 percent are freezing or considering freezing salaries for all employees.
  - With next year's economic outlook an uncertainty, organizations are wary about increasing the fixed cost of base salaries and are opting to err on the side of caution by decreasing increase budgets or freezing salaries to maintain costs.
- **Short-term variable pay.** While a majority of companies are making changes to their base salary budgets, only 19 percent are making changes to the design of short term variable pay programs (such as

bonus, incentive, and profit sharing) in 2008, down from 28 percent in March. The majority of the organizations not making changes seem to be indicating that these programs are working as they were intended (ie, to pay out well in times of good performance and not during times of poor performance).

- Some industries and regions are more inclined to change with 56 percent of consumer durable organizations, 32 percent of African companies, and 35 percent of Middle Eastern companies making changes.
  - Of those organizations that are making changes, approximately 12 percent are lowering thresholds and 14 percent are lowering targets in order to provide their employees some variable pay.
    - Fifty-six percent of healthcare organizations are lowering thresholds and 36 percent of Pacific respondents are lowering thresholds and targets.
    - By lowering thresholds or targets, organizations are enabling the program to pay at least pay out something, thereby motivating employees to continue to work towards organizational goals in spite of lower performance.
  - It is not surprising that some organizations are considering lowering thresholds and targets for 2008 considering that three-fourths of organizations reported that their short-term variable pay program will pay out less than 100 percent of target in 2008.
    - This includes approximately 34 percent of companies whose pay outs will be less than 70 percent of target.
    - Again, there are some significant industry differences. Only 15 percent of leisure and hospitality organizations are paying at or above target, while 39 percent of oil and gas and 42 percent of pharmaceutical organizations are paying at or above target.
  - For 2009, 27 percent of organizations are making changes or considering making changes to their short-term variable pay programs. This suggests that a majority of organizations recognize that these variable pay programs are likely doing what were intended to do – pay well during good times and not during periods of poor performance.
- **Long-term incentives.** Companies are also reviewing their long-term incentive programs, but only 12 percent of organizations indicated they are making or considering changes. While the vast majority of companies with long-term incentive programs are not making changes, the organizations that are considering changes are unsure of what actions to take:
- Fifty percent are considering granting fewer options/shares/units
  - Forty-two percent are considering granting more options/shares/units
  - Fifty-three percent are considering changing the mix of options/shares/units
  - Thirty-two percent are considering reducing the performance criteria for vesting
- **Benefits and HR programs.** As organizations seek to control costs, they are also looking at cutting or reducing other benefits and human resources programs. Training and development is being decreased or eliminated by 16 percent of organizations. Companies are also cutting overtime wages (11 percent) and the use of contract laborers (17 percent). However, companies are not significantly decreasing benefit programs at this time.
- Only three percent of organizations are eliminating or decreasing health care benefits and four percent of companies are eliminating or decreasing various retirement plans such as defined benefit or defined contribution plans.
  - An additional nine percent of companies are considering changes to health benefits and 14 percent are considering changes to retirement plans.

- These numbers represent a significant decrease from the March study where 27 percent of organizations were making or considering changes to health benefits and 21 percent were making or considering changes to retirement benefits.
- **Staffing levels.** Despite the uncertain economic outlook, only 15 percent of global respondents are planning lay offs with median staffing level decreases of approximately 7.5 percent. Another 33 percent of organizations are freezing existing staffing levels, up from nine percent in the March study. Globally, only three percent of organizations are planning to increase staffing levels, but certain areas are still experiencing some growth – the highest being Africa (17 percent of companies increasing staffing levels) and Middle East (11 percent of organizations increasing staffing levels).
- **Performance management.** While performance management programs are also being scrutinized, only 20 percent of organizations are planning on making changes to these programs. For those organizations looking to make changes to their performance management system, they are reviewing changes across the spectrum of performance management processes.
  - A large number of organizations are making or considering changes in terms of performance measures, targets, and linkage of performance and pay. Almost half of these organizations are also considering changing the role of line managers in supporting and enabling the performance management process.
- **Employees’ top concerns.** In these uncertain times, organizations need to not only consider their fears and worries, but also the concerns of their employees. If employees’ concerns are not addressed and acknowledged, organizations run the risk of a loss in motivation and engagement as well as increased turnover, which could cause a further negative impact on the bottom line. Responding organizations reported on their employees’ top concerns with the following themes most common:
  - Job security / fear of lay offs
  - Salary concerns (eg, reduced merit and frozen salaries)
  - Cost-of-living / inflation
  - Reduced revenue / customer retention
  - Lack of bonus pay out
- **Organizational concerns.** Respondents were also asked to list their organization’s biggest concerns regarding key employees during this challenging time. While employees fear losing their jobs, organizations fear the loss of top talent and critical skills. Consistent with the findings in March, the top concerns of organizations include:
  - Retaining top talent / critical skills
  - Maintaining / affording competitive pay
  - Maintaining employee engagement / motivation
  - Career development / training
  - Recruiting top talent / critical skills

## Summary of US findings

Of the 2,589 participating organizations, 725 (28 percent) were from the US. Overall, US findings are generally consistent with the global findings.

- **US business results.** The US results showed a slightly higher percentage of companies expecting business results to be significantly worse than targeted levels — 39 percent US versus 31 percent global.
  - This represents a significant increase from the March study where only 16 percent of U.S. organizations expected business results to be significantly worse than targeted levels.
  - Again, the retail sector has been hit particularly hard (51 percent significantly worse) as has the leisure and hospitality sector (50 percent significantly worse).
  - Some industries have seen less impact — 79 percent of respondents in both pharmaceuticals and utilities are reporting business results close to targeted levels.
- **US base salaries.** A higher percentage of US companies are planning to decrease their 2009 base salary increase budgets, 66 percent in the US versus 58 percent globally.
  - In the US, budgeted base salary increases for 2009 are significantly lower than 2008 actual figures. The median increase in 2008 for all employees was 3.6 percent while the 2009 median estimates hover at three percent across most employee groups (executives, management/professional, support/clerical, and blue collar/skilled trade are all at three percent).
  - Median base salary increases for high performers/potentials is 3.8 percent. These numbers indicate that organizations are not providing much differentiation for their high performers.
  - The downturn seems to be leveling the playing field as industries with relatively higher salary increase budgets (over four percent) last year have dropped their budgets significantly while industries with lower budgets (three to three and a half percent) are only decreasing their budgets slightly. Education organizations in the US have dropped median budgets from 4.2 percent for all employees to 2.8 percent. Pharmaceutical companies are currently able to maintain their median budgets at four percent for all employees.
- **US variable pay plans.** While 73 percent of both global and US organizations' variable pay plans are paying less than target for 2008, US organizations are faring a bit worse than global organizations with almost 40 percent of companies paying less than 70 percent of target (as compared to 34 percent globally).
  - In the US, no respondents in the leisure and hospitality industry are paying at or above target.
- **US staffing levels.** Nineteen percent of US companies are planning to decrease staffing levels (versus 15 percent global). However, globally the median decrease is 7.5 percent while in the U.S. the median is three percent. So while more US companies are planning to decrease staffing levels, they are cutting fewer positions as a percent of their total workforce than their global counterparts.
- **Concerns of US employees.** US employees share many of the same concerns as global employees with a few exceptions. Whereas cost-of-living/inflation is a major concern globally, in the US it is much less of a concern. US employees are more concerned about the value of their retirement plans. The volatility of the financial markets has caused 401(k) plans to drop significantly, a problem especially worrisome to the aging Baby Boomer population on the verge of retirement.

## Implications

In this period of economic uncertainty, organizations must take care to avoid knee-jerk reactions that may seem to help the organization in the short term, but may compromise long term viability. Rash decisions without careful thought may do more harm than good, especially when it comes to impacting employee engagement. There are five areas organizations can focus on to help ensure success through these trying times.

1. **Communications.** If employees are left in the dark wondering if they will have a job tomorrow, then morale, engagement, and motivation suffers dramatically. Clear and frequent communications from senior leaders builds trust and credibility and will help employees understand and believe in the company's direction. If employees are aware of the state of the business, they will worry less and trust that the company will make it through the downturn.
2. **Careful cost cutting.** In the rush to cut costs and stay afloat in challenging times, organizational leaders can forget that their people are the lynchpin in helping the company get through the crisis. When cutting salary budgets or headcounts, keep the future of the company in mind. Who will you need to help turn the company around? Consider key roles, past performance and future potential in the cuts. Don't ignore or alienate high performers/potentials and risk losing them.
3. **Top performers.** Don't make the mistake of assuming that a tight market will retain top performers; they are always in demand and can always find other opportunities. The first step is to identify who the organization's top talent is and then ensuring that their needs and objectives are known and addressed. Do your high performers know that they are indeed high performers? Do you tell them? Do managers have frequent, meaningful conversations with high potentials to know their needs and wants and to keep them engaged? When additional financial rewards are not possible, emphasize and leverage the core intangible rewards offered by the organization: career development, interesting and impactful work and non-financial recognition can markedly improve engagement with top performers.
4. **Total rewards.** Do employees understand the total value of the reward programs that the organization is offering them? Research has shown that employees are more satisfied with their reward programs the better they understand them – not necessarily the more they are paid. Organizations can get significant mileage in communicating the value and costs of the total remuneration programs and intangible rewards. More and more organizations are implementing total rewards statements to help employees understand the value of their benefits as well as their compensation.
5. **Solid reward foundation.** With the increased focus on cost cutting for many organizations, now is a good time to take a close look at the rewards programs you are offering employees. Understand what programs your employees really value relative to their cost and increase/decrease programs as appropriate. Employees may or may not value certain benefits, perquisites, work rules, or compensation programs. Consider what employees value as cost cutting decisions are made. Making changes to these programs often comes with low cost from the organization and good will from employees.

It is critical to keep employees engaged and motivated during these times so that the organization can weather the storm. In the current business environment, organizations have the opportunity to take a hard look at the intent, design, and implementation of the organization's reward programs. The organizations that think strategically and creatively will emerge in a position of strength to take advantage of the future upturn.