

# HR Update

Third Quarter 2009

News and information for better people results

## Recession-Proof Your Annual Incentive Plan

Current economic conditions are causing many organizations to closely examine their annual incentive plans. Not only has the downturn affected the 2008 payout levels, but it has created challenges in setting 2009 performance targets.

A 2008 year-end survey, conducted by Hewitt Associates, showed that 54 percent of participating organizations would not meet targeted performance levels. One might assume that incentive programs would be less prevalent in 2009 based on this, but the same survey indicated that organizations were planning to spend an average of just 2 percent less (as a percent of overall payroll) on such programs for 2009.

With many organizations intending to keep incentive plans as part of their total reward package, there are several areas that should be considered to ensure the effectiveness of these programs.

### Eligibility

During these difficult economic times, organizations need to take a closer look at the positions included in their incentive plan(s). In years when profits are down and the incentive pool is small, the plan may be more impactful if larger amounts are awarded to fewer participants. Confirm that employees in these positions have a direct impact on the performance measure(s) being used in the plan. Some organizations have broad based "profit sharing" plans that pay cash to all employees (rather than deferring payment to a retirement account) if the company is profitable. While these plans can be effective, it typically represents a significant cost to the company to include lower level employees who may not understand how payments are earned, or what they did specifically to affect the payout.

### Performance measures

Growth measures are common metrics to use in incentive plans, and still may be appropriate for your particular organization. However, most industries expect growth to be flat (if not declining) in 2009. Now may be the time to consider other indicators of success, such as cash flow, EBITDA or other income-related measures. Non-financial objectives may also be important to incorporate during this downturn (such

as customer satisfaction or quality), to ensure customer retention.

Relative measures are increasingly being used for executive incentive plans, according to

Equilar, an information services firm known for collecting and analyzing proxy data from publicly traded companies. Instead of developing absolute or 'hard' internal measures, organizations are establishing relative goals against the performance of a pre-defined peer group. Companies are taking this approach in response to the difficulty many are having in projecting reasonable target and stretch goals, even one year into the future. In these cases, some controls, including financial thresholds or minimums, are also being put in place to prevent incentive payouts when performance is poor.

As a standard, use no more than two or three measures in your incentive plan. Beyond this, the plan becomes too complex for participants to understand, it defuses rather than focuses effort, and may actually de-motivate rather than drive desired behaviors.

### Payout levels

This is an appropriate time to confirm payout levels for the plan. Consider the following:

1. Are target payout levels appropriate considering the competitive market and your organization's total rewards philosophy?
2. Are actual payout levels calibrated to the performance results expected for the target? For example, if company performance is minimally satisfactory but incentives are still being paid at substantial levels, you may need to calibrate your payout levels to the performance goals.

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## Implementing Human Resources Information Software – How Your Company Can Benefit

As business continues to change, more and more companies are using Human Resources Information Software (HRIS). HRIS is software that allows companies to track the data information needs of Human Resources, such as payroll, management and accounting functions within a business. Many HRIS systems enable employees to update their information, therefore freeing HR staff for more strategic functions. Every company is different and it's important that you research different HRIS systems and find a system that will fit the company's needs. By implementing an effective HRIS system, your company will be well on its way to increasing confidentiality of their employees' information. Below are just a few of the daily benefits companies can count on when using an HRIS system:

- Streamlined HR and payroll processes
- Paper generation decreases significantly with a good system
- Documentation of training, benefits, disciplinary warnings and workplace accidents is more consistent
- Historical wage rates, salary increases and information on current and former employees are stored in one place
- Accurate and consistent calculations of accruals for vacation, sick or other PTO programs
- Allowing employees to make changes and view information on line, thereby improving accuracy and cutting down on HR administrative time
- Allowing supervisors immediate access to pertinent and allowable staff information without going to HR
- Tracking government regulations such as Family and Medical Leave Act and OSHA (OSHA is a regulatory body, not a regulation)

In today's fast-paced world, where instant information is expected, a strong HRIS system can help business leaders make more informed decisions around their key assets – people. Quick decisions in these areas are needed whether the economy is strong or weak. HRIS systems that most effectively serve companies, track the following:

- Utilization of employees
- Liabilities as it relates to PTO payouts and severance calculations
- Employees' statistics that can make succession planning decisions easier and more objective

- Direction for training based upon current employee skill sets and future business directions
- What-if scenarios around the ultimate impact HR decisions would have on the business
- Back-up and storage of key employee information for disaster planning purposes

Whether companies operate globally or locally, HRIS systems are a necessary asset for companies. Being able to provide important employee information quickly is always essential, especially during these tough economic times.

To determine what type of system your company needs, follow these five simple steps:

1. Define your company's goals, future needs and what key items you must have in this software. Be brutal and exhaustive in your assessment. It's far easier (and less costly over the long-term) to include any extras in your initial implementation, than to add them later.
2. Conduct a system needs assessment. This includes, but is not limited to:
  - a. Current network and hardware capabilities
  - b. Upgrading required
  - c. Skill levels of current employees that will use the system
3. Evaluate your system requirements to find the right software to meet your needs.
4. Determine a skilled project team for the implementation, including representative from your vendor as well as from your own company.
5. Develop a training plan for learning the software, and designate a point-person from your company to implement this training

Your HRIS systems will likely need updating every five years (or possibly sooner). As business conditions changes, your HR information needs will evolve and your HRIS will have to evolve with them. If you aren't currently using an HRIS system, you are missing the ability to assimilate and analyze data about your and most important and costly assets at an economic time where it's imperative to have it.

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## Rethinking Your Compensation Philosophy and Programs

Typically, during short-term economic downturns, there are limited changes in the structure of the competitive labor market. If the economic downturn in your industry or company is severe and projected to last several years; or if the recovery period is volatile or unpredictable, this is the time to rethink your company's compensation philosophy and strategies. Consider the following questions:

- What permanent pay cuts do we want to make by level?
- At the company, division or individual level, what performance should we be driving in the next few years?
- Will we replace this reduction with increased short-term or long-term incentives?
- If a long-term incentive plan exists, should we enhance the current program to attract and retain key talent?
- If the company has no long-term incentive plan, should we consider implementing one to provide some real incentive to retain talent, especially if annual incentives may be marginal at best? If so, what type of long-term incentive program makes sense?
- What is the competition doing? What are other companies doing outside our industry but in similar situations?
- What is the local marketplace doing for its hourly workers?
- What is internally equitable when we look at the different cost-reduction strategies?
- What benefits should we take a long, hard look at? Should we reduce our 401(k) match or even eliminate it? Have we thoroughly evaluated our health care costs?
- When does it make sense to reduce these costs and what is the most internally equitable approach and yet externally competitive?

Reviewing your compensation philosophy will provide a framework for these important decisions. It is important to realize that across-the-board direct compensation actions taken for a period of 12 to 18 months can be less dramatic if properly communicated, especially if the cuts will be restored.

For a more in-depth discussion related to this article, please download the comprehensive white paper, "Managing Compensation and Human Capital Investment in an Uncertain Economy," at [www.rsmmcgladrey.com](http://www.rsmmcgladrey.com)

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3. Is total cash compensation appropriately leveraged? Some organizations are electing to provide higher levels of incentive opportunity in lieu of base pay increases to convert payroll expense from fixed to variable. If your organization adopts this approach but expects it to be a temporary change, then open and frequent communication will be necessary.

### Discretionary plans

Incentives are considered a variable rather than a fixed expense. However, companies that consistently pay discretionary bonuses – even in years when profits (or results) are down significantly – inherently create an entitlement mentality among employees. The employees see no impact to their compensation and make no connection between company performance and rewards. Despite what employees have come to expect,

companies with discretionary bonus plans should make sure incentive payments (if any) are in line with company performance.

Companies should use a systematic approach when revising or designing incentive plans:

1. Determine plan objectives
2. Determine eligibility
3. Determine funding mechanism(s)
4. Determine size of awards/timing of payout
5. Determine plan measures and formulas
6. Determine plan administration and communication

Incentives are meant to reward "above and beyond" performance. Organizations should take this opportunity – particularly during difficult economic times – to analyze their plans and make sure they are receiving the appropriate return for its investment.

# HR Update

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## RSM McGladrey

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