

Improving Employee Value Proposition during a Pay Freeze

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When companies are faced with economic and financial challenges, the knee-jerk reaction is to deploy cost-cutting measures.

With the increase in operating costs, the daunting challenge for HR is to ensure that Staff Cost to Income ratio remains at sustainable levels, while also keeping an engaged workforce. The options typically hover around rightsizing, pay-cuts, recruitment freeze and pay freeze.

Pay freeze, commonly known as salary freeze or pay flattening refers to a company's policy of maintaining current pay levels for some or all categories of employees for a period of time.

A pay freeze can mean "*business as usual*" for companies that do not typically increase pay. Conversely, for organisations that are driven by annual and promotional increases, this can pose a major change management issue, impact employee engagement and overall business performance if not properly managed.

This article explores various reasons and forms of pay freezes, possible effects and options for enhancing employee value proposition, even in "drought".

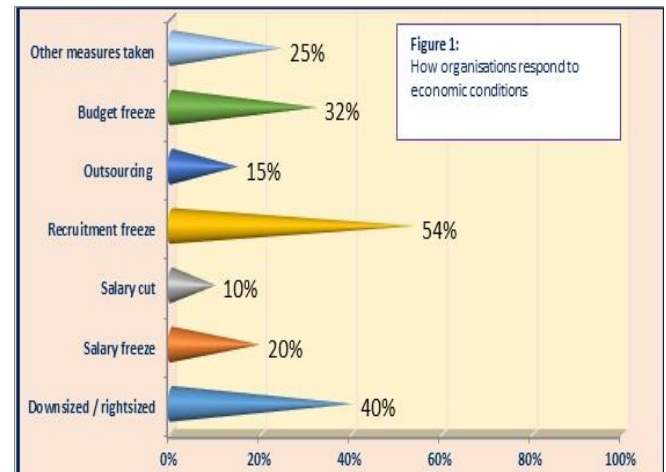
Reasons for Pay Freeze

Organisations adopt pay freezes for the following reasons:

- **Restructuring:** Some organisations carry out restructuring through mergers & acquisitions, while some make structural changes to optimise resources and adapt to the changing business environment. These project types have a time span of about six months to one year or even longer periods in unionised environments and to this end, some companies freeze pay, as a temporary measure until key and informed decisions are taken.
- **Pay Market Practice:** Organisations may adopt a pay freeze to:
 - Adjust pay movement, where pay-out is above the desired market reference point.
 - Manage red circled employees. i.e. employees who are earning above the maximum of their respective pay bands.

- **Economic Climate:** In an economic downturn, a pay freeze is considered an alternative to massive employee layoff, except in cases where the company really needs to shed weight.

The results of the KPMG 2015/2016 HR Practices Survey of one hundred and twenty one (121) companies across various sectors in Nigeria shows that companies have responded to the current economic situation as follows:



Source: KPMG 2015/16 HR Practices Survey

- **Ability to Pay:** A company's ability to pay and sustain its desired pay levels is dependent on its financial size and the efficient utilisation of its resources. Where the business performance is moving at a slower pace than pay reviews, a company can consider freezing pay, while leveraging on incentive schemes to drive individual and business performance.

Forms of Pay Freezes

Base Pay usually takes the first hit during a pay freeze. Some of the possible options to pay freeze are highlighted below:

- **Freeze Basic Salary** – This implies that only Basic Salary would be held constant. Fixed pay elements may be reviewed periodically to douse tension amongst employees.
- **Freeze Guaranteed Pay** – Here, all items tied to Basic Salary would be held constant. However, this should not be prolonged, to manage retention.

In addition to freezing base pay, organisations may consider the following:

- **Review of Incentive Schemes:** Whilst freezing guaranteed pay, an organisation may need to review its performance management system and incentive schemes to ensure linkage between

individual and company performance. A common practice is to modify Key Performances Indices and ensure pay-out is reflective of performance.

- **Treatment of Benefits-In-Kind:** The depreciation in value of the Naira coupled with the reviewed automotive policy have increased the cost of certain benefits. To cushion the effect of the escalating cost, some companies have undertaken to:
 - **Monetise Certain Benefits** – More companies have joined the band wagon. Companies must however consider the resulting tax implications, in the case of assets such as status cars, furniture and generators, e.t.c.
 - **Set a Cost limit** – Companies may choose to cap the benefits at a fixed amount, rather than incurring additional costs for the purchase of the same benefits.
- **Restructuring of Retirement Benefits:** Based on the 2015 Consumer Market Remuneration Survey, 22% of companies have either restructured or closed their gratuity schemes between 2014 and 2015 to optimise cost. It is important to note that a pay freeze would also have reducing effect on pay-out from retirement benefits schemes and should be considered before taking key decisions.

Effect of Pay Freezes

Pay freeze may look good on the financials, however, if not properly managed, it may affect employee motivation and engagement. Key considerations for employers are provided below:

- **Employee-Employer Relationship:** Pay freezes may put a strain on relationships which is detrimental to business growth. It is therefore important that employees are carried along and that the process is considered fair.
- **Impact on Recruitment:** Competitive pay is not only beneficial to employees. Attracting the right talents during a pay freeze can pose a challenge if prolonged or not properly managed.
- **Employee Motivation & Performance:** During a pay freeze, employers may experience increased employee sensitivity as the excitement of a pay increase wears off faster than the resentment of a pay

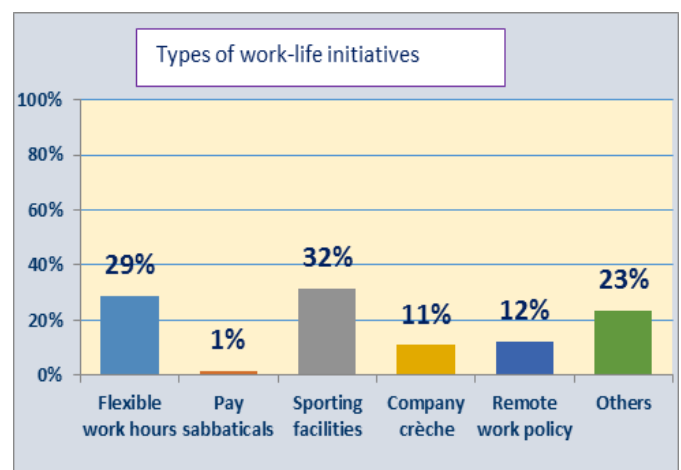
freeze. Employers may struggle with employee motivation and performance in these times.

- **Talent Management:** Cutting overhead cost also affect other employer obligations such as training etc. For **Generation X** employees, career development is as important as compensation. Organisations that implement a freeze on training and development may pay for their frugality when things begin to turn around.
- **Union Negotiations:** Time may be lost obtaining union buy-in. Organisations have to weigh the cost of union strike actions and incessant meetings against the gains of a pay freeze.
- **Risk of Increased Employee Turnover:** A pay freeze may render a company vulnerable to talent loss. This signals the need to seek other ways to improve employee value proposition.

Improving Value Proposition - Leveraging Soft Areas of Reward

This includes every aspect of the employee experience. The key areas for delivering value while keeping an eye on cost are detailed below:

- **Work-life Initiatives** – This is an efficient way to drive employee engagement. The common work-life initiatives provided across industries are presented in the chart overleaf:



Source: KPMG 2015/16 HR Practices Survey

- **Performance & Recognition** - These Programs can compensate for pay freezes. Cost effective programs such as a handshake from a superior, open declaration to other colleagues, plaques, branded gifts and a special parking spot

may be explored to show appreciation for hard work.

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- **Career Development:** This should not necessarily take a back seat when reducing overhead cost. A clear path for personal development may foster loyalty from employees.
- **Performance Management:** The need for a well-designed and clearly communicated performance management system that links individual and team Key Performance Indices (KPIs) to business goals cannot be over emphasized.

During an economic recession, a company may consider designing relevant and effective KPIs to encourage performance. This way, employees can focus on other key areas important to the business and what they have to do to achieve them.

- **Pay for Performance:** Companies can leverage on well-designed self-funding short or long term incentive schemes to reward employees. Payouts from these schemes should be based on defined criteria and proportionate to individual contribution. Also, for organisations with cash flow issues, a portion of the payout from the schemes may be deferred for a specified period.
- **Effective Communication:** This should include a situation analysis supporting the pay freeze. Communication should also be geared towards clearly stating the behaviours and cultures that will substantially increase the success rate and trigger a turn-around in the company's financial performance.

In addition, employees like to know that “*we are in this together*”. Management teams must therefore demonstrate that a pay freeze is not peculiar to levels below management, to gain employee trust.

Conclusion

Pay freeze may be required for business survival. However, this should only be a temporary measure. Therefore, organisations should enhance their Employee Value Proposition to remain the employer of choice, while anticipating the upcoming business boom.