

# Performance & Reward Strategies For Difficult Economic Times

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N. H. R. M. A.  
CONFERENCE**



**Robert J. Greene,** PhD,CCP,CBP,GRP,SPHR,GPHR

# **Do The Economic Conditions Warrant Different Strategies?**

- It depends on how current conditions impact you**
- It depends on what is likely to happen in the future and when**
- It depends on what your competitors do**
- It depends on your capacity to respond and to implement change**

# **Economy's Impact On You?**

- **Magnitude of revenue decline**
- **Cost of debt/restrictions on credit line**
- **Adequacy of cash flow**
- **Increased pressure from shareholders**
- **Increased anxiety among employees**
- **Increased pension funding costs**
- **Social pressure (no layoffs, closings or off-shoring) or regulatory constraints**
- **Supply-demand balance for critical skills**

# Define Possible Futures

- **If you built future scenarios would they read like one of these... or in between?**
  - **Pessimistic**
    - Long, deep recession
    - Weak recovery
  - **Optimistic**
    - Government intervention the right thing to do
    - Consumer and investor optimism returns
    - Sharp recovery within two years

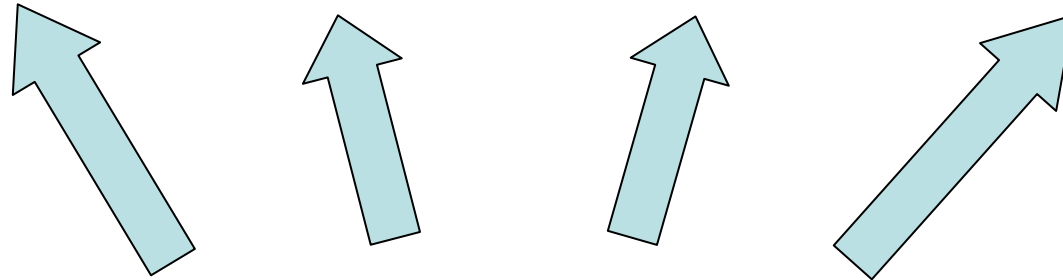
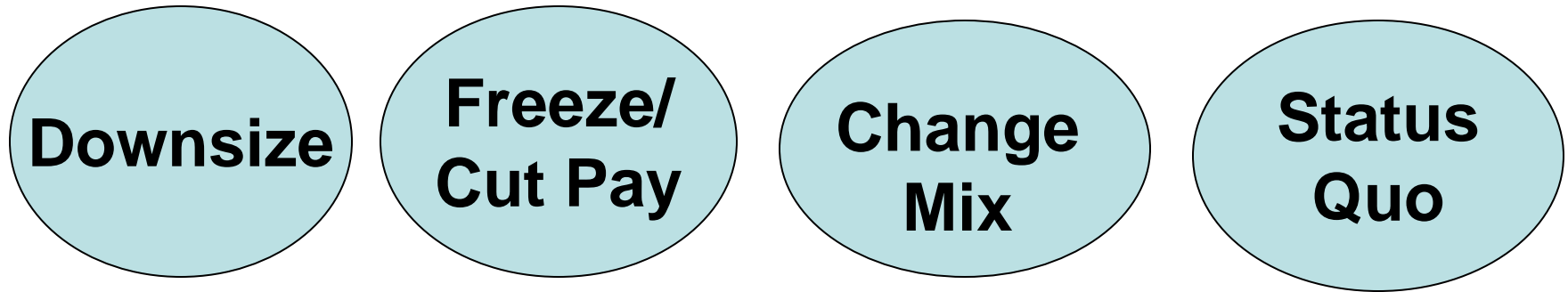
# Competitor Actions

- **Is getting/keeping talent a big problem now?**
- **Do actions by others provide “air cover” for layoffs?**
- **Do actions by others provide justification for pay freezes?**
- **Are others increasing supply of talent by downsizing?**
- **Are competitors using tools you do not have available?**
- **How visible is your talent pool to them?**

# **What Are You Capable Of Doing?**

- **Have your employees had quite enough change? Receptive to more?**
- **Is management willing to take on major interventions? Have a clue as to direction to be taken?**
- **Is the fix apt to take only after what is being fixed has changed yet again?**
- **Do collective bargaining agreements limit actions you can take?**

# What Should You Do?



# Downsizing: The Right Choice?

- Will you need the people back when the economy turns back up?
- Will they be available?
- **What will headcount cuts save you?**
  - Calculate real reduction in cash outflow
  - Deduct cost of severance pay
  - Deduct cost of paying out on vested benefits
  - Deduct added unemployment tax costs
- Will you break even in time for upturn?

# Research on 2000-02 downturn (*Responsible Restructuring, Cascio*)

## Downsizing organizations

- \* less profitable in that year
- \* did not recover ROA until 2yrs
- \* stock price no better over 3 yrs

### **Direct Costs**

***Severance***  
***Accrued time off***  
***Unemployment benefits***  
***Outplacement***  
***Vested pension/benefits***  
***Administrative costs***  
***Costs of rehiring***

### **Indirect Costs**

***Costs of new hires***  
***Low morale/loss of trust***  
***Risk adverse employees***  
***Short staff during rebound***  
***Loss of knowledge/memory***  
***Heightened insecurity***  
***Potential legal liability***

# If Downsizing Is The Strategy Consider Present/Future Impact

FUTURE

P  
R  
E  
S  
E  
N  
T

<i>Impact</i>	MAJOR	MINOR
MAJOR	<i>Software Programmers</i>	<i>Financial Analysts</i>
MINOR	<i>R &amp; D Personnel</i>	<i>Distribution Center Staff</i>

# **Is Restructuring A Viable Alternative?**

- **Is it possible to increase productivity**
  - **by doing the work differently?**
  - **by changing structure/role definitions?**
  - **by improving motivation?**
  - **by improving career management?**
  - **by ensuring lost people leave critical knowledge?**

# Alternative Rewards Strategies: Existing Workforce

- **Base pay**
- **Variable compensation**
- **Benefits**
- **Work environment**
- **Career opportunity**

# Helpful Advice

If you find yourself in a hole  
the first thing to do is to  
*stop digging!*

**Example...** if your fixed  
payroll costs are already too  
high, *don't increase them!*

# Reduce Base Pay Rates

- **Probably only in dire circumstances or as an alternative to layoffs**
- **May be viewed as a breach of contract**
  - **Admittedly it is legal if done same for all**
  - **If done in way that has adverse impact the exposure to legal liability must be considered**
  - **People established standard of living on base pay rate (+ assumption of raise?)**

# **Freeze Base Pay Rates/ Defer Increases**

- **Stops the digging (raising fixed costs)**
- **Explainable if conditions warrant it**
- **Impacts everyone the same way**
  - **That may sound “fair”... but only to some**
  - **What happens to high performers being paid low in the range?**
  - **Can promise a review in 6 months, with outcome based on actual conditions**

# **Reduce/Freeze Pay Rates: *Competitive Scene***

- **Dec. 08 WAW follow up survey showed**
  - **pay increase budgets went from 4% to 3%**
  - **about 15% froze base pay rates**
  - **over half said variable pay would be down**
- **NACE survey shows 2009 offers are flat**
- **Mercer survey shows 1/4 of orgs have frozen salaries for 09 – may go to 1/3. Budgets cut .5% from October to end of year**
- **Pattern is clear; question is what any one organization should do**

# **Key To Successful Voyages**

**Build a navigation system  
that will head you in the right direction  
and re-direct the course when needed**

**How about using our old friend...  
the increase guidechart?**

# Reduce Merit Budget From 4% to 3%: Two Approaches

Pos. In Range > Perf. Rating	Lower Third	Middle Third	Upper Third
Outstanding (10%)	8 > 7 > 8	6 > 5 > 6	4 > 3 > 4
Significantly Exceeds (20%)	6 > 5 > 6	4.5 > 3.5 > 4	3 > 2 > 2
Fully Meets (65%)	3.5 > 2.5 > 3	2.5 > 1.5 > 1.5	1.5 > .5 > 0
Does Not Fully Meet (5%)	3 > 2 > 0	2 > 1 > 0	1 > 0 > 0

# Which Approach Fits You?

- Depends on whether current rates are distributed appropriately
- Depends on how current rates match up to prevailing market rates
- **Depends on how sound your performance management system is**
- Depends on culture of organization
- Depends on how capable managers are

# Using Control Points

- **Traditional ranges: Use control points to match more closely to market if large differences in criticality of skills; calculate compa-ratio off control points**
- **Broadbanded structure: Use control points to both match more closely to market and to better recognize career progression**

# Reduce Merit Budget To 2%: Allocate 1% To Cash Awards

<b>Pos. In Range &gt; Perf. Rating</b>	<b>Lower Third</b>	<b>Middle Third</b>	<b>Upper Third</b>
<b>Outstanding (10%)</b>	<b>8 &gt; 5 +5% cash</b>	<b>6 &gt; 3.5 +5% cash</b>	<b>4 &gt; 2 +5% cash</b>
<b>Significantly Exceeds (20%)</b>	<b>6 &gt; 4 + 2.5% OPA</b>	<b>4.5 &gt; 2.5 + 2.5% OPA</b>	<b>2 &gt; 1 + 2.5% OPA</b>
<b>Fully Meets (65%)</b>	<b>3 &gt; 3</b>	<b>2.5 &gt; 1.5</b>	<b>2 &gt; 0</b>
<b>Does Not Fully Meet (5%)</b>	<b>3 &gt; 0</b>	<b>2 &gt; 0</b>	<b>1 &gt; 0</b>

# Replace Increases With Cash Awards: 2 Options

Pos. In Range > Perf. Rating ↓	Lower Third	Middle Third	Upper Third
Outstanding (10%)	9% 7%	7% 7%	5% 7%
Significantly Exceeds (20%)	6% 5%	5% 5%	4% 5%
Fully Meets (65%)	3%	2%	1%
Does Not Fully Meet (5%)	0	0	0

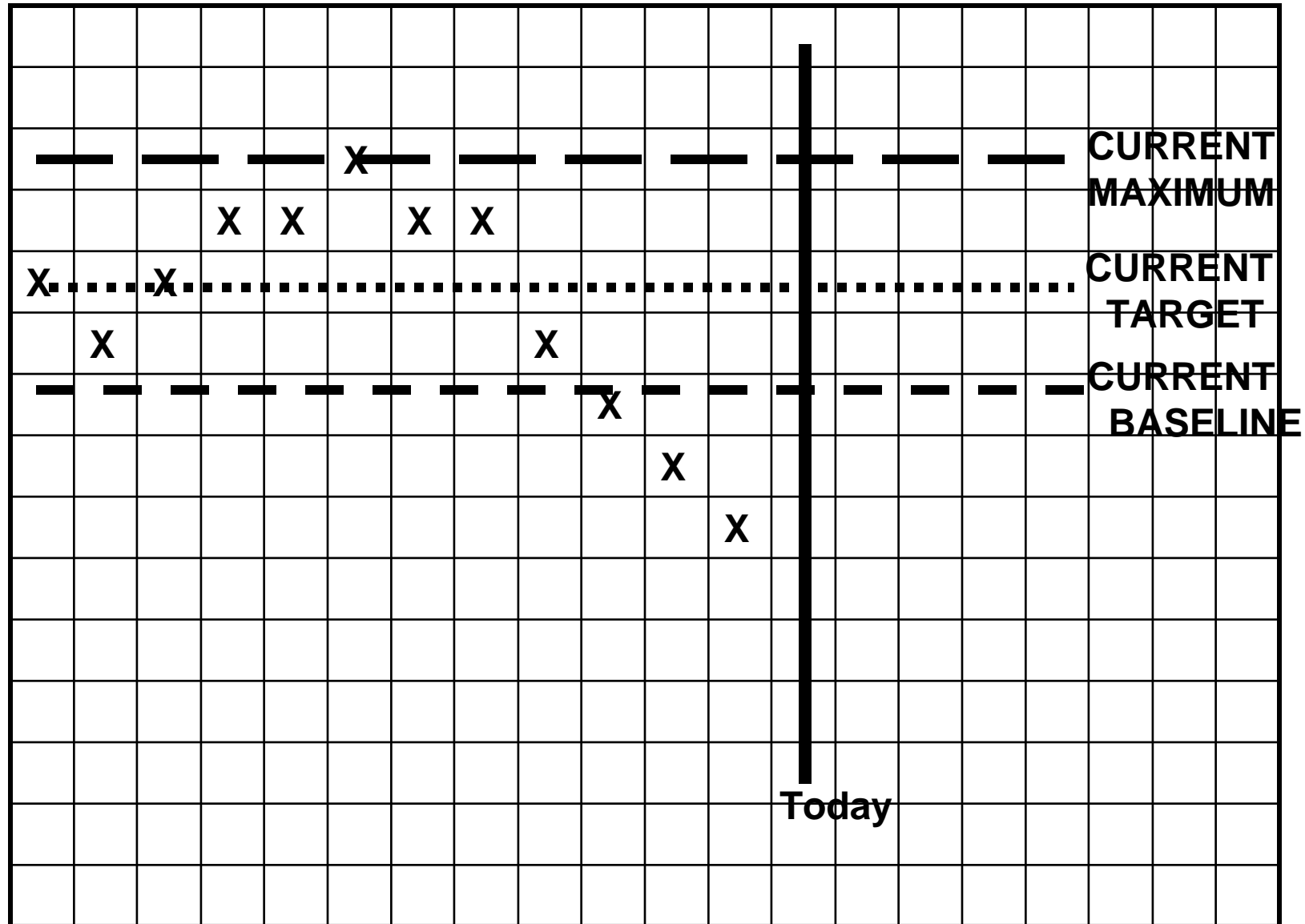
# **Change Direct Compensation Mix**

- **Replace fixed cost base pay with variable pay opportunity**
  - **Reduce base pay levels; add incentives**
  - **Freeze base pay levels; add incentives**
  - **Split budget for pay adjustments into base pay increases and cash awards**

# Variable Compensation

- **Performance criteria/standards**
  - Lower threshold for generating award fund
  - Raise threshold for generating award fund
  - Change performance criteria
    - Focus on cash flow rather than current profit
    - Reward innovation producing new revenue sources
- **Change eligibility**
  - Reduce number of employees eligible
  - Increase number of employees eligible
- **Change timing; measurement &/or payout**

# Where To Set Baseline For Incentive Awards?



# **Variable Compensation:**

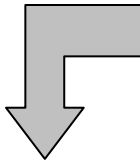
## ***Timing***

- **If cash flow is the burning issue, defer cash awards or use non-cash awards?**
  - **Have 401K match depend on results, with vesting over longer period**
  - **Paid time off earned (e.g., 1 week off in lieu of 2% cash award)...especially if attempting to retain critical skills and workload permits it**
- **If uncertainty is great, quarterly cash awards that “earn back” lost BPIs (e.g., earn back 1%/qtr in cash to replace 3% BPI not given)**

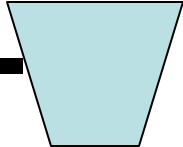
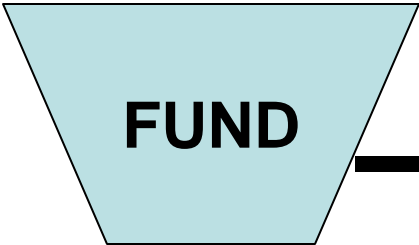
# Variable Compensation

- **Change manner of distributing funds**
  - **Egalitarian**
    - Same percentage of current base pay?
    - Same percentage of range midpoint?
  - **Tied to performance**
    - Tied to individual performance more closely?
    - Tied to group/unit performance more closely?
- **Be careful to motivate **right** behavior...**
  - Merit pay/individual incentives → competition?
  - Shift to “shared destiny” plans (group)?

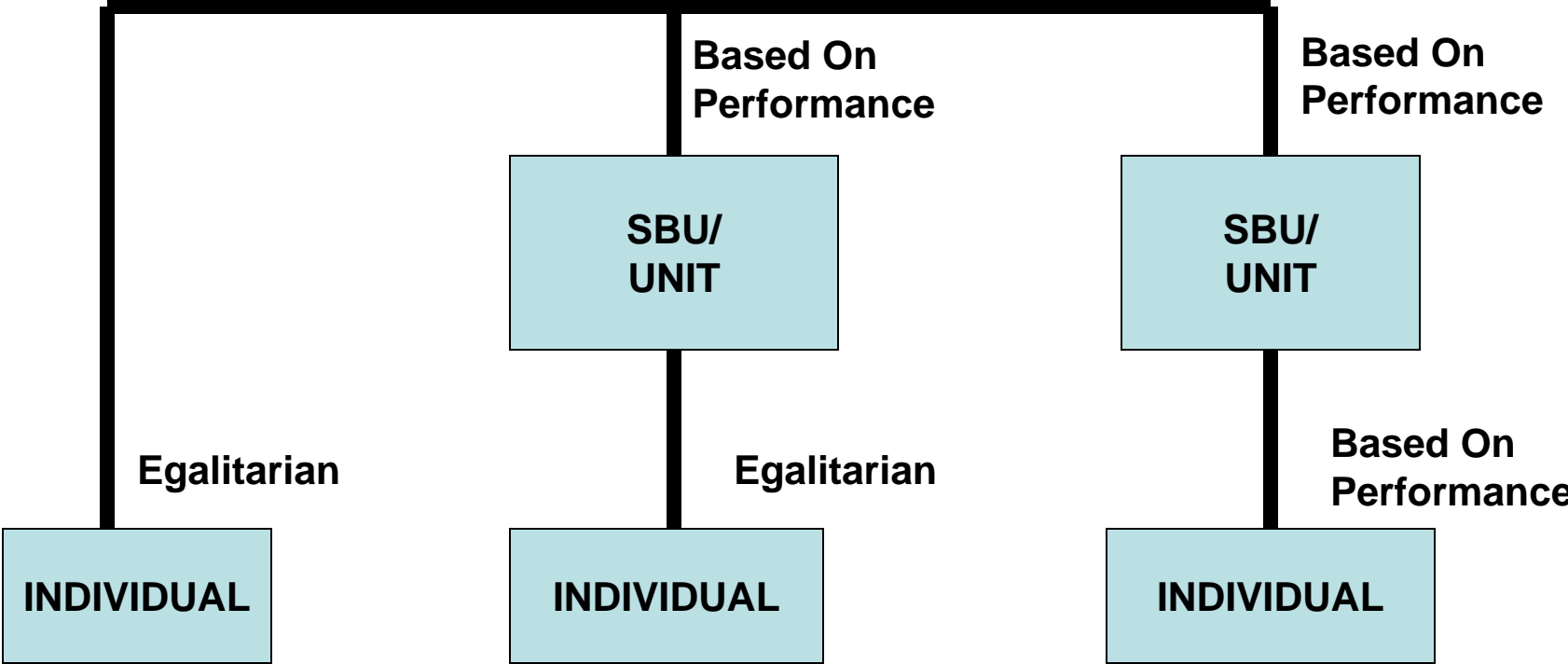
# Distributing Incentive Funds



Organization Performance



Outstanding Contribution Award Fund



# Which Method To Use?

- **Always create a “side fund” to reward outstanding contributions, even in bad year**
- **Use egalitarian method to convey message of shared destiny**
- **Use variable allocation to units if each tend to stand alone and may vary in both performance and criticality**
- **Use performance based allocation within units if it fits the culture**

# **Distributing Funds To Individuals**

- **Equal percentage of current base pay**
- **Equal percentage of range midpoint**
- **Equal percentage up to maximum**
- **Varied based on organizational level**
- **Equal dollars to each individual**
- **Equal dollars per hour worked**
- **Based on individual performance**

# **Variable Compensation:** ***Form Of Reward***

**Cash >>> Equity?**

**Options**

**Restricted Stock**

**Mandated Ownership Levels**

**Equity delivered how?**

**Based on performance**

**With longer vesting**

# **Change Indirect Compensation Strategy**

- **Reduce costs of benefits programs**
  - Increase employee share of health care
  - Implement consumer directed health care
  - Reduce level of benefits provided
  - Provide flexible benefits
  - Rethink paid time philosophy
    - Vacation carryover
    - Specified number of sick days
    - Separating different types of time off

# Changing Strategy

- ***Sustainability*** should be a major consideration
- **Yet continuous evaluation & refinement are necessary in turbulent environment**
  - *What works is what fits – now!*
- **But continuous change is challenging**
  - **Employees cool to frequent change**
  - **Administrative resources probably limited**

# **Status Quo**

- **If you do what you have always done... you will get what you always got**
- **Insanity can be defined as...  
“repeating the same actions and expecting different results”**

**But change has its costs... can you afford them... afford the status quo?**

# **If You Could Do One Thing... Any Thing...**

- **What one thing do you believe would be the best action to take... now?**
- **What stands in the way of doing it?**
- **Can you remove the obstacles? How?**