Reward in a downturn

Hay Group global survey
US report - April 2009

Contents

Executive summary

The March 2009 *Reward in a downturn* survey reveals a deepening recession that has become truly global, and which is affecting the pay, benefit and job prospects for employees at all levels throughout the world. Pay has been affected in all countries, with salary increases at or below inflation rates, even in previously fast-growth economies. Salary freezes have become very common with employees in 36% of companies globally facing salary freezes, and actual or proposed salary cuts looming for others.

The pace of change is also remarkable, with a sharp decline in business confidence and the severity of impact on reward practices since our last survey. Projected salary increases for 2009 have fallen to only 2.8% – down from a projection of 4% only four months ago. Around the world, 27% of organizations are decreasing their staffing levels, compared to 17% in November 2008. Many organizations which a year ago were having trouble filling vacancies are now having to resort to job cuts.

In contrast to recent years, executive pay is likely to rise even less than that of their employees – and in practice many executives will receive significantly less than in previous years, as bonus pay-outs drop and the value of share-based payments is hit by stock market falls.

In such a difficult environment, organizations top concern is maintaining employee engagement. When doing more with less, the discretionary effort of employees willing to ‘go the extra mile’ is even more critical for surviving the downturn and being positioned to grow once the environment is more favorable. Similarly, organizations are concerned about retaining their high performers in order to get through the downturn and take full advantage of the upturn when it comes.

However, employers can’t afford to pay more on reward. But employees work for more than money: they work to get training and career development, to make a valuable contribution, and because they enjoy contributing to a common vision and making their place of work a better place to be. Leading organizations understand this and are focusing on improving non-financial aspects of reward, even if financial rewards are being squeezed.

Based on the trends shown in this and previous surveys, if the global downturn continues to deepen then the following scenarios are real possibilities for the rest of 2009 and beyond:

- An increasing number of companies will impose salary freezes
- A growing number of employees will face the choice of either accepting pay cuts or facing job losses
- Pay-out levels from bonus schemes will fall further
- Companies will increasingly look to cut their contributions to pension schemes, and the trend away from defined benefit schemes will accelerate
- Other benefits (such as medical insurance, car schemes etc) which have been spared review so far, will come under scrutiny.

In a growth market, some companies were able to take a simplistic approach to pay, relying largely on benchmarks (internal or external) plus set annual increments to determine salaries. The downturn will force many of those companies to adopt a more strategic approach to reward based on their strategic goals, ability to pay and critical talent needs, in addition to market comparability.

About the survey

A total of 2000 organizations from 88 countries across six continents participated in Hay Group's *Reward in a Downturn* survey in March 2009. This is the third survey in the series, with the first conducted in March 2008 and the second in November 2008. The results show clear trends in the downturn's impact on reward practices globally and in significant economies around the world.

Data collected in the research survey includes organizational changes to base salary increases, short-term and long-term incentive programs, as well as changes to other reward-related programs (e.g. benefits plans, staffing and work rules programs and training and development programs). Typical respondents to the survey include top HR and reward executives within medium to large size organizations across a wide range of industries.

For more information on the survey, including details on results for individual countries or industry sectors, please contact your local Hay Group office, www.haygroup.com or email rewardservices@haygroup.com.

Findings – reward in a downturn

The global downturn continues to deepen, with the impact on reward programs becoming more significant and widespread. Compared to our last survey in November 2008, companies are now projecting salary increases in 2009 of 2.8% – compared to a forecast of over 4% only four months ago. What is more, at least 25% of all employers globally are projecting zero pay increases across the board in 2009.

In a significant reversal of past trends, executives are forecasted to receive the lowest level of salary increases – 1.5% compared to 2.5% for clerical/support roles. This is in stark contrast to a long history of executive pay outpacing wage growth at other levels.

Table 1 What is your organization's base salary increase for 2009 as a % of base salary? (Global respondents)

	First quartile	Median	Third quartile
All employees	0.0%	2.8%	5.0%
Executive	0.0%	1.5%	4.5%
Management/professional	0.0%	2.5%	5.0%
Support/clerical	0.0%	2.5%	4.5%
Blue collar/skilled trade	0.0%	2.2%	4.2%
High performers/potentials	0.0%	3.0%	6.0%

Organizations are also taking a variety of other actions to reduce costs, with the most common being restructuring to reduce staffing level, temporary pay freezes, promotion freezes and reducing benefits.

Table 2 Is your organization taking any other actions to reduce its salary spend? (Global respondents)

	Utilising	Considering	Utilising/ considering
Organization restructuring to reduce staffing levels	22.6%	19.2%	41.8%
Temporary pay freeze	23.1%	14.5%	37.6%
Promotion freezes	9.7%	15.0%	24.7%
Reduced benefits (other than retirement)	7.1%	15.4%	22.5%
Reduced incentives that are otherwise earned	7.3%	14.1%	21.4%
Job sharing	6.0%	11.7%	17.7%
Early retirement packages	7.4%	9.6%	17.0%
Increasing co-pays on benefits programs, and scaling back on employer paid coverage.	5.8%	11.1%	16.9%
Voluntary reduced work week/working hours, with reduced pay	3.1%	12.4%	15.5%
Voluntary unpaid leave / unpaid sabbaticals	3.9%	10.8%	14.7%
Enforced reduced work week/working hours, with reduced pay	3.9%	10.3%	14.2%
Other	3.7%	8.6%	12.3%
Voluntary/negotiated salary cuts	3.0%	7.7%	10.7%
Reduced retirement benefits	4.4%	6.3%	10.7%
Temporary salary cuts	2.7%	7.5%	10.2%
Enforced unpaid leave / unpaid sabbaticals	1.9%	6.6%	8.5%
Compulsory salary cuts	2.3%	5.6%	7.9%

Executive pay hit hardest, but job restructuring highest for white collar employees

Globally, executive positions are more likely to face a salary freeze than other employee groups. In many cases, the organization's leadership has decided to model behavior by not taking pay increases, and have asked senior staff to demonstrate similar restraint. The survey shows that in 42% of companies, temporary pay freezes are in place or in the process of being considered for executive positions – compared to 28% for blue collar/skilled employees. Actual salary cuts are also highest at the executive level: for executives, 12% of companies are utilizing or considering voluntary salary cuts, 8% are utilizing or considering compulsory cuts, and 11% are utilizing or considering temporary salary cuts. This compares to 8%, 6%, and 8% at the blue collar/skilled worker level.

However, organizational and job restructuring to reduce staffing levels is highest amongst white collar employees – 46% of companies are considering such restructuring compared to 36% at executive levels. Given the much higher numbers of employees in these populations, organizations are likely to obtain more overall labor cost savings in these employee groups than in the executive ranks.

HR programs hitting the chopping block

Training and development programs are being decreased or eliminated by 27% of global respondents. Companies are also cutting overtime wages (19%) and the use of contract laborers (30%). However, most are keeping their benefits programs relatively intact for now. Few organizations are eliminating or decreasing health care benefits (5%) or savings plans (3%).

Short-term variable pay relatively unchanged, but paying less than target

Sixty nine percent of organizations reported that their short-term incentive programs had paid out less than targeted levels in 2008, with 34% reporting payments of less than 70% of targeted levels.

A substantial number (38%) of organizations are making design changes to bonus/incentive plans. Those organizations that are making changes tend to be doing so to align their bonus programs with a changed business strategy or model, although increasing employee motivation and decreasing cost were also significant factors. Only 12% felt that public opinion and 11% felt that corporate governance requirements were a significant factor in their decision to redesign short-term incentive programs.

Long-term variable pay value drops significantly

Many organizations have stated that the value of their long-term incentive programs have dropped substantially – by an average of 37%. Approximately 28% of respondents indicated that they have already made changes or are considering changes to long-term incentives, with 47% considering or making changes to the mix between options, shares and units, and 41% considering or making changes to grant a lower value of options, shares and units per employee in 2009. As a result, the value of 2009 total direct compensation programs globally is likely to be less than 2008 because of both diminished organizational performance as well as decreased grants.

Employees most concerned about job security

The primary concern for employees (as stated by survey respondents) is around their job security, with 88% of organizations reporting this as a concern. Eighty seven percent of organizations state their employees are concerned about their salary levels and 85% about the cost of living and inflation.

Pension funds hit hard

The fall in funding levels of many defined benefit retirement programs will have a huge impact. Our survey shows 19% of organizations with defined benefit funds reviewing those funds, and 15% with defined contribution plans doing the same.

Defined benefit programs in particular are likely to need significant additional funding to meet their obligations. Of those looking to change their defined benefit programs, 35% are planning to move employees to a defined contribution plan, 30% will close membership to the plan and 21% will close the plan altogether.

Talent management top of the list for employers

The two primary concerns for employers during these challenging times are the ability to retain top talent and employees with critical skills (89% of employers stating concern), and the ability of organizations to maintain an engaged and motivated workforce (91% of employers stating concern).

Impact deepening around the world

While the downturn was slower to impact on high-growth economies in Asia, Eastern Europe and South America, the survey confirms that the downturn has hit these economies hard in the past four months. In many cases, the drop in business performance and the need to cut costs is generally now being felt as strongly as in the developed economies. Fast-growth economies with high wage inflation – such as India and China, which have seen double-digit wage growth for some years – are now predicting salary increases of less than half of 2007 levels, with China's wage inflation now around the same rate as the global figure. South America (with the exception of Brazil) is yet to feel the full force of the downturn, but companies are taking the opportunity to 'get their house in order' and review reward programs to protect against the risk of impact in the near future.

	Business results significantly worse	Median salary increase – all employees	Decreasing staffing levels
Global	39%	2.8%	27%
North America	40%	2%	33%
South & Central America	23%	10%*	18%
Europe	45%	2%	30%
Asia	39%	5%	13%
Pacific	33%	3%	33%

* increases for South / Central America are inflated by high levels of pay increases in Argentina and Venezuela; in other countries in the region, the increase is around 5-8%, closer to the global norm.

The impact of the downturn in smaller and emerging economies is frequently exacerbated by local conditions, which are magnifying its effects and impacting particularly on business confidence. Factors such as the property crash in Ireland, political turmoil in Thailand and the ongoing currency crisis in Hungary are increasing the vulnerability of those economies in the downturn and requiring organizations to take even more pronounced actions to shore themselves up. In contrast, other countries such as Australia and Peru are experiencing a delayed (and sometimes moderated) impact of the global downturn, but without locally intensifying factors.

Counting the cost – business and people impacts

The talent management challenge

In recent years talent markets have been overheated due to the lengthy economic boom, and more so in certain industry sectors and geographies. The economic slowdown will have its counterpart in the talent market: as organizations move to slow growth or retrench, so the demand for talent slows and unemployment grows. In high-growth geographies and industry sectors, the slowdown will have the potentially welcome side-effect of taking some heat out of the talent market, enabling organizations to perhaps more easily source the talent they need to sustain their business at more reasonable prices. Some talent shortages, such as in nursing, high technology and engineering, may also be eased by the baby boomers who are being forced to put off their retirement date until their pension funds recover.

However, organizations cannot afford to be complacent and assume that their high performers will not have motive or opportunity to leave. The best employees will always be able to move on and find new opportunities. Talent will be a critical factor in getting organizations through the economic storm, and smart organizations will be looking to poach key individuals from the competition.

Employee engagement across the entire workforce will be a concern, particularly when wage freezes or headcount reductions are necessary. When doing more with less, the discretionary effort of employees willing to ‘go the extra mile’ is even more critical for surviving the downturn and being positioned to grow once the environment is more favorable.

With compensation budgets continuing to be limited, organizations will need to focus more on ‘total rewards’, and particularly intangible rewards, to achieve this engagement. Hay Group research shows that rewards such as career development opportunities, a great climate, interesting work, the opportunity to work with talented colleagues and non-financial recognition are the keys to retaining employees and maintaining employee engagement.

Restructuring and pay freezes

As labor costs are generally one of the largest costs for an organization, it is often the first target of cost cutting. Organizations in crisis mode too often resort to quick, overly simplistic one-size-fits-all cuts in headcount or salary budgets. Uniform cuts across the board have a profoundly demoralizing effect on the workforce – especially on high performers – as these cuts fail to take into account the contribution of individuals and groups on past performance, or the increased need for some job roles in certain market conditions. It sends out a signal to employees and the market that the company is in trouble, and it may lead to the best talent jumping ship.

Redundancies and compensation contractions should always be undertaken strategically and surgically, based on an understanding of which roles and functions will be critical now and when moving into recovery mode. If job cuts or pay freezes have a strong business rationale, employees and other stakeholders are less likely to respond negatively. This means organizations may need to do some work to establish which roles, functions and people are critical to their success and to be able to demonstrate to stakeholders why they are continuing to invest in those roles, functions and people, but not in others.

Variable pay and incentives

The downturn will have a double impact on many employees. Incentive programs linked to organization financial and operational success are likely to pay much less than in previous years, or may pay nothing at all.

The extended period of market growth means that many employees will have received some sort of bonus for many years, and may have come to see their bonus as a right rather than as a reward for success. Organizations are likely to come under pressure to provide incentives that will not pay out well under current conditions.

By design, when performance is down, the incentive plan should not pay out as much as in good years. Well designed performance bonus plans should act as an ‘automatic stabilizer’ for companies: leading to the paying out of less remuneration in poor years when profitability has been hit, and more in good years, and therefore acting as a cushion against job cuts. The success of incentives depends on them being seen as strongly related to performance. Many organizations are seizing this opportunity to further strengthen the relationship between pay and performance via the incentive program and to remove any remnants of an entitlement mentality.

Pensions

The cost of covering additional funding for pensions may mean less money for pay increases, bonuses, benefit programs and other forms of reward. In many cases organizations may need to reduce the cost of these programs through closing them to new entrants, shifting to defined contribution programs, raising the retirement ages of participants, or decreasing employer contribution rates.

With defined contribution retirement plans, the funding burden falls more directly on the employee. The value of these programs has fallen by up to a half in many cases – a major concern for older employees considering retirement. In addition, a number of organizations have begun eliminating or suspending the organization contribution and/or match for these plans given current economic conditions.

The trend away from defined benefit to defined contribution plans will continue to be accelerated as the downturn continues. This can be a highly sensitive issue for employees and any changes to pension plans should be considered carefully. Understanding the demographics, needs and preferences of the workforce is critical to building a sustainable solution that is understood and accepted by employees. While older employees are likely to prefer a generous defined benefit fund, many younger employees will welcome a shift to defined contribution programs, which offer greater flexibility and mobility. Involving and communicating with employees throughout the change will be critical to its success.

Resourcing and succession

Organizations may also need to rethink their succession and labor resourcing plans. Delayed retirements mean organizations retain experienced and skilled workers. However, these employees are likely to be more expensive, may not be fully engaged and can act as blockers on the career aspirations of younger employees. It will be important for organizations to develop their engagement strategies with this new segment of the workforce fully considered.

Performance

Good times can hide a lot of sins. In a boom market, organizations often gloss over poor performance and may be reluctant to enforce strong performance management systems. In crunch times, many organizations do the same thing in reverse, imposing restrictions on all employees regardless of performance. Mediocre performers are unlikely to see the need to change, and high performers see no return on their discretionary effort and leave. Employee engagement suffers at a time when the organization needs it most.

Robust performance management processes are critical to success in a downturn. Organizations should clearly define and communicate what good performance looks like, recognize and reward good performance as well as bad and appropriately differentiate performance and related rewards. Organizations also need to broaden out their thinking on the pay and performance relationship and include the whole suite of rewards in this context – not just base salary increases and incentives.

That doesn't have to mean spending more on reward. Employees work for more than money: they work to get training and career development, to make a valuable contribution, and because they enjoy contributing to a common vision and making their place of work a better place to be. Organizations need to understand what it is that their employees value and focus on improving these, even if financial rewards are being squeezed.

Lastly, this is an opportune time for organizations to do a better job putting their 'mouth where their money is' in terms of communicating the value of the organization's total reward programs. Hay Group research has found that many employees do not understand the total value of reward programs that an employee receives, and that such an understanding has a clear positive relationship with organizational effectiveness.

Total remuneration

To date, employers have largely focused on saving money through adjusting salary levels or job restructuring. It takes longer and is often more complex to adjust non-cash remuneration such as benefits and pensions. But with non-cash items of remuneration accounting for 30% or more of total employee costs, these will increasingly come under scrutiny as the recession continues.

Leading companies are likely to take the downturn as an opportunity to look strategically at the total cost and structure of remuneration, and to alter this to better meet the needs of the company, while still providing incentives and motivation for employees.

Summary findings – US

A total of 40% US organizations continue to expect business results to be significantly worse than targeted or budgeted levels. This is up from 16% from a year ago. As a result, organizations have significantly tightened the reigns on wage increases, with executives taking the biggest hit. In Hay Group's research, 37% of organizations have instituted a wage freeze for their employees. Over half of the 511 reporting US organizations report that their executives will receive no increase. Budgeted base salary increases for 2009 by employee group are given below:

Table 1 What is your organization's base salary increase for 2009 as a % of base salary? (North America respondents)

	First quartile	Median	Third quartile
All employees	0%	2.0%	3.0%
Executive	0%	0.0%	3.0%
Management/professional	0%	2.0%	3.0%
Support/clerical	0%	2.0%	3.0%
Blue collar/skilled trade	0%	2.0%	3.0%
High performers	0%	2.0%	3.8%

Organizations have been swift and decisive in their actions around reducing their labor costs during these trying economic times. In addition to wage freezes and modest salary increase budgets, organizations have also substantially tightened their belts on overall staffing levels. Of the US organizations surveyed, 34% report decreasing their overall staffing levels, up dramatically from 19% only four months ago.

Significant changes to retirement programs are being made by US organizations as a result of the deteriorating economic conditions. A fifth of organizations with either defined benefit or defined contribution retirement programs are reporting that they are considering making changes to the value of these programs. Of organizations making changes to their defined contribution plans, the vast majority (78%) report they are considering decreasing the benefits levels to this plan. Organizations making changes to defined benefits programs indicate the most common likely changes are closing membership to the plan (34%), decreasing benefits levels (34%) and moving members to a defined contribution plan (32%).

Sixty nine percent of US organizations reported that their short term variable pay programs (e.g. bonuses, incentives, profit sharing) paid out less than target. However, it appears the majority of organizations (44%) are not making design changes to their 2009 short-term incentive plans. 39% of companies are making or considering changes to the design of their short-term variable pay programs in 2009. The most common reason given for making design changes was better alignment of the variable pay program with changes in business strategy (60%). Only 15% felt that public opinion and 4% felt that corporate governance requirements were significant factors in their decisions to redesign bonus/incentive programs.

Many organizations have stated that the value of their long-term incentive programs have dropped substantially – by a median of 40% in the US and 30% globally. Approximately 32% of US respondents indicated that they have already made changes or are considering changes to their long-term incentive programs. Of those organizations, 56% are making or considering changes to the mix of long-term incentives between options, shares and units. In addition, approximately 47% of organizations report they will be granting lower values of options, shares and units per employee in 2009. As a result, the value of 2009 total direct compensation programs in the US will likely be less than 2008 because of both diminished organizational performance as well as decreased grant values.

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