First Quarter Optimization

2009 will offer many opportunities for firms to emerge leaner, more efficient, and well poised to take advantage of the opportunities that will be available.

By Warren Rosenstein, Head of Client Business Analysis, McLagan
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After working harder than ever, in the most stressful year-end environment any of us have seen, it would be nice to say that we can coast a bit in the first quarter of 2009. But we can't – there is still much work to be done. What follows is a checklist of topics for Compensation and HR professionals to consider, for optimizing performance in the new year:

1. 2009 Talent Repricing
2. Plan Design
3. Salary Management
4. Right Sizing

1. 2009 TALENT REPRICING

After a breakneck run that began in 2003, it appears that talent is once again a buyer's market. In the aftermath of massive layoffs, consolidations, acquisitions, and troubles in the hedge fund sector, the market appears to have reached a saturation point—there is more talent than available jobs.

As Compensation and HR professionals know, a big part of the first quarter has traditionally been spent on bid-aways and counter-offers. Employees stayed for their bonuses, received offers at new firms, considered counter-offers, and what followed were rounds of negotiations. Will this process go away? Will everyone be happy just to have a job?

How firms approach this process—as well as how firms build their hiring plans for 2009—will be critical in shaping performance for years to come. If you think of talent as an asset, and that is the most critical asset that firms have, then appropriate care and discretion must be taken in what talent is retained and acquired, and how it is priced. In the same way that there are bargain stocks available, there is bargain talent available, and the proper pricing of this talent will decide which firms will simply weather the storm, and which will seize the opportunity to acquire valuable "assets" at fair prices, in a way that builds loyalty among these new hires.

Compensation / HR staff should work closely with their business partners to understand the opportunities, the available talent, the cost associated with these investments, and build a hiring plan early enough in the year to take advantage of opportunities, whether that plan includes:

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- Absolute hiring freeze
- Targets of opportunity / “best available athletes”
- Sector growth
- Regional growth
- Talent upgrades in existing business footprint

All variables in hiring negotiations may be in play: guarantees, sign-on awards, buyouts, target bonuses, incentive plans, titles, responsibility, etc. Firms are under little pressure to offer guarantees or sign-on awards, and buyouts are relatively inexpensive in the current climate. Candidates will pay particular attention to the deferral plans at prospective firms, and certainly a more prestigious title or increased responsibility is always attractive to job seekers. Unlike previous years, where firms could estimate the rates for these jobs, or age prior data, it is critical to have current and accurate information as early in the year as possible. Similarly, understanding the competitive landscape in terms of deferral plans is key to making competitive offers.

2. PLAN DESIGN

Several firms have already made dramatic changes to their incentive plans, including provisions like clawbacks for future performance, extended vesting / settlement cycles and delivering vehicles linked to illiquid assets to employees associated with these assets, as an incentive award. There has not been a time in recent memory of greater opportunity to redesign compensation plans in a way that truly makes sense.

This topic is very broad in and of itself, but let’s consider it in the specific light of talent acquisition in the current environment. The challenge is straightforward: firms see talent available, but cannot afford to pay traditional rates / guarantees. Employees are seeking engagement, but don’t want to work for a fraction of what they have earned historically, especially if they have no long-term interest in the upside of what they are contributing to. While there isn’t a single solution that will work for all circumstances, the fundamental principle of a clear line of sight between multi-year performance and multi-year pay is relevant to most situations.

Firms are now positioned to offer ownership stakes (equity / performance-based awards) in a meaningful way, that bridge the gap between the typical bid/ ask negotiation. Firms that have not offered performance-based awards can use these as a recruiting tool, and firms that have, can broaden the use and target the fluctuation of the award value to track specific business areas, rather than firm-wide performance.

Plans designed to create value based on incremental performance will be particularly attractive to job-seekers, as performance is at or close to the trough for many firms, creating enormous financial opportunities for

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employees receiving long-term awards. Implementing these plans properly can create significant recruiting opportunities for firms particularly concerned with retaining their newly acquired talent, rather than providing a stopover for displaced staff waiting for the market to rebound.

For firms that currently have option awards, it may be worthwhile, in some cases, to consider repricing the existing awards. A subsequent McLagan Alert will deal with this topic in depth.

3. SALARY MANAGEMENT

The watchword for 2009 will be efficiency, with smaller staffs trying to accomplish more work and dollars being kept under close watch. This is an ideal time for firms to consider building a more formal salary / job structure. Compensation and HR professionals can save valuable business management time by taking the lead on this. There are several advantages to these programs:

- Avoid overpaying new hires
- Reduce litigation risk
- Promote lateral employee movement where appropriate
- Simplify and reduce time spent on management decisions (bonus is already a merit-based decision)
- Ensure internal relativities
- Cost savings associated with structured approach

Salary structures are best built early in the year, so that as hiring decisions are made, employees are brought in at reasonable and standardized rates. This also gives Compensation / HR appropriate time to position this with management, so that when the year-end cycle approaches, salary decisions are largely accounted for.

Beyond managing salary efficiently, there is a greater decision to be made: is it time to move some of "bonus" into fixed pay? Historically, highly-compensated employees in financial services have had relatively small salaries, with the understanding that a bonus wasn't really a bonus, but rather an entitlement, at least to some degree. This has been palatable to employees, since up until now, no one questioned whether bonuses should be eliminated in an unprofitable year.

Consider the example of a lawyer at a law firm making one million dollars, who receives this as base salary, versus a lawyer in financial services, with a salary of $200,000, and a bonus of $800,000. In a bad year at the law firm, there is no expectation that the lawyer will forego his salary—it is simply a fixed cost, however, the lawyer on Wall Street is expected to give up incentive pay.

While companies are loath to incur even greater fixed cost, the time may be right to consider moving at least some amount of bonus pay into salary, particularly if we are entering a new pay paradigm, where bonuses really are a "bonus". While most applicable for infrastructure staff, this may make some sense for front office employees as well.

4. RIGHT-SIZING

Further down the path of efficiency is ensuring that after the flurry of downsizings, integrations and acquisitions—some done in haste—what is left is a fully optimized organization, with the right set of employees appropriately scaled to the right tasks.

Firms can benchmark their existing staffs in variety of ways:

- Front office to back office headcount ratios
- Front office to back office cost ratios
- Cost-per-trade metrics
- Revenue per head metrics
- Transaction per head metrics
- Comp cost per market share

All of these measurement tools, as well as many others, help firms pinpoint where there is room for better performance, and finding and acting on these opportunities represents a significant opportunity for cost savings and productivity. For this exercise to be most effective, a collaborative effort between Comp/HR, CFO/CAOs and business management is optimal.

2009 promises to be a challenging year, but chance favors the prepared hand. There are many opportunities available for firms to emerge leaner, more efficient, and well poised to take advantage of the opportunities that will be available. ■

Warren Rosenstein is Head of Client Business Analysis at McLagan. Mr. Rosenstein works with clients to develop customized analysis strategy across compensation, staffing and productivity. He has provided solutions for a variety of client needs, including compensation plan design, organization structure and salary strategies.

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