

Reviewing salaries when times are tough.....

There's no hiding from the news that costs are on the rise. The CPI has risen 4% in the year ending June 2008 and is now well above the Reserve Bank's permitted inflation range.

At the same time, the economy is on the wane. The Reserve Bank's recent decision to cut interest rates suggests economic growth is more of a priority even than inflation. Finance companies continue to falter and fail. The retail sector is already feeling the brunt of the economic downturn, as is the housing market and its related down-line industries. However, that's good news for first home buyers, who are in their best position for years.

Employees are looking to their employers to help ease the pressures of inflation on the family spend, at a time when employers are the least willing (and arguably the least able) to help. In April, Reserve Bank Governor Allan Bollard said there was a risk that wage settlements would respond to increases in food and energy prices, rather than adjusting to changing economic conditions, thus perpetuating inflationary pressures.

What do the figures show? Just that. Numbers out recently from Statistics NZ confirmed that the Labour Cost Index recorded an increase of 3.5% in salary and wage rates for the June 2008 year. A July EMA Survey found 81% of the 932 members surveyed were intending to increase staff wages with the most common increases being 2 – 3 %.

Figures in our recent surveys (including our *Financial Services Survey*) show increases over the past year ranging from 4 – 5%. As for looking forward, so far there appear to be only modest revisions of forecast increases, with most still exceeding an anticipated 4%.

As Westpac's Economist, Dominick Stephens recently commented, interestingly, wages tend to be the last cab off the rank during an economic upturn, but they also lag when the cycle turns down.

His comments are entirely consistent with our experience of the market, which took a long time to respond to the sustained low unemployment and skills shortages evident from 2004. Even now, anticipated reductions in increases or salary review budgets are slower to materialise than many of our clients had expected.

Still, cash may well be limited. How then should employers approach their forthcoming salary reviews, facing the following realities?:

- Many businesses need to tighten their belts and save costs in the face of falling profits
- The labour market, while easing, remains relatively tight for resources
- Many unions are looking for wage settlements to meet or surpass CPI to meet their members' expectations
- Employees are looking to their employers for relief as their 'take home dollar' buys less and less at the petrol pump, the grocery store and almost everywhere else it seems

Here are our five essential tips to get you through your salary review period successfully:

Five Top Tips

1. Take a robust approach to setting your salary review budget – affordability is the most critical determinant in the mix.
Ensure all the key players are involved in this discussion, the CEO, Finance and HR at a minimum. Consider recent and projected financial performance, market movements, supply and demand for skills, current competitiveness and current turnover levels.
2. Don't apply 'across the board' increases.
By trying to give a CPI based or even market based movement percentage increase to all staff, your budget will evaporate before you start. (While it might be philanthropic to help all employees out at the petrol pump, ultimately it's not why you're in business).
3. Use your budget wisely – address top talent first.
If your budget is limited, make sure you reward your critical talent and high performers first. It's this group of employees that you will really need to retain and who will make the most difference to your business, especially if times are tough. By not differentiating high performers positively from others, we motivate them to move on somewhere else that will.
4. Communicate! Share your 'story' and the context for your salary review with employees.
If your business is struggling and you have a low review budget (or no budget), don't wait until you are handing out letters with zero increases for people to hear that story. Schedule one-on-ones or group sessions to explain the parameters for your salary review. While they might not like the news, it's more empowering and palatable than not hearing anything. A zero increase without some context is most likely to be taken personally by an employee. By managing expectations you can begin to manage consequences.
5. Do more with less.
If you're cash strapped, consider other ways to recognise and reward your employees. Establish incentive schemes for the forthcoming year and make an 'upside' available for employees who can help turn the business around. Use one-off bonuses or lump sum payments in lieu of salary review increments to manage compounding costs. Continue to use relatively inexpensive recognition mechanisms such as dinner vouchers, mystery weekends and team lunches as a way of saying thanks and reminding people that their contribution is valued.

Conditions at the moment certainly make the balancing of salaries and cost management a difficult issue for employers, but the problem is not insurmountable.

Air New Zealand recently hit the headlines for its imposition of an executive salary freeze and pay rise barriers for other staff. This is a great way to 'lead from the front' and let staff know 'we're all in this together'.

Utilising the tips above should certainly help you in managing your way through a difficult review. As a last thought, if you're concerned about what reception your 'tight budget' might receive....most employees (when push comes to shove) would rather still have a job (and job security) than have an unaffordable salary increase.