

# Compensating Employees in a Down Economy

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| <b>Bottom Line</b> | Current economic conditions have organizations balancing two often conflicting priorities: cutting costs and maintaining positive relationships with employees. |
| <b>Subjects</b>    | Impact of the recession on compensation trends, employer–employee relationships, compensation surveys   |

## Cutting Compensation Costs

As the world waits for the global economy to turn around, U.S. organizations continue to reduce costs, taking aim at what is often their largest expense – compensation. According to recent economic impact studies, including one conducted by Salary.com:

- 52% of organizations have reduced their staff through layoffs
- 60% of organizations have implemented hiring freezes
- 53% of organizations have implemented pay freezes
- 7% of organizations have cut salaries
- 73% of organizations plan to reduce target bonus amounts over the year
- 70% of organizations are reducing their salary increase budgets

The Salary.com National Salary Budget Survey published early last fall reported projected 2009 merit increases to be between 3.6% and 3.9%. Preliminary results from this year's survey indicate approved merit increases for 2009 will be around 1.5% to 2.0%. Salary budget surveys from a variety of vendors are consistent with these results; actual 2009 increases will be significantly lower than initial projected increases. Because of this change, salaries are expected to grow much more slowly this year than in the past several years.

## Managing Relationships with Employees

The current economic conditions are stressful for all, as organizations struggle to survive and employees fight to hold on to their jobs, their homes, and their retirement funds. It is important that organizations acknowledge their employees are facing hard times outside of the work environment. Showing concern can go a long way, and this kind of support can help attract and retain employees.

Managing relationships with employees involves not only support and understanding but also honest, open communication about what the organization is doing. Effective communication is vital to engaging employees, developing and maintaining trust and respect, and promoting productivity. Make sure employees understand how and why they are being paid, particularly if there have been unfavorable changes to compensation due to the economy. Being aware of the circumstances and reasons for a decision will make employees more comfortable with and understanding of the situation.

Leadership should also work hard to engage employees during these difficult times. Reinforce the core competencies and values of your organization and discuss with employees how they can help the organization meet its goals. Setting a game plan that everyone can buy into will create a sense of purpose and ultimately motivate employees to perform at a higher level.

## Allocating Rewards

One pay practice that can help carry organizations through this recession is pay for performance. Limited funds may persuade organizations to hold off on any performance rewards, but this can reduce motivation from top performers. Top employees will always be in demand, so it is prudent to allocate some funds to reward their high performance. It may be a tough sell to

management, but the cost of losing superstars far exceeds the cost of an incremental increase. Once the economy turns around, your organization does not want to be caught trailing the market when it comes to compensation.

Hand-in-hand with pay for performance should be an effective, on-going performance management process that establishes clear expectations and goals used to measure performance. Continual feedback can guide employees and on-going discussions let managers demonstrate interest in their employees' performance. Organizations will find that ensuring employees are enjoying their jobs, growing in their roles, and developing new skills will go a long way toward securing their services for the future.

Challenging times may limit the ways organizations can reward employees, but they also offer the opportunity to focus on the non-financial aspects of total rewards. Your organization should try to leverage non-cash rewards and other programs to motivate employees. These can include training and development, recognition, and work-life balance programs such as telecommuting, job sharing, and flexible work schedules. These non-cash rewards often have high perceived value for employees and can take their focus off of financial rewards.

## Participating in 2009 Compensation Surveys

The value of compensation data may be greatest in tough economic times and this year's salary surveys are highly anticipated. How changes in the market will affect pay is currently difficult to predict, and organizations will need as much data as possible to support their compensation decisions.

With the busy survey season underway, it is important that organizations take every opportunity to participate and report their compensation data. Assumptions about how things are playing out are not enough and surveys offer organizations a chance to report what they have actually done. Survey output data is only as good as the input data, and high participation rates will enhance the value of surveys for all users.

For organizations changing their compensation practices, survey participation in 2009 is particularly important. Those that have changed incentive pay and bonuses need to report this information to accurately depict market pay levels. For organizations with workforce reductions, incumbents reported last year may no longer be employed and average salaries may have changed due to these cuts. If organizations who have frozen their pay decide against participating, the market will be based solely on those organizations that do grant increases. Subsequently, the market may appear to be moving faster than it really is and eventually organizations that froze pay will look as though they are farther behind than they really are. As a result, they may end up allocating higher increases than needed.

## Using Compensation Survey Data

The expected slow salary growth for this year has organizations looking at how they utilize compensation surveys. With most 2009 surveys yet to be published, organizations are aging 2008 data using assumptions about how salaries are growing. These assumptions are derived from yearly salary budget surveys and key market indicators, but often are not adjusted until special circumstances or major market fluctuations occur. Since salary increases are much smaller this year than previous in years, many organizations have made the decision to adjust the aging factors they are currently using. Once the economy rebounds and salary budgets increase, it will be appropriate to adjust these factors again.

What does this mean for your organization? It is important that salary increases are allocated according to your organization's compensation philosophy, but you should also consider what the market is doing. Your organization's particular circumstances will dictate how much can be allocated for increases, but your aging assumptions for survey data should remain close to the market. If you age your survey data too slowly, your pay may fall behind the market. Age the data too fast, and your pay may end up too far ahead.

## Using Compensation Survey Data

Salary.com has been closely studying the economic conditions and we have determined that reductions in salary increases are significant enough to warrant changes to our aging methodology for CompAnalyst Market Data. For this reason, we have decreased the aging factors used to update the underlying survey data for this product. Clients can expect that our data will generally grow more slowly over this year when compared to past years. We will continue to monitor the situation, but we do not anticipate making additional changes to our methodology until the economy rebounds.

### Takeaway

- **Salary increase budgets are shrinking as a result of the current economic environment.** Smaller increases mean salaries will grow much more slowly this year when compared to previous years.
- **Organizations need to carefully manage relationships with employees.** Communicating openly and honestly, paying for performance, and using alternative rewards can help organizations retain and motivate valued employees.
- **Participation in 2009 compensation surveys is critical.** Organizations need to report how they may have changed their compensation practices so the market will be accurately portrayed. This year's surveys will be valued data sources used to support compensation decisions.
- **Salary.com has made a methodology change within CompAnalyst Market Data.** Shrinking salary budgets prompted Salary.com to decrease the aging assumptions used to update the underlying survey data of the product.

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