

The Impact of Current Economic Climate on Compensation and Benefits Issues

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ABSTRACT

This is a brief overview of the impact of the downturn in the economy on the HR areas of compensation and benefits. The discussion is primarily restricted to the U. S. although it is recognized that nothing occurs purely in one country without some kind of global impact. The two areas of compensation and benefits have been discussed within the framework of Affordability, Accountability and Appropriateness. In the area of compensation the discussion is primarily about base pay and variable pay. In the benefits area the discussion is about health care and retirement programs. Both the employer's and employee's perspectives have been considered where appropriate. Most of the material in this discussion is based on studies and surveys conducted by various organizations and consultants.

Keywords

Human resources, compensation, benefits, economy, employer, employee, survey, forecast, affordability, accountability, appropriateness, health care, retirement

1 INTRODUCTION

The "great recession" of 2008-2009 has resulted in some changes in Human Resources related policies and programs. Some of the changes have been particularly noticeable in the areas of compensation and benefits. These two areas incur an enormous cost for the organization. Therefore, when it came to cost-cutting actions that needed to be taken to respond to the recessionary cost issues, the two line items that were affected directly and immediately are compensation and benefits.

The economic climate faced by the United States in particular, and the entire world in general, changed the business landscape with respect to affordability, accountability and appropriateness. The emphasis on these 'triple A' principles became even more critical due to the potential (and in some cases, actual) collapse of powerful financial institutions and other industry giants. Organizations had to balance their survival needs with the employees engagement and motivational needs. Some refer to this positive relationship between employer and the employee as the employee value proposition. This article

discusses decisions and actions organizations took during 2008-2009 and what they may planning for 2010 particularly in the compensation and benefits areas. The 'triple A' principles will be used as the framework for this discussion.

2 AFFORDABILITY

Compensation

In response to the declining economy, many organizations either froze or cut pay in 2008 and 2009. According to Watson Wyatt's *Effect of Economic Crisis on HR Programs, Update: December 2008*, salary freezes jumped from 4 percent in October 2008 to 13 percent in December 2008. This trend continued in 2009 which was a difficult year for employers and employees. WorldatWork's 2009 - 2010 Salary Budget Survey update found that 52 percent of U. S. employers froze pay in 2009 for some or all employees. At least 22 percent are planning to prolong the pay freeze in 2010. More than half of the companies that froze pay in 2009 plan to resume normal pay in 2010. Many other actions were taken to manage costs including the cost of compensation. 13 percent of employers cut pay in 2009; 37 percent of those employers consider themselves as still being in a recession and not considering restoring cut pay, 29 percent plan to restore in full and 15 percent will make the pay cuts permanent. Watson Wyatt also found that 61 percent of employers reduced their planned merit increases for 2009 from 3.8 percent to 2.5 percent.

According to The Conference Board Salary Increase Budgets for 2010 - Winter Update, new projections show that salary increase budgets in the U. S. will be below 3 percent at 2.8 percent and the projected salary structure adjustments are not expected to be above 2 percent. The highest forecasted median salary increase budgets for 2010 are in consulting services - 3 percent for all employee groups except non-exempt which stands at 2.85 percent. The lowest 2010 increase are in the banking industry (2%). This is understandable considering the turmoil banks have gone through since 2008.

Benefits

While almost all benefits are important at different stages in

one's life, the two benefits discussed most by the downturn in the economy are healthcare and retirement benefits.

A notable fact during this downturn is that employees and employers have a sense of "shared destiny" according to a Towers Perrin principal. The employee's stability rests on the success of the organization.

Aon Consulting's 2009 Benefits and Talent Survey points out that while there have been attempts at modest reduction in medical costs to the employer since 2008, health care spending is still increasing faster than the general rate of inflation. Employers are taking a two-pronged approach to reducing health care spending: looking to cut costs in the near-term while analyzing the root cause of health care spending (such as chronic illness, obesity, etc. to address costs long-term. In connection with health care, the number of employers who offer consumer-directed health plans, which emphasize wellness programs and encourage employees to take a more active role in their health care decisions, rose from 27 percent in 2008 to 32 percent in 2009.

Towers Perrin also found that retirement accounts are also driving new priorities. According to their 2008 survey, nearly two-thirds of respondents believe they face a much greater risk that they won't be able to afford to retire when they want to. Fourteen percent of the survey respondents said in August 2008 they planned to retire in the next few years; the number dropped to 9 percent in December 2008. In view of the uncertainty of the future employees are opting for phased retirement. The Pension Protection Act of 2006 enabled retirement plans to be less restrictive in the ability of employees to access in-service a portion of their retirement distributions, so they could afford to work less, but still maintain a standard of living. However, many employees, either planning for full retirement, or hoping for a phased-in approach have had to put those plans on hold, as economic conditions have made these options unattractive, unaffordable, or unavailable. According to a MetLife survey it is important to encourage employers to take a hard look at traditional models of retirement generally built around a fixed career end-date and 100% employer paid benefits.

While there has been much discussion about employers moving away from defined benefit (DB) plans to defined contribution (DC) plans, Aon Consulting found that not much change has really occurred. Also 92 percent those with DB plans are not making any changes to their DB plans. Aon also found that while the turmoil in financial markets highlights the financial volatility of pension plan costs, two thirds of respondents continue to employ traditional investment strategies and take investment risks, with most sponsors appearing to take a wait-and-see attitude.

Plan sponsors are generally confident about their ability to cost-effectively manage DC plans. They are not as confident about the employees' ability to understand retirement needs and plan for retirement. Aon found that close to 90 percent of respondents feel that employees are delaying retirement in light of the economic downturn. Employees have moved their 401(k) or 403(b) investment mixes out of equities.

3 ACCOUNTABILITY and APPROPRIATENESS

Compensation

Companies are now referring to "new normals" with respect to how pay will be distributed in 2010 and after. Greater accountability is expected of the employee. The new normal will require different approaches to salary management and greater alignment of variable pay to employee impact on organization performance. The 'line-of-sight' concept has become important. The alignment of the reward strategy with the business strategy has become critical. Organizations have found a revitalized need to retain mission-critical talent and reward such talent when they create value to the organization. To make this process a reality performance-related pay has taken on new significance. Selecting, communicating and measuring meaningful and relevant performance measures has become critical. According to Hewitt Associates, while employees may see a slight rebound in the salary increases in 2010, variable pay will be the real standard for increased compensation. This focus on variable pay is likely to lead to better overall organizational performance but also lower overhead costs. Increased emphasis on variable pay offers an effective way for organizations to deal with smaller salary budgets and find more ways to engage employees. Variable pay as a percentage of payroll for salaried exempt employees in the U. S. was 12 percent in 2009, an all-time percentage high. Hewitt projects 2010 budgets to be in line with that at 11.8 percent.

Benefits

Employers are gradually beginning to make employees more responsible for their decisions regarding health care and retirement. Consumer-driven health plans are aimed at such a shift.

Although there has not been an overwhelming number of companies switching to DC plans there is still the push to encourage employees to think about their retirement plans when they are young and new to the world of work, unlike their parents and grand parents who depended on their employer to make the decisions through DB plans. Aon believes that a clearer picture for DB plans may emerge as more employers evaluate and implement alternative retirement program designs in response to the financial market turmoil. In the short-term, it is understandable that

employers may be less willing to change their investment policy given the high cost of funding their pension deficit. Much can also be done to improve the efficiency of DC plans. Companies can maximize their value by aligning plans with their current and future workforce's emerging needs.

4 CONCLUSION

General Electric's CEO Jeff Immelt is credited with coining the term "the reset economy" which suggests that the U. S. is going through more than an economic cycle. The economy is being reset in many ways. We may never go back to many of the ways we used to do business in general, and in particular how we managed compensation and benefits. As we are moving forward in resetting the economy, there could be more changes in the economy and the surrounding political, regulatory, and global environments which could affect compensation and benefits in a very big way. The question is not whether this will happen, but rather when will it happen. The more prepared organizations are for such changes the sooner they will be on their way to be successful.

POST-SCRIPT

Since writing this proceedings document four consulting firms mentioned in this document have become two consulting firms. Towers Perrin joined forces with Watson Wyatt and Aon has joined forces with Hewitt Associates.

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