



Six Steps to Gain a “Talent Advantage”

The year 2002 was perhaps the most economically and emotionally challenging year we have ever experienced. People and companies reassessed their focus, activities and relationships. Many companies facing major declines in revenues responded by downsizing staff, implementing cost reduction and shedding unproductive units. Any investments were made cautiously and carefully.

The April 1, 2002 Wall Street Journal reported: “There are signs of strength in the economy, but the outlook is still uncertain.” As we enter 2003, there is an emerging (cautious) spirit of optimism for economic recovery. The unexpected economic growth of Q4, 2002, has been followed by what appears to be slow, limited growth in Q1, 2003. Consumer confidence and spending continue to rise, albeit slowly. Capital spending is starting to pick up steam, but the technology sector has yet to see growth similar to other industries. Projections for 2003 GDP growth averages around 2% to 3%.

Although the supply of talent is not as tight as it was in prior years, current projections still show staffing shortages in many areas. The BLS projects a labor shortfall of 5 million by 2005. Information technology, senior level design and development jobs and business-to business web application development jobs are showing strong hiring growth according to a survey by Comp Insight. Meanwhile entry and intermediate level jobs show significantly less growth in jobs and salaries.

Some companies are taking a “wait and see” approach to market uncertainty, others are using this time to implement strategies that take advantage of the market uncertainties to upgrade their talent and enhance their employment proposition. Which strategy are you pursuing?

From our perspective, based on published data and client experiences, we recommend these steps to prepare your company for what is likely to be a most intriguing year:

1. Assess the Damage and Determine Your Risk

Executives have a tendency to focus on current turnover as an indicator of problems. But, what is on the minds of your people? If we were to ask them about their level of commitment to your company, would they say?

“I know it’s been tough, but we’ve all done this together. I really respect and appreciate the way our company addresses its issues. It will take a great deal to get me to leave this company. It deserves my best efforts.”

or

“I can’t wait till the market opens up again. This has become a difficult place to work in and I particularly didn’t like the way they... (Fill in the blank). I’m out of here as soon as possible.”

Just because a company has had to initiate drastic measures to stay in business, does not mean that people are focused on “the door”. Some companies will emerge from the recession stronger than before, others will not. For some it is luck (good or bad), but for most it has been an effective implementation of a well-conceived strategy.

Now is the time to assess the damage and determine your risk:

- Are more cuts needed or have you reached the right balance between your revenues and expenses?
- Which areas of the company experienced the most serious cuts and what is likely to be the near term response to these actions?
- Given the state of your business, how well are you able to retain and motivate your key talent? How do you know this and what is your confidence?
- If you could do 2002 all over, what would you have done differently? How would the organization be different than it is today?
- What are the most difficult challenges you will face in the next 3-6 months? How will this impact your people?

Use these questions to identify where you are most at risk. By focusing on your priority areas, your action plans will be more effective.

2. Determine What’s Working, What Isn’t and You’re Top Priorities

An assessment of your programs is particularly important after major changes in the economy, marketplace, business strategy and significant events, like September 11th. Now is the time to examine what your current reward programs reinforce. Do they reward performance or build entitlement? What areas do your current reward programs have no impact, make a major difference on behaviors and results or create a barrier to achieving desired results?

To assess the effectiveness of your reward systems, consider the following:

- Do people understand the programs that impact them? Do they understand why and how these rewards work? Do managers use them effectively?
- Do the measures, goals, targets and behaviors directly support your firm’s 2002 strategy?
- Do people know what they can do to achieve the key goals?
- Where do the total compensation and other special rewards position the organization in the marketplace; behind, competitive or ahead of the market? Is the mix between the
- elements still appropriate?
- Is your company getting its desired return on investment from the programs? How do you now?
- Do managers and employees find the programs meaningful and motivational?

There are many methods you can use for assessment: cost/budget analysis of programs, conducting surveys, as well as interviewing employees, managers and top performers. These methods should help you identify what's working, what's not and determine the area(s) of greatest need. The key point is to identify where you have a competitive advantage over others in the market for talent and where you need to create one!

3. Revisit Base Salary

If the recession has taught one thing, it is that bonus plans and stock options are not a sure thing. Companies either: (1) worry that the organization needs to keep people whole with the losses they experienced (e.g., also known as entitlement) or (2) know that the future is uncertain and will determine how to achieve the right balance between security based rewards and performance based rewards.

Many companies are struggling with what to do about merit increases for 2003; to do or not to do? This is not unusual considering that when companies are looking for ways to reduce costs, base pay represents 40% to 60% of total costs, and the market appears to be picking up.

Studies show that merit pay increases have been adjusted downward by approximately 1% to an average merit increase of 3%. We recommend that companies:

- Review where you are in the market especially for your most critical jobs and what you can afford in 2003.
- Focus base pay on retaining top talent and rewarding superior performance.
- If you need to limit salary increases, consider extending the effective date 6 to 12 months and do not provide pay increases of less than 2% (the after tax result is often just aggravating).

4. Re-energize Your Variable Pay Programs With Better Performance Measures and Stronger Employee Line of Sight

Thirty percent of companies surveyed by Towers Perrin cut overall bonus payouts by more than 25% in 2002 compared to 2001 payouts and early projections are slightly greater in 2003.

The issue now is what to plan for in 2003? Most companies are making no adjustments to their plan's payout targets but are looking for ways to improve the effectiveness of the plans. If they make no change, then people may believe there is little opportunity for a payout unless the market changes. To address this issue, proactive companies are doing the following:

- Identifying the key factors that will influence the company's success in 2003 and building these into the plan objectives and measures.
- Establishing clearer, more meaningful measures and ensuring people understand what they need to do to impact them.
- Rebalancing the weighting between corporate and business unit results to minimize company risk without destroying line of sight. Most have at least 25% weighted on overall company results, but the right balance depends on many factors.

- Communicating performance goals and establishing mechanisms for regular, engaging reviews of the progress. Make at least 3 to 5 progress reviews before the end of the performance cycle.
- Planning for contingencies if the business does not materialize as desired (see Step 6).

These efforts can result in more clear focus for employees at this critical time. Research has shown that more people leave an organization because of the loss of confidence in leadership and lack of communication than for not receiving a bonus.

5. Rebuild Confidence in Stock Option Programs For Those Critical to the Long-Term

Prior to the downturn, companies with broad stock option programs awarded 80% to 100% of their employees with stock options. It was clearly the “*reward de jour*” in the 1990’s. Although stock option programs have lost their luster, companies are crafting new strategies. Such strategies include decreasing the number of people who are granted options, decreasing the vesting period and replacing stock options that are seriously underwater.

While there is increasing pressure for changing the accounting regulations on stock options and requiring companies to expense them as compensation, boards are concerned about finding the right balance between protecting shareholder dilution, excessive awards to executives and retaining their most critical talent. Some boards are asking us for assistance in developing Performance Vesting Options, Restricted Stock Awards and Indexed Stock Options (where the exercise price varies with an external index and the company must out perform this standard to realize any gain on their options). In addition, executives and boards are examining several forms of deferred compensation, such as Company-Owned Life Insurance (COLI) and other investment vehicles as a strategy to build personal capital value.

Privately-held companies or divisions of major corporations are establishing equity simulator plans or phantom share plans that provide opportunity for long-term gain in the value of the company, a new business venture, a division or operating unit. The risks and opportunities need to be carefully considered, but the concept of providing long-term capital appreciation in relation to something one can truly influence has become very appealing (See the Wilson Group newsletter: “Taking Stock of Your Options” for more information).

These practices are aimed at rebalancing the short- and long-term perspective of the company and providing key contributors with the ability to build personal net worth in relation to the company they serve. It is essential to re-energize and rebuild the confidence executives, managers, employees and shareholders have in the future value of the organization and the opportunity to share in its growth.

6. Increase the Value of Special Recognition by Targeting Top Performers

With limited resources, smart companies are either initiating individual special recognition programs or expanding programs to reward both team and individual contributions. Special recognition involves celebrating milestones or achievements, going well beyond one's job to increase revenues, reduce costs or improve customer relationships. Special recognition is often more difficult, but it is more important during troubling times. Celebrate even the smallest of achievements and thereby reinforce positive results and contributions.

There are many low cost ways to recognize employees, including movie passes and gift certificates to special restaurants. The real value is not in the "thing" that is provided, but in the process to clarify what is valued and to make it personal. Special recognition of any type (monetary, verbal or tangible) should always come with a clear message or sincere appreciation for what was done. For many, knowing that their manager knows and acknowledges their exceptional performance is highly important. Imagine the response if one could receive both a bonus (for what) and special recognition (for how). Look for ways to integrate both variable pay and recognition programs.

Successful companies are pursuing these actions regarding their recognition of performance:

- Taking time to understand what is meaningful to each person (this is a key management responsibility, not HR). For example, one company encourages people to provide a list of things they love to do, find meaningful and would indicate their employer valued them. The list is available to everyone and used very frequently to select what rewards to use. This has made the process more personalized than giving people a list of things they can select from.
- Don't limit the awards to only one or two people. If people feel there is little chance for achieving the "prize", they will not likely put much effort into the activity. Define the achievement by what is accomplished, not by who is excluded (e.g., limited to only the #1 performer).
- Use peers to select award recipients. One's peers often have a better perspective. To prevent this process from becoming a politicized process, use the previous "award recipients" as the judging body.
- Recognize managers for recognizing others. Have them discuss with other managers who they recognized for what and with what. This kind of public discussion has multiple advantages.
- Be careful about spending money on gifts if the company has just gone through major cost reductions. This conflicting message may undermine the principles and objectives you seek to achieve.