



COMPENSATING THROUGH ECONOMIC CHAOS **QUARTER 1, 2009**

These are challenging times for the U.S. workforce, to say the least. The national unemployment rate hit a 25-year high in February 2009 at 8.1% and could very well reach into the double digits in the coming months. Provided our own employment situation is stable, we undoubtedly know unemployed or under-employed friends and colleagues and others at risk of losing their jobs. In addition, retirement savings have taken a severe beating, pay freezes have replaced merit budgets for a number of organizations, 2009 performance-based incentives should fall significantly with weaker financial performance (assuming they were designed appropriately) and growth opportunities are limited: leaving a steady position for a better opportunity elsewhere is risky, and internal promotions are less prevalent as jobs are eliminated. No, there is not a lot of good news on the work front these days, and yes, the bad news creates a lot of anxiety. We all know that a stable job market is essential to a healthy economy.

At this time when organizations are focused on cutting costs and employee retention is not a front and center issue, keeping your compensation program up to date might not be a top priority. But effective compensation program management is always important and even more so when resources are limited. Eventually the economy and job market will improve and employees will leave for better opportunities if they feel under-appreciated by their employer and that their skills and experience have been undervalued. It is important to remember that actions taken now by an organization have longer-term implications. Staff cuts should be evaluated in light of needed skills and experience, as well as employee performance, and it is still necessary to understand market trends and how your organization's pay stacks up to the external market. In addition, there should always be a focus on keeping your organization's best performers engaged, interested and challenged in order to retain them over the long term and avoid the cost and frustration of having to replace them.

It appears likely that this economic crisis will impact the way some industries reward their employees and that the spotlight will continue to shine on appropriate pay for top executives. For now, though, getting by and making do are prevailing themes as we navigate our way through 2009. Here are some ideas for managing compensation during this economic recession.

Lead by Example

If an organization's financial situation requires pay freezes and/or business performance results in reduced or no incentive payouts, the worst decision is to treat top executives differently than other employees in justifying some or all of their performance-based income. Also, tread carefully in rewarding executives for cost savings linked to staff reductions; this is a great way to demoralize the rest of the workforce. A variable compensation program should fluctuate up with good financial results and down with bad, which means cash compensation will not steadily increase from one year to the next unless the organization's performance does the same. This applies to all employees. (It really is that simple.)

Be Creative

In order to avoid direct staff cuts, some organizations are using cost-savings alternatives, such as a few weeks of unpaid leave for all employees, temporary across-the-board salary reductions, elimination of overtime pay, job-sharing and temporary shifts from full-time to part-time status. While all of these options create hardship for those impacted, spreading around the misery instead of heaping it on a select group of employees supports a team environment and might actually boost morale. Avoiding layoffs for essential jobs impacted by the slower economy also affords an organization the flexibility to carry on with less disruption when its financial



situation improves and could reduce future hiring and training costs. Another alternative is early retirement offers to some employees. If your organization decides to go this route, employees should understand that this covers a select group of employees and that the organization reserves the right to limit the offer to those areas where staff reductions are necessary.

Don't Delay Bad News

If staff cuts are inevitable, careful deliberation in determining which employees will be laid off followed by straightforward communication are essential to a smooth transition. Living with job insecurity is stressful and unproductive, and there is no need to communicate potential job cuts months before they are actually announced. Fair warning of a few weeks to a month is appropriate; waiting much longer than this after announcing plans to cut staff creates unnecessary anxiety. On the other hand, be careful in making broad announcements that there will be no job cuts if this is not certain for the foreseeable future.

Before announcing layoffs, make sure you research the legal requirements for providing notice to employees that their jobs will be eliminated. These requirements vary by situation and the size of the staff reduction, and some states have recently introduced stricter laws to protect employees as layoffs become more prevalent. Severance pay for those employees who do not have a specific employment contract is typically one to two weeks multiplied by years of service, with benefit coverage continued during this period. Some organizations have begun to amend their severance policies to reduce the amount of severance in favor of preserving cash. Ideally, though, there will be some service recognition in the severance amounts and an employee will receive a few weeks of severance pay regardless of hire date.

It is also important to be realistic when cutting jobs and people. If cuts are made to meet a certain reduction in payroll without an analysis of how the work will be completed with the pared-down staff, this could end up costing an organization more money in lost productivity or dissatisfied customers. In addition, employee burnout will catch up with an organization when fewer employees are asked to take on unrealistic workloads.

Align with Market

Even if your organization is not providing base pay adjustments in 2009, it is still important to understand market movement and where your organization's pay is positioned against market. To the extent possible, continue to participate in compensation surveys in order to maintain consistency in the participant sample from year to year and to receive the cost savings provided to participants. There is no short-term solution to falling behind market if a budget for salary adjustments is not available and external job value is steadily increasing, but it is good to track the gaps nonetheless to understand where the organization is most vulnerable should there be some money available down the road. (Recent survey updates suggest a decrease in 2009 salary budget projections of as much as 2% compared to the initial projections—2009 salary projections are now at about 2.0% vs. the initial projections of 3.5% to 4.0% published in the last half of 2008.)

Define Performance Appropriately

Most of us found Merrill Lynch's decision to provide nearly \$4 billion in 2008 bonuses to "keep our best employees" infuriating given performance was so poor that government intervention was required to keep the firm viable. With that said, it is possible that at least part of that bonus money was indeed allocated to strong performers who met or surpassed performance metrics that were detached from corporate performance. If we needed a reminder of the importance of goal alignment and a corporate trigger to ensure incentive plan affordability, we have received it. Now is a good time to review your incentive plans for the appropriate financial safeguards. If corporate financial performance is not a specific performance metric in the plan, you



should consider establishing a threshold overall financial level below which an incentive plan will not pay in full or not pay at all.

Evaluate Pay Mix

Highly leveraged pay plans that provide significant upside opportunity when performance is strong are not so attractive at a time when the organization is not meeting its financial goals due at least in part to external forces over which employees have little influence. If this leaves your organization in a vulnerable spot, a pay program with a moderate increase to fixed costs (base pay) is an alternative provided it is feasible. But the reality is that the cash might not be available to make any such changes. If this is the case, there could be some allocation of stock options or longer-term cash awards to retain essential employees earning low base salaries vis-à-vis market. As always, it is about balancing affordability, external competitiveness and internal fairness.

Recognize High Performers

At every organization, there is a core group of go-to, get things done, high performers. These people are hard to replace, but fortunately money is not the only way to keep them happy. If monetary rewards are limited or unavailable, make sure these individuals are both engaged and challenged. Opportunities for growth, high profile assignments, small recognition gestures (such as gift cards or an afternoon off) and a simple “thank you” for their contributions or verbally letting them know how important they are to the organization and team will be appreciated more than you think.

Stay the Course

History repeats itself and tells us that eventually the economy will improve, more jobs will be created and recruiting and retention issues will resurface. While it could be some time before we see substantive signs of economic recovery and there are likely to be difficult decisions ahead, steady leaders who use good judgment and fairness in making such decisions attract employee loyalty. Employees are aware that they are fortunate to have jobs, but be assured that their employment situations will be re-evaluated when more job opportunities present themselves. Maintaining a positive and supportive work environment despite the ongoing economic challenges is the best approach to weathering this storm and perhaps emerging as an even stronger and more nimble organization.

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