What Do You Do in 2002?

Planning for the New Year

Perhaps at no time in recent history has compensation planning been so uncertain. In the past 10 years, we could count on a general rise in profitability and employee productivity to fund pay increases of between 4% and 6%. Companies increased the use of incentive plans to shift costs from fixed (base pay increases) to variable and people usually received a payout. Additionally, firms extended stock options to lower levels and people received yet another increase in their income. Finally, in order to compete aggressively for scarce talent, companies utilized creative recognition and work-life programs to become "the best place to work" within their market. Unfortunately, these strategies did not work in 2001 and probably won't work in 2002.

You may have placed a freeze on hiring and replaced staff only when absolutely needed. Further, there may be little or no payouts from 2001 incentive plans and the gains from the equity programs have completely gone. Employees have limited leverage to demand "special treatments" and executives are questioning the value of some of the more outrageous programs used to attract and retain people. In contrast, 2001 has been a time to cut out the frills, eliminate all discretionary expenditures and try to survive.

Let's consider preliminary projections, alternatives and hopefully, within this article you will be able to find an idea or two that will improve your company's situation.

Assess the conditions of your company, the business environment and then consider the talent market.

Despite the continual flood of poor earnings reports during the first half of 2001, the economists continue to project a turn in the economy during the latter half of this year. Perhaps it will not materialize until the first half of 2002, but most agree that we will either be in a strong recovery mode or in a serious recession by mid 2002. While each industry sector is different, there are two economies emerging from the confusion of 2001.

The Conference Board's Leading Economic Index is now showing a clear move to positive growth, rising 0.5% in May. But, the emerging economy will depend on which

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one of two forces will dominate: the growth stimulants of reduced interest and tax rates **OR** the consumer will yield to uncertainties and reduce expenditures that then cause a real recession. According to The Conference Board, the evidence clearly weights in favor of the former positive outcome, but they are highly uncertain. This is likely to be a year to assess your firm's strategy to "fix" and analyze gaps you have. If there is a rapid rise in growth rate, then strategies to attract and retain talent should increase in priority. It is always quite interesting how it takes times like these to expose weaknesses of various policies and practices. This is a time to fix yours and be ready for what lies ahead.

Remain appropriately competitive with base salaries, especially in those areas where talent remains scarce and critical to your business.

This is the year (2002) where you will need to keep salary increases to a minimum 3.0% to 4.0% (as compared to the average 3.5% to 4.5%). If you were aggressive with base pay when profits were flush, now is the time to keep the dollars in check with minimal increases. I do not expect salary increases to drop to below 3%. Instead, companies will delay pay increases to between 18 months to 24 months and give a 5% pay increase which will yield a 2.5% to 3.3% annual increase.

While 98% of employees usually get annual pay increases, you may need to allocate available dollars to perhaps only 25% to 40% of employees. What will your criteria be for these awards: top performers, critical to retain, below desired market, below one's peer group or a weighted combination?

These judgments require reliable data on which to make decisions and an executive team that leads by example. There will be little confidence in leaders if executives receive standard pay increases and most others do not. However, this can serve as an important catalyst to have in-depth discussions on who are the firm's key contributors and why.

When there are no payouts for incentive plans, it may mean that the plans are working. Use this time to reinforce a good plan or fix one that is broken.

A well-structured plan uses measures that drive the key success factors of the business, encourage people to focus on those actions that matter and provide the rewards directly associated with performance. When performance is seriously down and a payout is made regardless, the program immediately transforms from being performance contingent to entitlement based. If people are surprised at no payouts, they should listen better or the company should communicate progress better. Both situations create opportunities to make important improvements.

The key dilemma in these times is whether or not to adjust the performance goals in light of a changed business environment. If the assumptions on which the goals were based are no longer relevant and if the payouts are not perceived as achievable, the company looses the motivation to achieve and faces increased risk of retention. On the other hand, how can a company responsibly provide payouts when its profitability and shareholder's value have dropped dramatically? While there is a strong possibility of a lose-lose outcome, rational decision making and strong leadership are now critical. If the goals were too

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aggressive and the company can afford reduced payout levels, moderately adjusting performance levels may be appropriate.

While retention is always an issue, I hope the bonds that hold people to the organization are stronger than the dollars spent on compensation. However, the company needs to examine both the fiscal impact and cultural risk associated with adjusting performance levels. This will be the challenge to leaders for 2002.

In 2002, make sure that the variable pay programs work as they should. Increasing the line of sight for the measures, providing regular updates on progress, celebrating contributions and improvements as they occur and demonstrating how results are achieved by accountability and collaboration, are all keys to effective variable pay systems. In many cases providing tracking data on performance prevents entitlement. Then, when the results improve, people will never see the variable pay program in the same light.

Address the lack of confidence in equity programs in a direct manner.
Stock options and related programs (stock appreciation rights, restricted stock, phantom stock, etc.) were in high fashion in 1999 and 2000. If a company did not have stock options to provide new hires, they were at a competitive disadvantage; if they did not extend options to people internally, it risked losing the best talent. Now, however, people have lost significant confidence in these programs. Perhaps this "irrational exuberance" can be replaced by a more balanced view of equity programs as an important element in a meaningful total reward program.

Much has been written about stock programs and many companies are implementing changes, including re-pricing or replacing options, directing them to fewer people or convincing people that current option grants are now at historic lows, with historic upward potential. If you haven't taken one of these strategies, you should in 2002.

In addition, it is time to remember the fundamental purpose of these programs. In 2002, your challenge will be to use stock or other equity programs as a way to reinforce a special relationship between people and the company. Then, people should be guided toward actions that improve long-term results. When people are focused on how to make an important difference, there is less impact on what investors think at a given time.

Providing recognition and celebrations in troubling times are more important than in successful times. The year 2002 should be a time when performance recognition increases at an increasing rate.
It is easy to recognize people when times are good. You look at the results and spread around the good cheer. People can take credit for results, even if they had little to do with it. The real leadership challenge is to recognize contributions when desired results are not achieved without turning the process into a whitewash of reality or a paternalistic gesture to give credit out of guilt.

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The task for 2002 is to identify (in 2001) those actions you want to encourage, recognize and celebrate regardless of the results. These strategies keep people doing the things that are necessary for the company to succeed; they define "how" things ought to get done. Then, when people truly achieve results in a manner that is consistent with your company's values, you have something very special to reward. This applies to individuals as well as project teams, business groups and your managers and leaders (don't forget them).

Conclusion

There has probably never been an era more important for those in human resources than now. Now is the time to make a more critical contribution. Most companies have learned that growth and success are highly dependent on people. Their company's market value is linked more than ever to the quality of the leadership, intellectual property and customer relationships. People, as most executives now realize, make the difference.

The role of human resources then is to work on the core business issues, develop/implement/improve programs that will make a major impact. Further, rather than seeking to do what the competition does with pay, incentives, benefits and workplace conditions, do what they don't do. Do those things that are directly linked to your company's success drivers and focus on implementation. If your firm only does what others do, you will have no competitive advantage. Human resources is all about creating competitive advantage.

The year 2002 is likely to be an exciting, challenging, difficult and possibly rewarding time. It will define the difference between those who see opportunities and implement them well from those who wait for guidance or look for others to follow.

One thing I can predict with certainty for 2002, it will be a different kind of year.

Reports and projections from The Conference Board's Leading Economic Index include:

	2001	**2002 Forecast**
Real GDP Growth	2.5%	3.4%
CPI Inflation	3.7%	3.8%
Real Capital Spending	4.2%	6.4%
Pre-Tax Profits	$930B	$955B
Unemployment Rate	4.4%	4.3%

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