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Retention strategies during difficult economic conditions

Results from a new Deloitte Survey

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About the survey

This survey was conducted in September 2008 and closed at the end of the month. At that time, the market was down 25% year to date. The survey generated 151 responses from companies of all sizes in all industries. See the demographic information about our participants at the end of this report.

The Challenges

Many companies are currently facing particular challenges retaining their valued employees:

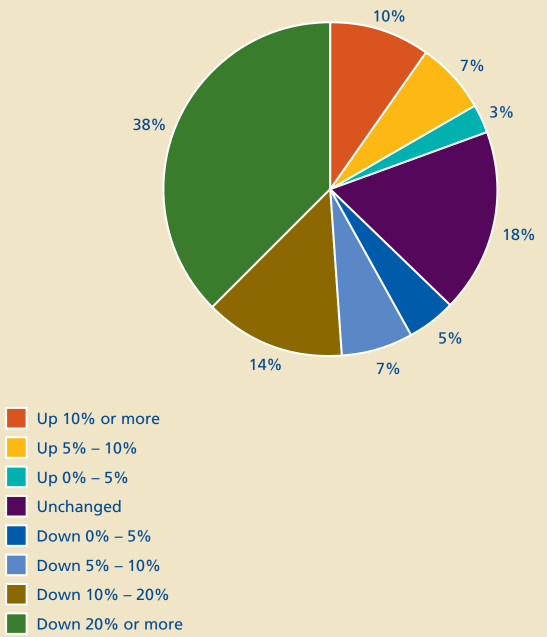
- Long-term incentives may have lost value due to the declining stock market
- Commodity prices have lowered company profitability, reducing the potential for payouts from annual incentive plans
- Consumers are purchasing fewer products and services, reducing opportunities for company growth

These companies are searching for ways to help their employees feel valued and motivated while still adhering to their existing compensation philosophies and principles. Deloitte's survey was designed to capture ways companies are approaching this problem. Over 150 companies responded.

How are companies faring?

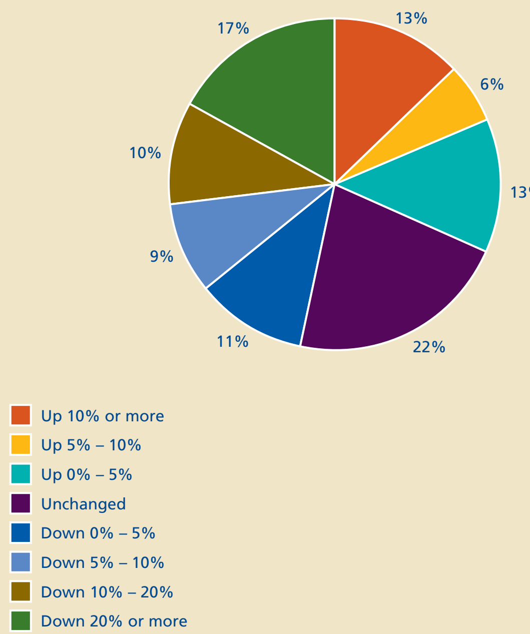
At the time this report is being written, the stock market is down 25% or more over the past twelve months. The companies participating in this survey have been similarly hard hit – over one-half told us their company's stock is down 10% or more. Only 20% of companies have managed to see an increase in their stock price this year. (See Figure 1)

Figure 1. How has your company's stock price changed over the past 12 months?



Company earnings have also been hit, but not nearly as badly as stocks. Nearly one-third of companies have seen an increase in their earnings per share (EPS) over the past twelve months. However, 47% have seen their earnings decline, including 27% who have seen a decrease in excess of ten percent. (See Figure 2)

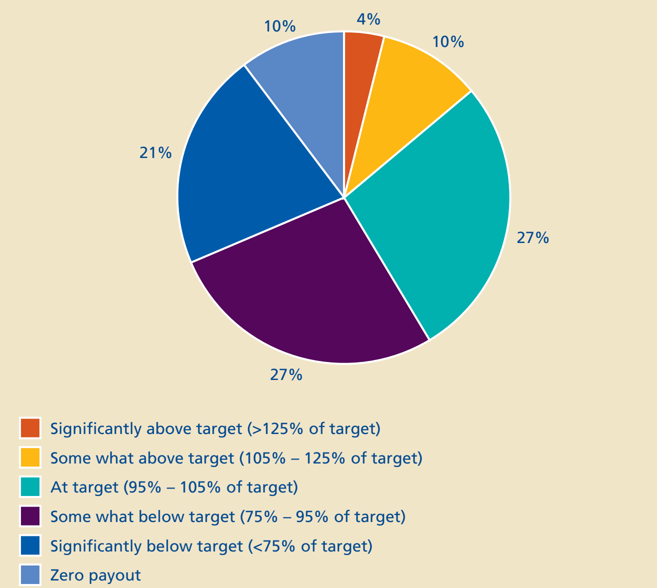
Figure 2. What has been the effect of recent economic conditions on your company's earnings per share (EPS) over the past 12 months?



Compensation plans are being hit

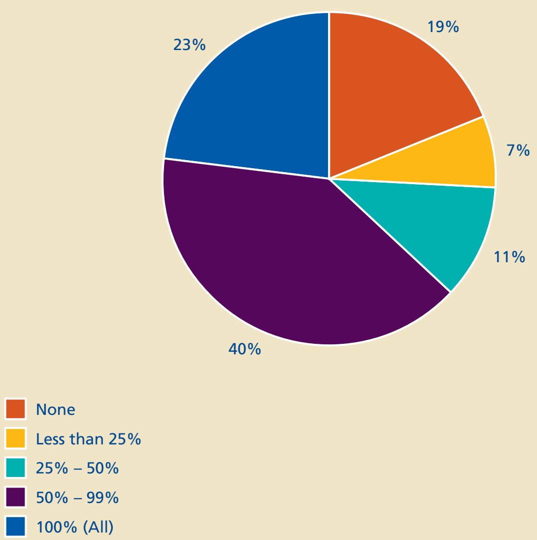
Taken together, decreased earnings and a falling stock price will destroy the value in most companies' annual incentive and long-term incentive plans. While 41% of companies expect their annual incentive plans to pay out at or above target, fully 58% expect a pay out below target. Eleven percent of companies believe that their current annual incentive plan will not yield a bonus at all this year. (See Figure 3)

Figure 3. Based on your company's current performance, at what level are your company's annual incentive plans likely to pay out for the current fiscal year?



Among those companies offering stock options, the news is also dismal. Sixty-three percent of companies report that all or most of their stock options granted within the past five years are currently "underwater" (i.e., the exercise price is above the current stock price.) (See Figure 4) Employees will need to see a significant rise in their company's stock price before their stock options will have any value at all.

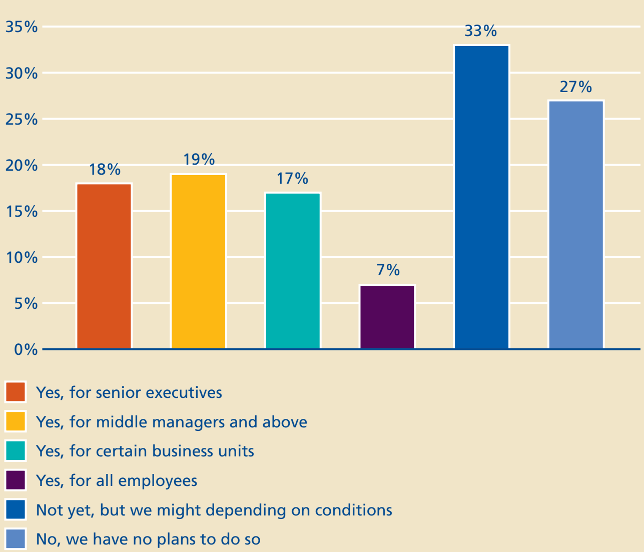
Figure 4. What percent of your stock option grants made within the past five years are currently "underwater"?



How are companies reacting?

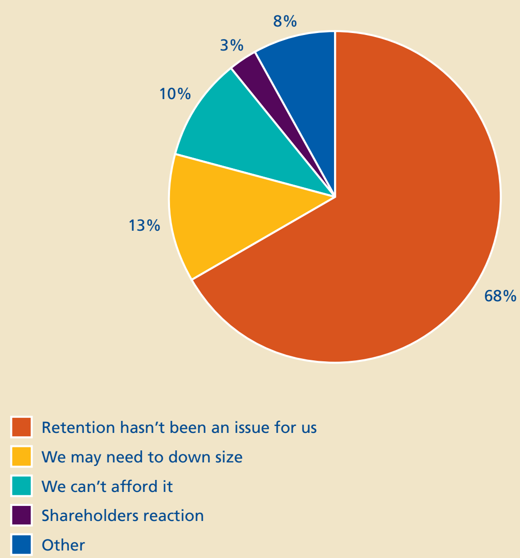
Companies are clearly feeling the need to take steps to retain their valued employees during this difficult time. Approximately 40% of the companies responding to our survey have already implemented a retention program; another one-third of companies are taking a "wait and see" approach. Only 27% of companies told us they currently have no plans to adopt any retention programs. (See Figure 5)

Figure 5. Has your company implemented any retention programs for your employees?



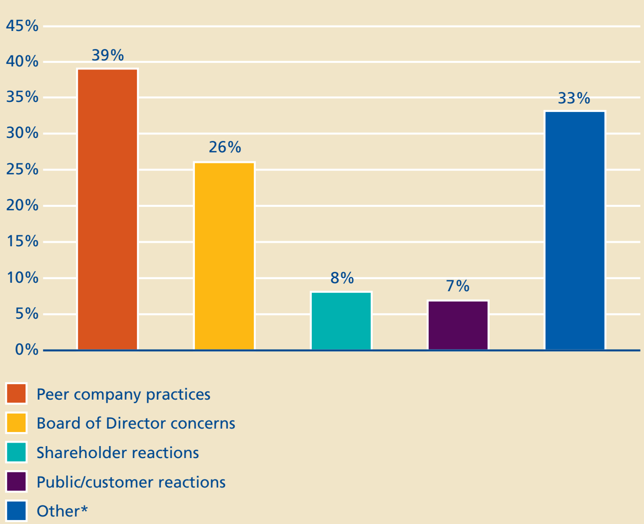
If a company does not plan to implement a retention program, what are their reasons? The majority of these companies told us that retention hasn't been an issue for them in this economy. Perhaps they're in an industry that has seen a lot of job losses and employees are holding on to the jobs they have. Other companies foresee a possible downsizing in the near future, so implementing a retention program doesn't currently make sense. The position of many of these companies can be summed up in the comments made by one participant, who told us, "Retention hasn't been a problem for us yet, but we are watching. Affordability is a limiting factor if we do need to do something." (See Figure 6)

Figure 6. If your company has no plans to implement a retention program, what is your primary reason?



Companies that have taken action feel compelled to stem the tide of low employee morale and the resulting high turnover. Many companies feel vulnerable to the pressure from other companies competing in the war for talent. (See Figure 7)

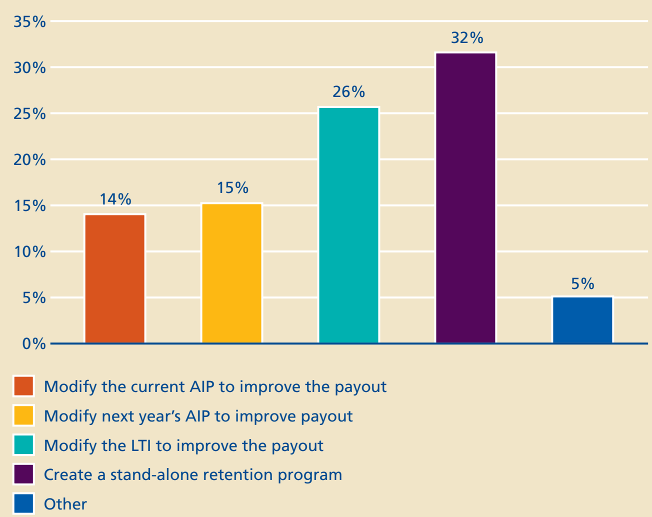
Figure 7. What factors influenced your company's decision to implement a retention program?



*Includes employee morale, turnover, management concerns, etc.

The retention programs currently being implemented by these companies will take many forms. Many companies are hesitant to "change the rules of the game" in the middle of a performance period (either annual or long-term). The most prevalent response was to create a stand-alone retention program for the executive and employee groups these companies are most concerned about retaining. (See Figure 8)

Figure 8. What form will your company's retention program(s) take?



Changing the current plans

The vast majority of companies (78%) are not planning to change this year's annual incentive plan midstream. The companies that are willing to make modifications are taking a varied, sometimes highly individualized approach:

- Some will modify the performance targets but keep the same performance measures (6%), like the participant who told us, "we will adjust targets based on inflationary pressures in certain global regions."
- Others will change the performance measures used (e.g. 6% of respondents indicated a change from revenue/profit measures to strategic/operational/individual goals)
- A few (3%) will create a new plan for the second half of the year. One participant "may offer special 2^{nd}-half plans for certain groups only." Another company "did a mid-year payout. We changed the percent of bonus tied to EBITDA so it was more lucrative for employees. Many divisions did not reach goal."

- Still fewer (2%) will adjust for unbudgeted expense increases due to higher commodity prices.
- A number of companies (8%) could not categorize their approach due to the individualized nature of their changes. One participant said, "We may fund individual business units based on their own performance, and special payments for high-performing individuals." Another company created a "special retention/incentive program for a few key individuals most at risk."

Even fewer companies are willing to make changes to their current stock option or long-term performance plans. Our survey found that fewer than 5% of companies, if any, companies are planning any of the following changes:

- Re-pricing current stock option grants
- Canceling and re-issuing currently outstanding options on either a 1-for-1 or a value basis
- Accelerating future option grants
- Adjusting either the performance targets or measures of performance plans currently in cycle

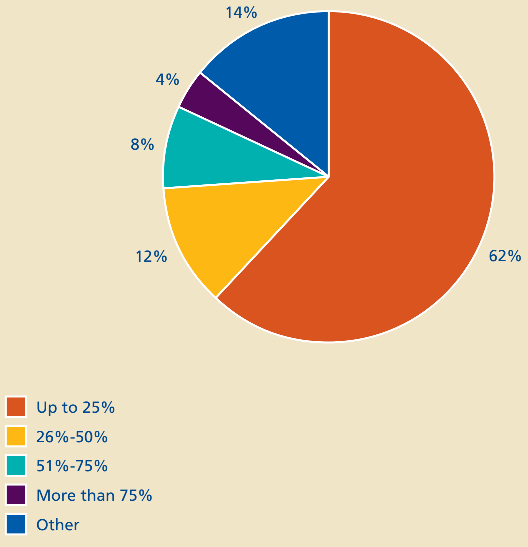
Changes for next year

While current incentive plans are likely to remain static for most companies, changes will be coming in 2009 to help reassure employees that their bonus opportunity is worth striving for and has a realistic possibility of payment. For example, over one-half (53%) of companies are planning to adjust next year's annual incentive plans due to current economic conditions, including one-third of companies that will modify the performance targets while keeping the same performance measures. Another 14% will actually change the performance measures, such as including more strategic, operational or individual goals. Similarly, a noticeable number of companies with performance plans (19%) will modify the performance targets for upcoming plan cycles.

Stand-alone plans

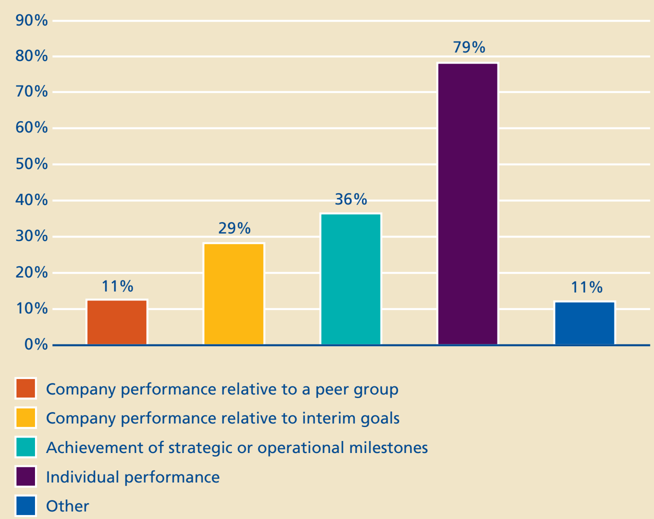
In keeping with the highly individualized nature of the planned retention programs, many companies (22%) will create a stand-alone bonus pool for 2008. These pools allow companies the flexibility to reward employees and business units that have shown exceptional performance, despite the current economic environment. Most companies are keeping the pool relatively small, funding it with 25% or less of the annual incentive pool target awards. (See Figure 9)

Figure 9. What is the size of your discretionary bonus pool (as a percent of the annual incentive plan target award)?



Most of the companies (79%) that are creating discretionary bonus pools will pay awards in cash, while the remainder will pay awards in both cash and stock. Individual performance will determine payouts for most companies, although other methods will also be used. (See Figure 10)

Figure 10. How will you determine payments of awards from the discretionary pool?



A slightly smaller percentage of companies (18%) plan to create a stand-alone longer term incentive plan. Like the discretionary plans, most will pay awards in cash, although some will use stock or restricted stock units. These plans will span two to five years. They are typically highly targeted to key executive or employee groups deemed to be at particular risk of leaving their respective companies. Some plans specifically exclude senior executives and focus on mid-level managers or highly specialized functions, such as IT.

Other plans

What else is under consideration? Very few companies plan on making modifications to their existing deferred compensation plan, such as suspending future deferrals, funding benefits in a secular trust, or terminating the plan and distributing balances. A small number of companies (6%) will allow participants to modify existing distribution elections prior to yearend as allowed under the Section 409A transition rules.

Similarly, very few companies plan to implement a new or newly-modified severance plan. Fewer than 14% of companies have adopted or changed their severance plan in response to current economic conditions. Among the few companies that have, a nearly equal number have made changes just for executives as have made changes for all employees.

Companies are wisely trying to ease the strain on employees by improving their work environment. Many companies are implementing or expanding workforce programs that are designed to make balancing work and family easier. These include flexible work schedules, telecommuting and compressed work weeks. (See Figure 11) While these programs won't put dollars in employees' pockets, they can go a long way toward helping employees view their company more favorably, making them less likely to leave.

Figure 11. Has your company considered implementing or expanding any other workforce programs to help retain employees?

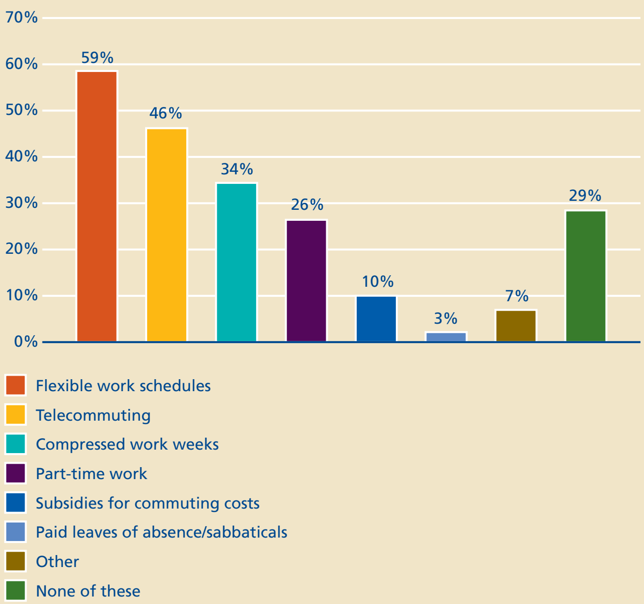


Figure 12. What is your company's primary industry?

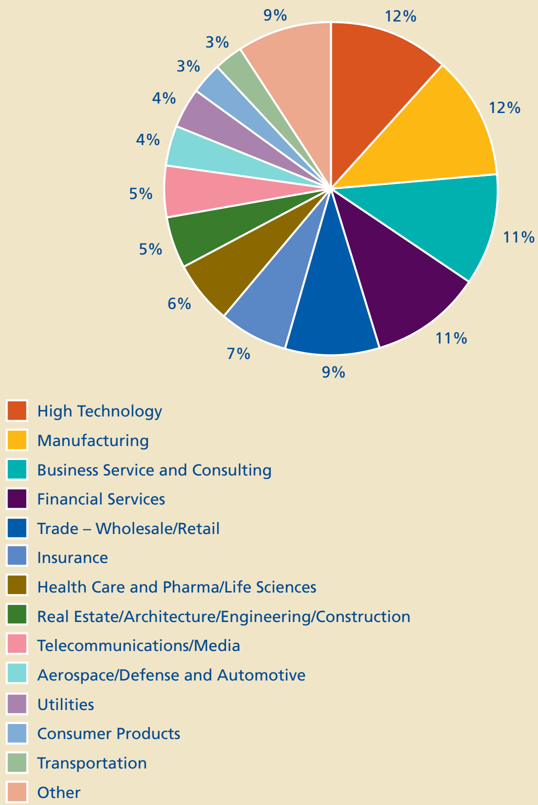
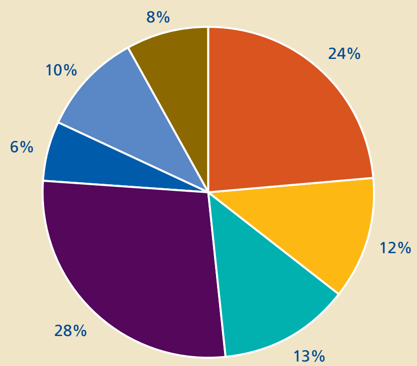
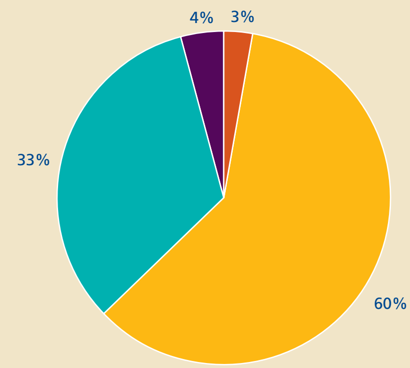


Figure 13. What is your company's revenue during the most recent fiscal year?



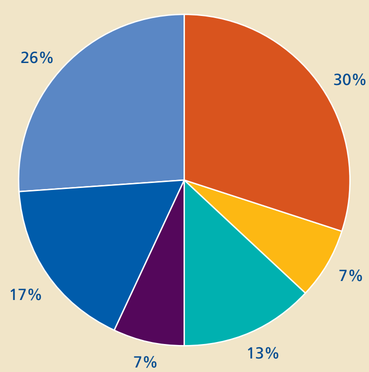
- Less than $100 million
- $100 – $500 million
- $500 million – $1 billion
- $1 – $5 billion
- $5 – $10 billion
- $10 – $20 billion
- Greater than $20 billion

Figure 15. Is your company:



- Other
- Publicly traded
- Privately owned
- Not for profit or government

Figure 14. Approximately how many employees does your company have?



- Fewer than 500
- 500 – 1,000
- 1,000 – 2,500
- 2,500 – 5,000
- 5,000 – 10,000
- More than 10,000

For more information,
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