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Subject: Employment Cost Index Outlook for EconoPlay Subscribers (thanks!)

Employment Cost Index:

Compensation Execs: 4Q Wages Unchanged, Downward Pressures Loom in 1Q

- Employers Keep Options Open Amid Shaky Economic Outlook
- Pain Awaits Workers as Conversation Turns to Wage Freezes, More Layoffs
- Healthcare Costs Seen Dropping as Insurers Play Nice Ahead of Elections

By Gary Rosenberger

NEW YORK (EconoPlay) Jan. 29 – Salary and benefits costs were little changed in the fourth quarter – but with recession talk mounting, contingency plans are in the works to reduce those costs should conditions deteriorate in the next 90 days, compensation consultants say.

Solutions would include wage freezes, layoffs, more cost-shifting on healthcare and other draconian measures aimed at transferring the pain of an economic slide from employer to employee, they say.

So far, employers outside the immediate subprime maelstrom have taken no actions. But nobody is wed to the salary increases or bonuses that were proposed last fall, and companies could delay or scuttle them as they keep their options open to outlast the storm.

With healthcare under special political scrutiny, insurers won't draw attention to themselves with further increases until the dust settles on the presidential elections. After that, all bets are off.

Energy also has taken a backseat to the more pressing issue of a global downturn, which would have one positive benefit in reducing demand for oil and lowering fuel bills.

Jim Stoeckmann, practice leader for compensation at WorldatWork, an association of compensation professionals, said last year's subprime blowout and last week's market gyrations are forcing businesses to reevaluate their budgets for 2008.

“From a rewards perspective, we have seen many top executives lose their jobs as they pay the price for mediocre or negative return on shareholder equity. Now we are beginning to see the price for these poor returns paid by the general workforce in terms of layoffs and wage freezes,” Stoeckmann said.

In an uncertain economy, “companies view their belt-tightening exercises as an opportunity to save costs across a wide range of activities like inventory management, travel, administrative expenses and overtime,” he said.

“When times get really tough, controlling or even freezing salary increases might be required. But companies will normally try to preserve their talent resources at all costs because they represent an invaluable investment in human capital that will be called upon when the economy turns around,” he added.

Last November, when fears were already running high over the subprime contagion, WorldatWork published a survey that found 32% of respondents intended to reduce workforce in the next 12 months, Stoeckmann said.

The high cost of crude, when added to concerns about diminishing home equity and stock-market volatility, has companies watching for changes in consumer behavior that would further undermine the economy. “Companies are monitoring these trends closely and are taking a conservative stance now until more information becomes available,” he said.

“Everything Impacts Healthcare”

Aaron Berg, president of Health Plan Manager Corp. in Mount Arlington, New Jersey, sees big headaches brewing over healthcare costs now that people got a whiff of a global economic downturn. “One thing this really has brought to the fore in my mind is that everything impacts healthcare because it’s such a large percentage of a company’s budget these days,” he said.

“When companies look at the business climate and wonder if they’ll be profitable, they’ll look for places to save money,” Berg added. “They’re going to have to look at medical expenses and make even tougher decision now, especially if they anticipate a recession. I am expecting this to have a long-term impact on my business.”

A recession would be very harsh on health benefit budgets “because companies have pretty much exhausted all their plan design changes that have shifted benefits costs to workers,” he said.

“But employers are scared, and they’re looking harder for ways to reduce those costs. That will bring health savings accounts deeper into the limelight,” Berg said, noting that HSA’s are widely seen as one of the more onerous ways in which management shifts healthcare costs to workers.

Nothing that happened last week would directly or immediately impinge on insurance bills because premiums in place for 2008 were negotiated last fall. But repercussions will be felt when contracts come up for renewal, Berg said.

“If we go into recession and the cost of medical delivery also goes down, it wouldn’t be so bad,” he said.

But he doesn’t think that will happen. “If anything, claims are costing more every month,” Berg said. “I don’t see healthcare providers cutting their rates. I don’t see the cost of a hospital stay going down.”

Jim Watt, president of Employee Benefit Solutions in Houston, sees healthcare cost increases “continuing to soften” as the November elections approach.

“Healthcare providers, doctors, insurance companies, managed care networks all find ways to cooperate leading up to elections. The antagonism subsides and the adjusted medical CPI is softened,” he said.

In the interest of evading the media radar in an election year, providers and insurers generally “lay down their swords, begin to work together, and the increases during these times are generally smaller than those outside of election years,” Watt said.

A Shallow Recession and a Shallow Recovery

“The companies that we work with are just starting to implement the salary budgets that they approved last September and October, when last week’s avalanche wasn’t on their radar scope,” said Paul Gavejian, managing director of Total Compensation Solutions in Armonk, New York.

Right now his clients consider last week’s stock market gyrations and the response by central bankers and politicians to be a blip on the screen. “They expect it will go away as fast as it arrived,” he said. “They are certainly hoping it won’t impact their bonuses, presuming that they had a good year.”

Clients that are planning for a recession expect it to be shallow – “and to be replaced by that other R word, recovery, albeit they see an equally shallow recovery,” Gavejian said.

Under the latest scenario, employers should move ahead with the increases and bonuses they planned months ago, “a dividend that will pay back in higher productivity and worker satisfaction when the market turns around, the economy improves, and the next administration takes over,” he said.

The clients he spoke with last week told him they intend to go through with their salary budget plans that are already “squeezed to the low point at 3.8 to 4.2 percent increases,” he said.

The exception, of course, is financial services – where bad decisions have already been punished at the very top – and where planning is geared around a recession mindset. “All others have adopted a wait and see attitude,” Gavejian said.

Meanwhile, the cost of energy has moved down on people’s worry lists, as oil prices retreat from the \$100 a barrel mark and companies make adjustments by promoting energy-savings programs like teleconferencing, car pooling, less travel and lowering thermostats.

Steve Gross, employee compensation leader for Mercer Human Resources Consulting, said he was peppered with questions all week on what happens to salary budgets in light of an impending recession.

So far, none of his clients outside of financial services have changed their compensation budgets. "For the next 90-day period, I don't think companies will change plans at all. They will explore alternatives. But as for salary budgets, they'll stick with what they planned," Gross said. "Nothing has changed in the last three weeks."

There are exceptions, such as one mortgage banker client that reduced its workforce by 25% last fall then jettisoned a planned base salary increase and "threw it all into bonuses so as not to get saddled with higher fixed costs," he said.

Most companies are far along into their planning cycle for 2008, but the decisions from last fall are hardly engraved in gold. "With two-thirds of employers instituting salary increases between now and April 1, there's still time to change things. I just haven't seen anything yet," Gross said.

For most companies 2007 was still a good year, and Gross therefore expects bonuses to be "about equal" to the prior year. "The increases would obviously depend on the sector," he said.

In financial services, "we'll see more segmentation within the company. Some units will feel the pain, others will do better," he said.

Companies affected by housing's problems face a choice of retaining head count (and worker morale) or satisfying the demands of Wall Street and downsizing. "It's a paradox because it's a problem of trying to select between two right answers," Gross said.

"The answer is to figure out how hard it would be to replace the workforce and then preserve as many as you can," Gross said, adding that clerical workers would probably be the first to go because they're the easiest to replace.

It remains unclear how much help employers will get from interest rate cuts or the promised stimulus package because it is even less clear whether the government acted from strength or desperation. "Right now, it looks to people like George (Bush) and Ben (Bernanke) put up the red flag," Gross said. "We'll see if what they did softens the impact."

Not the Driver's Seat He Had in Mind

"All the volatility last week was amazing, but sometimes it takes a while to hit," said David Leach of Strategic Apex Group, an executive compensation consultancy based in Santa Monica, California.

"It's all about perception. In everybody's mind, the publicity surrounding the housing market, subprime and higher mortgage payments is creating caution because everyone is so confused by what's happening. Some companies are not as bullish as they were and are waiting to see what happens next," Leach said.

But in terms of cutting back salary budgets, "I'm not seeing that yet," Leach said.

Shareholders are generating fresh scrutiny over top executive compensation – and jobs are at stake. “But new management is not going to be punished for what the old management did. We will know more when company compensation filings come out in March,” he said.

With the exception of Goldman Sachs, which successfully hedged against subprime losses, Leach doesn’t see Wall Street bonus payouts as big as they were a year ago. “Even though some divisions had good results, there’s not as much money left in the bonus till because of the divisions that lost in the mortgage market,” he said.

So what has become of people with careers in mortgage financing? “Well, one of them took me to the airport the other day ... in a cab,” Leach replied.

In further testimonial to bad timing and even worse judgment, the cab driver told Leach he was studying for his real-estate license.

The U.S. Labor Department is scheduled to release the Employment Cost Index for the fourth quarter on Thursday, Jan. 31 at 8:30 a.m. ET. The above also looked ahead to the current quarter.

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