How to Navigate Compensation Planning in Volatile Global Markets

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Employee Retention Considerations for Multinational Companies
The Russian economy has faced increasing headwinds due to falling oil and commodities prices as well as heightened geopolitical instability. As a result, local Russian and global multinational companies are focused more acutely on exchange rate volatility and ensuring that employee retention policies remain consistent and impactful. However, over time uncertainty will abate, economies will stabilize, and opportunities for top performing executives will grow.

Navigating the complex waters of compensating employees in declining foreign currencies can be achieved in several different ways, including one-off payments, increased pay, shifting pay delivery into hard currencies, adding a portion of the annual bonus to the fixed salary, and increasing or introducing new benefits to employee compensation plans.

Deloitte Consulting Partner Mike Kesner shares three approaches regarding foreign exchange planning in volatile currency environments:

• **Do nothing.** This approach is based on the notion that changes in budget assumptions occur all the time, and it is up to management to adopt and adjust to the new conditions. This view also considers the fact that if shareholders are experiencing lower-than-expected profits, management should earn less than expected incentive pay. Proponents also argue that because incentive compensation was not adjusted when profits received a boost from a weak US dollar against foreign currencies, then for consistency, no adjustment should be made when profits suffer from FX swings.

• **Hold-harmless approach.** This approach neutralizes the impact of certain unplanned or unbudgeted items that affect profits used for incentive purposes, including foreign exchange. The rationale is that unplanned or unbudgeted items are largely out of management control, and excluding such items from incentive plan calculations allows Boards to more properly recognize management performance. Advocates of the hold-harmless approach also exclude unplanned gains—such as lower commodity costs, gains on sale of assets, and positive FX—from reported earnings when calculating incentives. This is of particular relevance in commodity-rich Russia.

• **Corridor approach.** In this scenario, the Board holds management accountable for a portion of the variation in foreign exchange. Unlike the hold-harmless approach, management is not completely insulated from FX fluctuations, and will be more inclined to take prudent steps to manage the impact of FX on earnings, such as sourcing of raw materials in local currency, borrowing in local currency, and so on. To illustrate, suppose the euro is budgeted at US $1.14; as long as it remains within a given band, say, US $1.07 to US $1.21, the company allows the FX impact to flow through to the incentive plan calculation. When the exchange rate falls outside of that corridor, an organization can exclude the impact on earnings outside the FX corridor, whether positive or negative. In this manner, management is not indifferent to FX, nor is the organization taking extraordinary measures to manage the impact of FX swings.

Radford Compensation Consultant Marie Brinkman reflects that HR and compensation professionals may benefit by assessing the following topics prior to taking any action to adjust employee compensation:

• **What is the true degree of hardship faced by your Russian employees due to the current economic situation?**
Has the weakened ruble impacted employees' ability to purchase basic necessities or is it difficult for employees to maintain their current standard of living? The answer to this question might influence whether a company decides to implement a special allowance in a fixed amount (e.g., for basic goods and services) or a bonus set as a percentage of salary (e.g., to maintain a current standard of living).

• **How should the amount of a special pay accommodation be determined?**
While acknowledging that the Russian ruble has depreciated and inflation is increasing, it is best not to tie salary actions or special accommodations directly to these indicators in a formulaic way. Rather, if entertaining any special pay actions, do so with a clear rationale in mind as to what any change in practice, special allowance or temporary bonus is intended to accomplish — and for how long. Then, monitor actual market pay as per usual practice.

• **How will a special pay action align with current retention policies?**
Consider whether requests from the local business unit for special pay actions are on behalf of all employees or key employees. While voluntary employee turnover in general has not changed significantly in Russia over the last year, for highly talented employees there may be more outside opportunities given current market conditions. If requests for additional pay are made on behalf of key employees, these requests might be handled selectively within general retention policies.

• **How will your policies for managing a special pay action in Russia align with corporate policies elsewhere in the world?**
Many companies, especially large multinational firms, operate in diverse markets, many of which experience dramatic currency fluctuations at one point or another, whether recessionary or inflationary in nature. Do you have a process in place to monitor and address similar situations in a consistent manner? Do you have precedents you can follow from operations in other parts of the world over the recent decade or two? During the past 15-20 years, numerous Latin American, Asian, Central European and former Soviet nations have seen radical swings in currency value, spurring inflation and impairing consumer confidence. The recent strengthening of the USD versus the Euro has caught many analysts off guard, and compelled US multi-nationals to put into place enhanced forex hedging policies.

Remaining Competitive While Keeping Costs Down

When assessing a country's labor market and candidate compensation environment, companies should bear in mind that unemployment rates and the availability of relevant talent are more accurate indicators to follow than consumer price indices and exchange rates. Certainly all companies need to remain competitive while keeping costs down. During Russia's recent economic crisis, for example, most companies have elected not to make significant changes to their compensation and incentive calculations. In certain cases, multinational technology companies have started paying senior employees in Russia in USD or Euro (multiplied by the prevailing RuR: USD/Euro rate). In other cases, multinational companies have raised compensation across the board for all employees by a modest five to 10 percent — more of a good will gesture than a material boost to the employee's standard of living. Certain larger, non-Russian financial services institutions have significantly increased ruble compensation for their Russian executive level employees. Overall, Russia-based multinational companies have held the line on employee salaries, opting instead to increase bonuses for higher performing or key executives.

Some companies may conclude that in today's market conditions there is increased risk aversion among candidates, and therefore will delay implementing a high performing employee retention policy. That may be a questionable strategy since motivated, entrepreneurial individuals with career aspirations who seek intellectual challenge will find it — and will be remunerated accordingly. No matter what the market conditions, to survive in this increasingly global and competitive world companies must retain employees – high and mid-performers. Companies that treat their employees with empathy, transparency, respect and acknowledge their contributions – monetarily, symbolically or otherwise – will succeed over time. Those employing more short-term, mercenary tactics may indeed bolster this quarter's performance, but are less likely to see long-term success as economic volatility diminishes.