



Looking Toward Recovery

Focusing on Talent and Rewards

2009/2010

U.S. Strategic Rewards Report

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At a Glance

Organizational restructuring has been pervasive and deep.

Actions taken to combat the downturn have had a significant negative impact on some employee perceptions.

Employees believe the changes made by their companies are affecting work quality and delivery to customers.

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Executive Summary

The recession has had widespread and unprecedented impact on U.S. employers and their employees. While the worst might be over, companies need to be prepared for the effects to linger even after the economy recovers. The scope and number of actions employers have taken in response to the economic crisis could have a long-lasting and detrimental impact on productivity, quality and customer service.

A critical first step for employers as conditions improve is to understand how their actions have affected their Employee Value Proposition (EVP), especially in terms of creating significant attrition risk among top-performing employees. As companies emerge from the recession, they need to ensure their EVP aligns with changes in the business environment and their own strategy and goals. Reviewing and rebuilding their EVP will enable these employers to engage and retain the current workforce and to provide a compelling employment deal to critical-skill and top-performing employees.

Key Findings

Organizational restructuring has been pervasive and deep.

- Seventy-two percent of participants have gone through a restructuring or made layoffs since the economic downturn began in 2008.
- Regardless of whether companies downsized, 89 percent of respondents report taking at least one or two actions to minimize the extent of workforce downsizing.
 - On average, survey participants report taking 3.5 different actions.

There has been a negative impact on some employee perceptions that could lead to higher attrition when the crisis is over.

- Top-performing employees are 20 percent less likely to agree that they understand the link between their own goals and the company's goals than in 2008.

Employees believe the changes made by their companies are affecting work quality and delivery to customers.

- Forty-one percent of employees indicate that changes have had an adverse impact on quality and customer service, while only 17 percent of employers believe this is the case.

These results are a signal that things are not going to return to "normal." As a consequence, companies must take proactive measures to mitigate the negative effects of cost-cutting actions on employee morale and productivity. Employers will need to re-evaluate the "deal" with employees — the Employee Value Proposition — and create a renewed bond as the economy recovers.



About the Survey

This report includes research findings from two surveys completed by Watson Wyatt before its merger with Towers Perrin.

The 2009/2010 U.S. Strategic Rewards Survey, conducted by Watson Wyatt Worldwide and WorldatWork and representing 235 organizations, is the primary source for the employer data in this report. These organizations span all industries and have a minimum of 1,000 employees each. The survey was fielded in May 2009.

Selected data featured in this report are drawn from the August issue of Watson Wyatt's Effect of the Economic Crisis on HR Programs, our bimonthly survey series. The August survey included responses from 175 companies.

Data cited in the report are from the U.S. Strategic Rewards Survey unless otherwise noted.

The employee data are taken from a survey of a representative sample of 1,300 full-time workers at organizations with more than 1,000 employees.

Definitions

High-performing organizations: This report differentiates companies based on self-reported responses to the question, "How well did your organization perform financially compared with other firms in your industry over the past year?" Respondents were given five choices, ranging from "substantially below peer group" to "substantially above peer group." In our analyses, we characterized companies that identified themselves as "above peer group" or "substantially above peer group" as high-performing organizations. Where possible, we have validated these responses by comparing them with publicly available financial performance data.

Top-performing employees: Top-performing employees are those whose performance was rated "far exceeds expectations" (i.e., in the top 10 percent) by their supervisor in their most recent performance review.

Employee Value Proposition: The Employee Value Proposition (EVP) encompasses the collective array of programs the organization offers in exchange for employment and is influenced by the organization's brand, values, culture and leadership.

Restructuring Activities

Employers have taken a range of actions in response to economic conditions. Seventy-two percent of participants have gone through a restructuring or made layoffs since the economic downturn began in 2008. The average number of layoffs speaks to the depth and breadth of the recession. High-performing organizations laid off (or expected to lay off) an average of 7 percent of their workforce, while all other firms laid off (or expected to lay off) an average of 9 percent of their workforce. Employers restructured to protect their bottom line.

Eighty-four percent of participants indicate their key objective for downsizing was to maintain profitability, while 66 percent say they cut staffing levels to reflect future demand. Regardless of whether companies downsized or why they did so, the majority of respondents report taking action to minimize the extent of workforce downsizing (Figure 1). On average, survey participants report taking 3.5 different actions to minimize or avoid layoffs.

The most prevalent action taken was implementing a hiring freeze, followed by salary freezes and restrictions on overtime. There were significant differences between companies that took fewer actions (three or

fewer) and more actions (four or more). Companies that took fewer actions focused activity on freezing programs as a pre-emptive measure, while those that took more actions began to cut into the core financial components of total rewards. As the data indicate, financially high-performing organizations took fewer actions (an average of closer to three actions, while all others took closer to four actions). In fact, high-performing organizations were better positioned to respond to the crisis and to avoid cutting the core components of total rewards such as salary, benefits or bonus (Figure 2).

Figure 1. Number of actions taken to minimize workforce downsizing
Percent of respondents

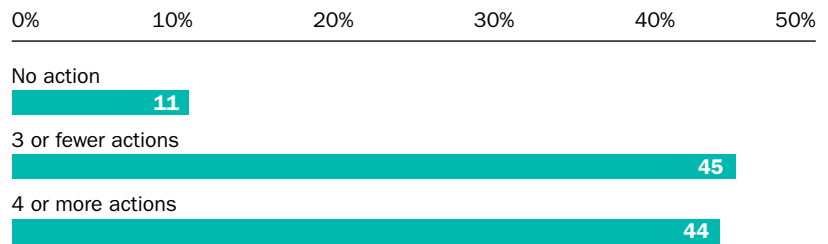
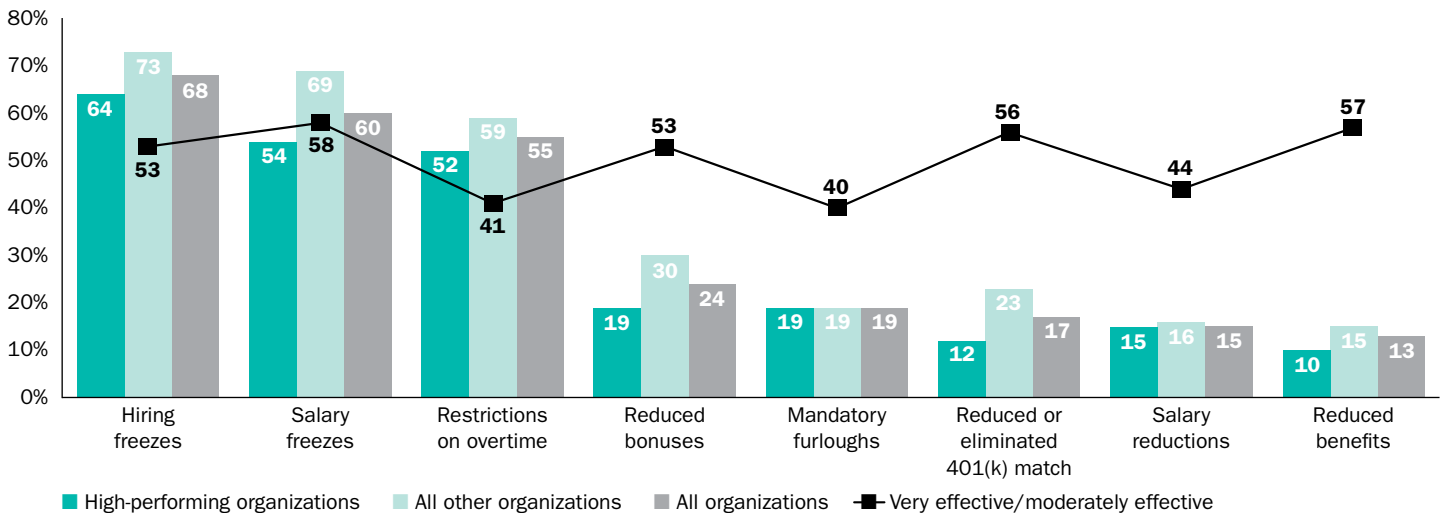


Figure 2. Actions taken to avoid or minimize layoffs and their effectiveness

Percent taking action





Planning and preparation prior to the downturn provided high-performing firms with tools to utilize in the crisis.

- Seventy-eight percent of financially high-performing organizations indicated their existing contingency plans were effective for responding to the recession versus only 56 percent of all other firms.
- Fifty-seven percent of high-performing organizations used a formal workforce plan to determine which employees to lay off versus less than half of all other firms (47 percent).
- Fifty-three percent of high-performing organizations indicated their performance management system was effective for evaluating which employees to lay off versus less than half of all other firms (45 percent).
- Performance management tools have been critical this year: 71 percent of organizations used performance as a factor in determining which employees to lay off (73 percent used functional skills as a factor as well).

Landscape of Current Reward Programs

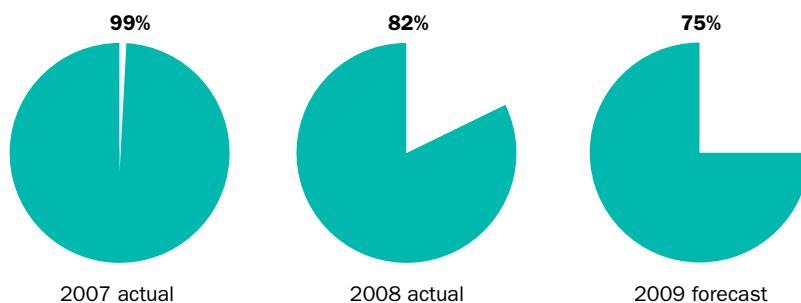
As a consequence of the cost-cutting actions companies have been forced to take, many employees are experiencing a net decrease in the value of their total reward programs. As outlined in Figure 2, many companies have reduced the value of their core reward programs. For example, companies report bonus funding levels are dropping (from 82 percent for 2008 to 75 percent for 2009) (Figure 3). In addition to the changes to core reward programs, a majority of companies have also implemented restrictions on travel (74 percent*), and some have reduced training opportunities (45 percent*). Slightly offsetting this trend perhaps is the finding that 23 percent of companies* have increased their use of recognition programs. Such programs offer a cost-efficient opportunity to recognize the contributions of top-performing employees at a time when the average company has reduced core forms of compensation and benefits.

As the economy begins to turn around, companies are making plans to reinstate the changes made to their reward programs. For example, although companies have significantly cut back on merit budgets (in line with salary freezes for 2009), these are expected to rebound in 2010 (Figure 4). The majority of participants report they will reverse hiring freezes and salary freezes (72 percent and 79 percent respectively*). Even so, most companies do not foresee a return to “business as usual.” Twenty-two percent indicate they will not restore reduced salaries to their earlier levels, two-thirds (66 percent*) say they will not reverse increased percentages employees now pay for health care premiums, and 22 percent* are unsure when they will reinstate the 401(k)/403(b) match.

Looking ahead three to five years, employers view the landscape as changing in comparison to the pre-economic crisis level (September 2008). Eighty-three percent* expect an increase in employees working past their desired retirement age, and 68 percent* believe employees will pay a greater percentage of health care costs. At the same time, 43 percent* expect a decrease in staff sizes. These changes will certainly have an impact on attracting and retaining critical talent. For example,

despite the finding that many employers say staff sizes will be smaller, 46 percent* think they will face increased difficulty attracting critical-skill employees, and 50 percent* say retaining such employees will be harder. As employers begin to rebuild, it will be important to look at the impact of current and future changes on employee engagement.

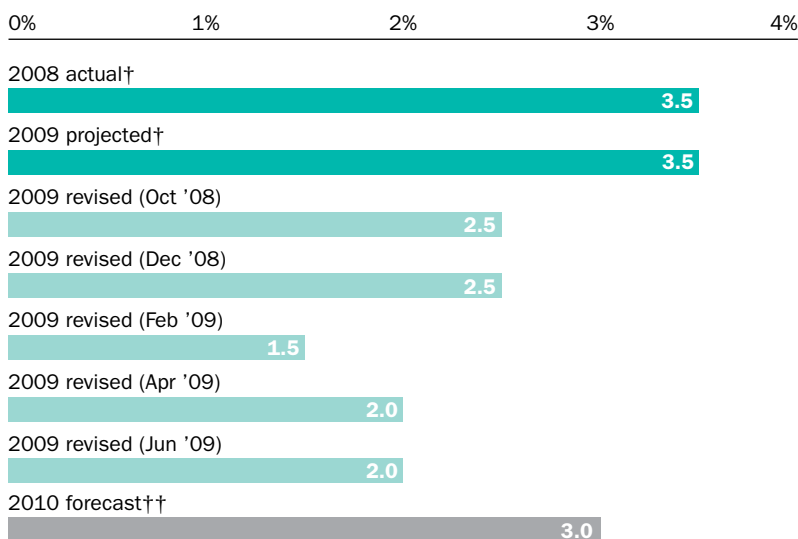
Figure 3. Most recent year funding for annual incentive awards*



*Average funding as a percentage of target

Figure 4. Trend in median merit increase budgets

As a percentage of salary



† U.S. data as reported in the 2008/2009 Global Strategic Rewards Survey. Collected in May 2008.

†† As reported in the 2009/2010 U.S. Strategic Rewards Survey and the August 2009 update to “Effect of the Economic Crisis on HR Programs.”

* As reported in “Effect of the Economic Crisis on HR Programs – Update: August 2009”

Impact of the Recession on the Employee Value Proposition

The EVP encompasses the collective array of programs the organization offers in exchange for employment and is influenced by the firm's brand, values, culture and leadership. Given the numerous actions taken at U.S. companies over the past year, few are immune to changes to their EVP. However, many companies misunderstand the significance of the EVP to employees.

Seventy-three percent of employers indicate their EVP is informal (implicit and evolved over time); only 27 percent indicate their EVP is formal (articulated, documented and communicated). Employees' views are just the opposite: 74 percent indicate their company has a formal EVP, and 26 percent say their company's EVP is informal.

In other words, employees view the array of programs offered by employers as an articulated deal. At the same time, a majority of employers do not recognize the explicit power of their reward programs or the impact of the changes they have made on both employee engagement and on the business overall in terms of productivity and customer satisfaction.

Only 20 percent of the companies that took four or more actions related to their reward program (to avoid layoffs) believe the changes have negatively

affected their EVP. Most employers might not believe the changes are negatively affecting their EVP, but they do recognize the impact on the employee experience, particularly on workload. While this is a first step, employees tell a different story. Forty-two percent of top-performing employees indicate that cost-cutting and/or restructuring activities resulted in significant changes to their EVP. Employees agree their workload has increased, but they also report these changes have had an impact on the business, specifically on productivity and quality and customer service. And while 41 percent of employees think that changes have had an adverse impact on quality and customer service, only 17 percent of employers agree. These trends are even more pronounced in organizations that took increased actions to avoid layoffs (**Figure 5**).

This decline in productivity might be attributable in part to employees' feeling they lack the resources to do their job well, but it is also due to less clarity of expectations and fewer rewards for job performance.

Figure 5. Impact of changes on business and employee experience

Changes have had an adverse impact on:

Business impact	Employer	Employees in organizations that took 3 or fewer actions	Employees in organizations that took 4 or more actions	All employees
Quality/customer service	17%	34%	47%	41%
Productivity	36%	36%	56%	44%

Employee experience	Employer	Employees in organizations that took 3 or fewer actions	Employees in organizations that took 4 or more actions	All employees
Loyalty/commitment to the company	49%	37%	54%	47%
Ability to have a healthy balance between work and personal life	64%	36%	52%	44%
Ability to manage work-related stress	69%	42%	59%	48%
Workload	79%	57%	76%	65%

Retention Risk for Top-Performing Employees

Changes in the economy and related changes within the organization have had a major impact on the views of top-performing employees and particularly on their long-term commitment to their company. Thirty-six percent of top-performing employees say their company's situation has worsened in the last 12 months, and the number who would recommend others take jobs at their company has declined almost 20 percent. Further, top-performing employees are 22 percent less confident that senior management is doing the right things to help the company return to growth and 29 percent less confident in management's ability to grow the business.

As we emerge from the recession, employers must specifically focus on responding to the concerns of top-performing employees. Compared with last year, these employees are 26 percent less likely to be satisfied with the opportunities for advancement at their company (Figure 6), and 29 percent say promotion opportunity would be one of the top three reasons they would leave. Overall, they are 14 percent less likely to want to remain with their company instead of taking a comparable job elsewhere than at this time last year. Clarifying the promotion opportunities available to top-performing employees and proactively working with them to ensure they develop the competencies necessary to assume these roles would help address this concern.

While employers are benefiting from reduced difficulty attracting and retaining employees this year (Figures 7 and 8), employers should expect retention risk to increase as the economy rebounds. Employees are already reporting a decline in productivity and customer service, and the loss of top-performing employees would likely exacerbate these concerns for years to come.

Figure 6. Top-performing employees' declining satisfaction with key aspects of employment deal (2009 vs. 2008)

	Percentage change
Company lives up to the employment deal	▼ -30%
Company aligns the employment deal with what it stands for in the market	▼ -31%
Satisfied with opportunities for advancement	▼ -26%
Satisfied with organization culture	▼ -28%
Prefer to remain with company rather than take comparable job elsewhere	▼ -14%

Figure 7. Trend in difficulty attracting employees

Percent reporting difficulty

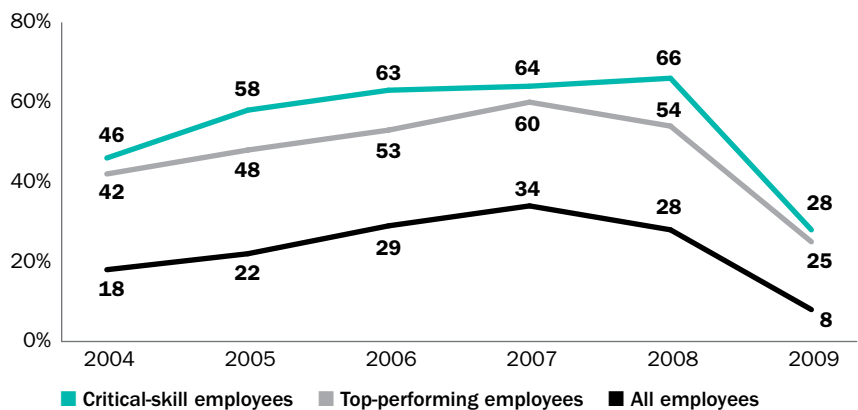
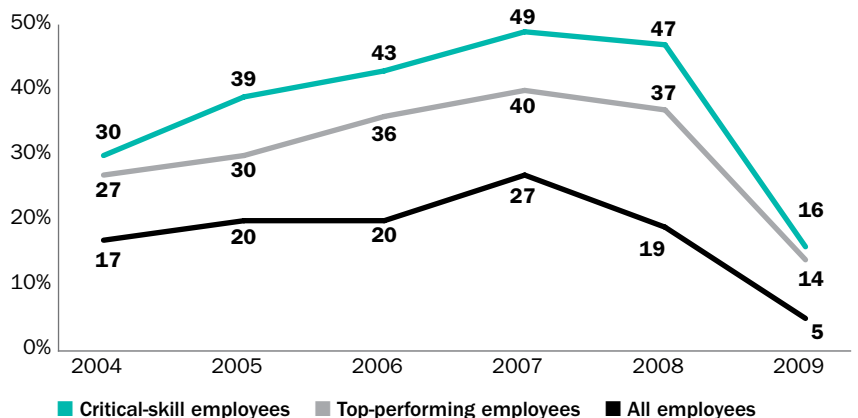


Figure 8. Trend in difficulty retaining employees

Percent reporting difficulty





Response to Legislation and Governance

Along with the economic changes, 2009 also brought legislative developments that affect how organizations set and manage pay. The Lilly Ledbetter Fair Pay Act redefines the statute of limitations on discrimination, which now restarts every time someone receives a paycheck or other remuneration that has been affected, in some way, by a prior discriminatory decision. Seventy-one percent of organizations indicate they plan to review their HR programs in light of the act, and 53 percent have already begun planning a response. Implications of the Lilly Ledbetter Fair Pay Act suggest employers take a proactive approach to ensure their pay programs are credible, rational, defensible and bias-free. Best practices include:

Job Classification

Sixty-five percent of respondents indicate they have a systematic, organization-wide job leveling process in place. Of these, 55 percent continue to rely on market-based job slotting to develop the job hierarchy. Organizations might consider a hybrid approach that balances internal equity with market value to ensure like jobs can be easily organized by level in a defensible way.

Pay Audit

Fifty-two percent of respondents report they conduct pay audits to review pay programs on an annual basis, and another 33 percent indicate they do so but at no set time. Organizations are currently auditing competitiveness of pay (93 percent) and the way jobs are assigned to levels (39 percent), and conducting statistical analyses of base pay differences by demographic group (38 percent).

Reward Plan Governance

The Lilly Ledbetter Fair Pay Act requires that companies retain records regarding pay decisions. Seventy percent of respondents say their organization is working to improve governance procedures related to gathering, storing and monitoring data in the United States, and 73 percent are implementing consistent tools, processes and/or technology to improve governance procedures.

Summary and Next Steps

The worst part of the downturn may be behind us, but the recession is likely to have a longer-term legacy for employers. Rebuilding for future success requires that companies review their total reward offerings and related EVP in light of the new business environment. Reframing the EVP and communicating it to employees will help them refocus and recommit.

This is particularly critical for a company's top-performing employees to mitigate the risk that they will leave as the economy improves (and more jobs are available elsewhere). Employers should take the next year to review and rebuild their EVP and associated programs. This will require both strategic changes to reward and talent management programs as well as tactical changes to address immediate needs of the workforce, as follows:

- Determine organizational business drivers and objectives in the new economic environment and their implications for talent management and broad people practices and programs.
- Redefine the EVP for relevance and strategic alignment with the business objectives.
- Identify and implement changes to reward and talent management programs that the business can support.
 - If salaries were reduced as part of cost-cutting measures, reinstate those as quickly as business results allow.

- Return merit increase budgets to pre-recession levels in 2010 if possible and differentiate increases to the greatest extent possible based on employee performance.
- Review short-term incentive metrics for alignment with modified business priorities and communicate any changes.
- Review career development and performance management programs to ensure they align with the new business landscape.
- Heighten the focus on differentiating bonus awards based on performance, in particular if funding remains below target.
- Promise and deliver on the revised EVP
- Establish and track EVP-related metrics to ensure successful delivery and identify any additional actions required.

Realigning the EVP to re-engage employees and support future business performance is not a "quick fix." It requires vision, action and sustained commitment over time.

About WorldatWork®

WorldatWork (www.worldatwork.org) is a global human resources association focused on compensation, benefits, work-life and integrated total rewards to attract, motivate and retain a talented workforce. Founded in 1955, WorldatWork provides a network of more than 30,000 members and professionals in 75 countries with training, certification, research, conferences and community. It has offices in Scottsdale, Arizona, and Washington, D.C.

About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.

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