Weathering the Compensation Storm of 2009
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The economic downturn that started with the meltdown of the financial sector in the United States has now spread well beyond one country and one sector into the real economy worldwide. The initial devastating impact of overleveraging on financial institutions and the crash of the housing market on overextended home owners has spread widely (and wildly) to even those companies, industries and countries with savings, cash and healthy balance sheets as they have seen their customers cut spending and consumer confidence dry up.

This unprecedented systemic and synchronized rapid-fire drop in economic activity the world over has caused companies to take drastic measures to reduce costs to stay afloat – with a major cost item being labor. As companies have cut staff, and the compensation and benefits packages of those remaining, unemployment and uncertainty about the future have caused the demand for goods and services to drop off the charts, and all economies are feeling the impact. While the impact is not identical across the board, world growth in GDP is now predicted to slow almost to a halt in 2009, at 0.5% - compared to 5.0% in 2007 and 3.5% in 2008.

**GDP Growth**

Advanced vs. Emerging Economies

*Data Sources: IMF World Economic Outlook Projections: WEO Update January 28, 2009 (for 2007 to 2010); October 2008 WEO data for 2000-2006*

*Real (Constant) GDP: Annual percentages of constant price GDP are year-on-year changes; the base year is country-specific.*

**Asia-Pacific Landscape**

While the impact on many of the economies of Asia-Pacific is drastic, there are bright spots and they are large. The major, emerging markets of Asia-Pacific, notably China and India, while not “decoupled” from the economic troubles of the developed economies as had previously been hoped, are still experiencing growth that looks very healthy by Western standards, although at the 6.5% and 5%, respectively anticipated for 2009, a sharp decline from the overheated pace of 2007 when China saw 13% growth and India was over 9%.

China, still largely an export-driven economy, has felt the ripple effect of the drop in consumer demand worldwide. This has lead to numerous layoffs, plant closures and dislocations of the population. To buffer the impact, the Chinese government has adopted an aggressive four trillion Yuan (nearly US $600 billion) stimulus package of infrastructure spending, interest rate cuts, subsidies, and tax cuts for businesses. Structural reforms such as property ownership and social safety nets are underway with the intent of encouraging the newly developing middle class to become stronger domestic consumers so China can rely less on exports to sustain its economic growth. This shift also brings more opportunities for companies targeting the growing Chinese middle class consumer market.
India’s traditionally strong domestic consumer market and agrarian economy, along with its relatively stable banking system have mitigated the impact of the global downturn on its economy. India may face challenges, however, in adopting nation-wide measures to address the economic downturn because of a more decentralized approach to government that limits coordinated intervention in the economy. However, the high-technology sector in particular, a major success story in India, continues to realign its strategy evolving from merely a low cost labor market to a highly talented pool of employees and a growing middle class population that embraces and can increasingly afford higher-end technology and consumer products.

Other countries in Asia, particularly the industrialized and export-driven are experiencing sharp contractions in their economies in 2009. Japan’s GDP is expected to decline by 2.5%. Taiwan and South Korea are heavily exposed to the US for exports and are also expected to contract dramatically. Members of the Association of South-East Asian Nations are likely to experience similar challenges. This will be dependent on the degree to which they are experiencing reduced demand for the commodities they supply the world market, to reductions in tourism and other export-related industries.

**Coping Strategies**

In spite of the gloom and ratcheted down expectations for this year, many forecasts are that many sectors of the economy will start improving during the latter part of the year, and 2010 will be strong. Companies are feverishly planning for the future – whether with innovation in products, technologies or processes, acquisition of key talent (or key competitors). Many are laying the groundwork to emerge much stronger.

**Salary Budgets for 2009**

In the meantime, companies are taking strong, focused and careful cost reductions to endure the current downturn. A major difference in this downturn, compared to previous recessions, is that while many companies are downsizing and reducing staff, when at all possible, companies are far more inclined to adopt strategies that will avoid or at least minimize the most drastic action – termination of employees. After all the great efforts to attract and develop talent in recent years, companies are mindful of the need to retain their most important resource.

According to Radford’s *International Semi-Annual Summary of Industry Trends (ISSIT)* report, current compensation strategies can be summed up in two words: cost cutting. The report reflects the actions of primarily US-headquartered multi-national high-technology companies with global operations. Typically, the actions taken by US-headquartered firms are applied universally. Of course, adherence to local laws for employee/union/government consultation and notice periods for changes to employment contracts means that cost cutting strategies may take on different permutations in each location.

In general, late last summer, salary increase budgets globally had already been adjusted lower, indicating that companies were preparing for slower growth ahead. But after the seismic shock to the economy last fall, companies quickly modified their plans to include salary freezes, reductions in salaries, mandatory time off, including plant shutdowns and furloughs, and layoffs.

Radford’s ISSIT report indicates that close to a majority of companies in the high-technology sector are on a salary freeze with no salary increase budgets planned for 2009. In Asia-Pacific, about half of the largest high-technology companies are reporting a salary freeze. The numbers do not vary significantly by country: 47% of Radford’s survey participants with operations in China reported a salary freeze; 47% in India; 53% in Japan; and close to 54% in Singapore.

For those companies granting a salary increase, it’s clear they are trending lower. “Diluted” budget figures (including those companies reporting a freeze or zero increases) are drastically lower than the salary budgets among only those companies who can afford an increase. Prior to October 2008, hardly any companies anticipated a zero salary increase – earlier in the year the worry had been keeping up with inflation and runaway commodity prices including fuel and food! Since then, most have grown far more conservative.

The salary increase figures in Table 1 show a significant drop in salary budgets now from what was anticipated last fall, and the big difference between the whole market (the diluted figures) and the smaller group that can still give increases (undiluted).
Table 1

Average Pay Increases Projected for 2009 as a Percentage of Base Payroll

<table>
<thead>
<tr>
<th>Countries</th>
<th>Average Increases Per Fall 2008 Report</th>
<th>Average Per February 2009 Report</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Undiluted</td>
<td>Diluted</td>
</tr>
<tr>
<td>China</td>
<td>8.6%</td>
<td>8.5%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>4.7%</td>
<td>4.6%</td>
</tr>
<tr>
<td>India (fixed)</td>
<td>13.5%</td>
<td>13.5%</td>
</tr>
<tr>
<td>Japan</td>
<td>3.7%</td>
<td>3.6%</td>
</tr>
</tbody>
</table>

Data Source: Radford International Semi-Annual Summary of Industry Trends (ISSIT), Q1 2009

In addition to salary budget actions, Table 2 shows the percentage of US-headquartered multi-national companies taking these major compensation-related cost control measures:

Table 2

Compensation Cost Reduction Strategies

<table>
<thead>
<tr>
<th>Action</th>
<th>Percentage of Companies Taking Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Layoffs last 12 months</td>
<td>67%</td>
</tr>
<tr>
<td>Layoffs last six months</td>
<td>45%</td>
</tr>
<tr>
<td>Salary freeze for 2009</td>
<td>45%</td>
</tr>
<tr>
<td>Base salary reduction last six months</td>
<td>2%</td>
</tr>
<tr>
<td>Base salary reduction next six months</td>
<td>10%</td>
</tr>
<tr>
<td>Mandatory time off last six months</td>
<td>33%</td>
</tr>
<tr>
<td>Mandatory time off next six months</td>
<td>20%</td>
</tr>
</tbody>
</table>

Data Source: Radford Quarterly Summary of Industry Trends Report (QSIT), Q1 2009

In the current environment, US-headquartered multi-national companies have been adopting compensation cost-cutting strategies that are intended to generally apply across the board, meaning globally. In implementing these strategies, however, exceptions are made to ensure adherence to local laws. In addition, the company's sales/marketing, product development and staffing strategies may differ by country and these also impact the degree to which the overall compensation/cost reduction strategy is carried out.

Since company announcements about cost reductions often proceed the actual implementation of these activities, there is generally a lag between an announcement and the impact on employee turnover statistics. We would expect that employee turnover statistics primarily from involuntary terminations will show an
increase later this year before stabilizing. It is also no surprise that voluntary turnover is dropping in most countries, with the exception of India, where opportunities remain for experienced individuals and management skills are still in high demand.

Despite many labor force reductions, still some companies are planning for an increase in their workforce, with India having the most optimistic outlook where 25% of the companies anticipate a workforce increase. China is relatively strong, too, with 20% of the companies expecting to increase their staff. On the other hand, Japan had the lowest forecast for increasing employment – only 10% of the companies expect to add to their workforce there.

What Next
While the economy is expected to be stressed throughout 2009, efforts at resuscitation are underway. Government intervention in the form of recovery packages that provide banking sector relief, economic stimulus and social support are being pumped out. Despite the headlines, ricocheting stock market and dismaying macro economic statistics, many, many companies and economies are in a strong position to weather it out.

Many are now scrambling to improve their competitive position by selective hiring and investment. While some operations may be temporarily idle, research and development and innovation continue. Performance-based compensation approaches are more critical than ever in aligning the company's cost structure and performance with rewards to the most deserving employees. Employee stock strategies are being restructured to better balance the interests of shareholders and employees.

How employees are treated now during this downturn may impact the ability to ramp up again when the economy rebounds. It has been reported that employee job satisfaction is higher now, during a time of major uncertainty, than it was during the “good years.” Typically, this is because employees tend to be more grateful to have a job during difficult times and are more likely to try to outperform and think creatively. Frequent communication from supervisors and management about what is happening with the company is important, and appreciated by employees, more than ever before.

Reference:
International Monetary Fund (IMF) World Economic Outlook, February 2009
Radford International Semi-Annual Summary of Industry Trends, Q1 2009
Radford Quarterly Summary of Industry Trends Report, Q1 2009