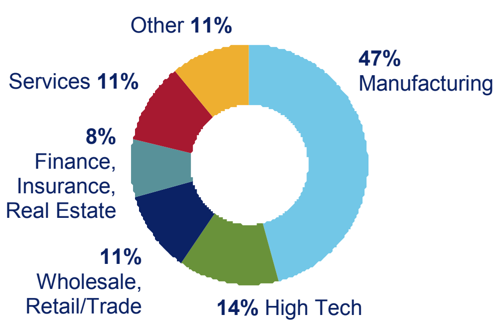
# Managing Global Market Pressures

## About the Survey

The 2008 Survey of Global Market Pressures was conducted in July and August 2008, before the most recent manifestation of the credit crisis. It was completed by 66 North American multinational organizations spanning a variety of industries (Figure 1). The respondents consist of senior managers from human resources (62 percent), benefits (30 percent), and finance or treasury (8 percent), with significant operations outside North America. On average, they employ 22,000 workers in the United States and another 27,000 in the remainder of their global operations.

**Figure 1 |** Represented Industries




## Executive Summary

Managing a business through the downside of an economic cycle is challenging for multinational organizations. They must effectively manage the compensation and benefit costs of a global workforce during periods of intense profit pressure and divergent inflation rates.

Watson Wyatt's 2008 study of North American multinational organizations reveals that in the face of volatile market conditions, they are most concerned with the impact of rising global inflation on people costs in their non-U.S. operations. To manage pressures of profitability, they are focused on the areas where they have immediate and direct control. Multinationals are planning to move more operations offshore to lower-cost regions. They also plan to address the costs of governance and support by regionalizing benefits, compensation and HR staff in order to increase efficiency and stay close to the market.

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## Key Findings

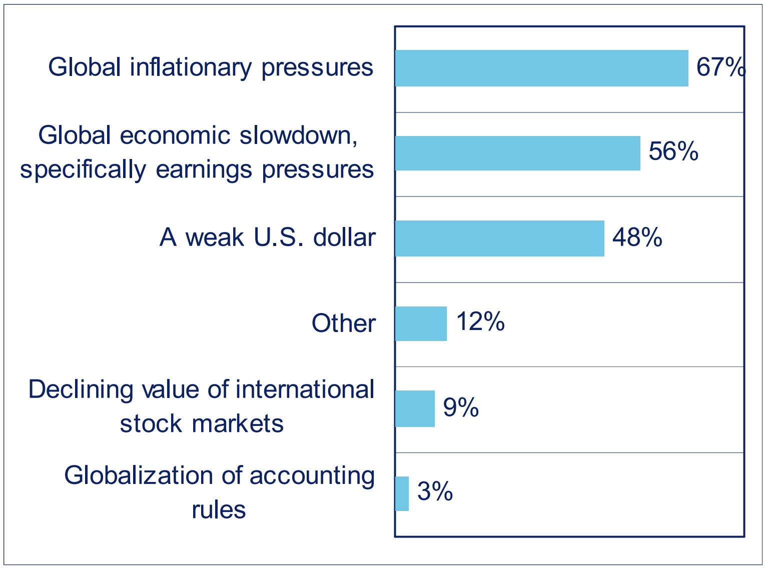
- The chief concerns for North American multinationals in managing their people costs are global inflation (67 percent), a global economic slowdown (56 percent) and a weak U.S. dollar (48 percent).
- Multinationals expect to reduce costs by moving even more production/work offshore to lower-cost regions (42 percent) and scaling back HR/infrastructure at headquarters (26 percent). A large majority do not see expanding production in the United States as a cost-saving option (76 percent).
- Overwhelmingly, multinationals do not view reducing benefits — at home (68 percent) or abroad (75 percent) — as a course of action to manage profitability pressures in the next 12 months.
- Most concerns about the impact of a weak U.S. dollar are centered on the value of long-term incentive (LTI) programs (66 percent). Even though a large number of LTI programs are pegged to the dollar, few companies have taken action (8 percent) or are considering changes (13 percent) to control currency risk associated with these programs.

## Interpreting and Prioritizing Market Pressures

The deterioration of the global economy has created an escalating set of challenges for multinationals in managing business costs and the financial health of their operations. This is particularly the case for North American multinationals and the management of their offshore locations. Declines in the U.S. dollar place new focus and importance on overseas operations, while unstable inflation rates and softening markets place increasing pressures on profitability and budgets for pay and benefits.

The greatest concern facing multinationals today in managing the people costs of their offshore operations is rising global inflation (67 percent). In addition, an economic slowdown (56 percent) and the weakening of the U.S. dollar (48 percent) are also major concerns (Figure 2). Interestingly, survey respondents are less concerned about recent advances toward the globalization of accounting rules (3 percent) and the declining value of international stock markets (9 percent). This might be a result of recent shifts globally to pay for performance and defined contribution retirement programs around the world. Twelve percent of multinationals are concerned with “other” issues, specifically the skills shortage and the war for talent.

**Figure 2 |** Global Inflation Highlights Multinationals' Concerns About People Costs in Their Offshore Locations*

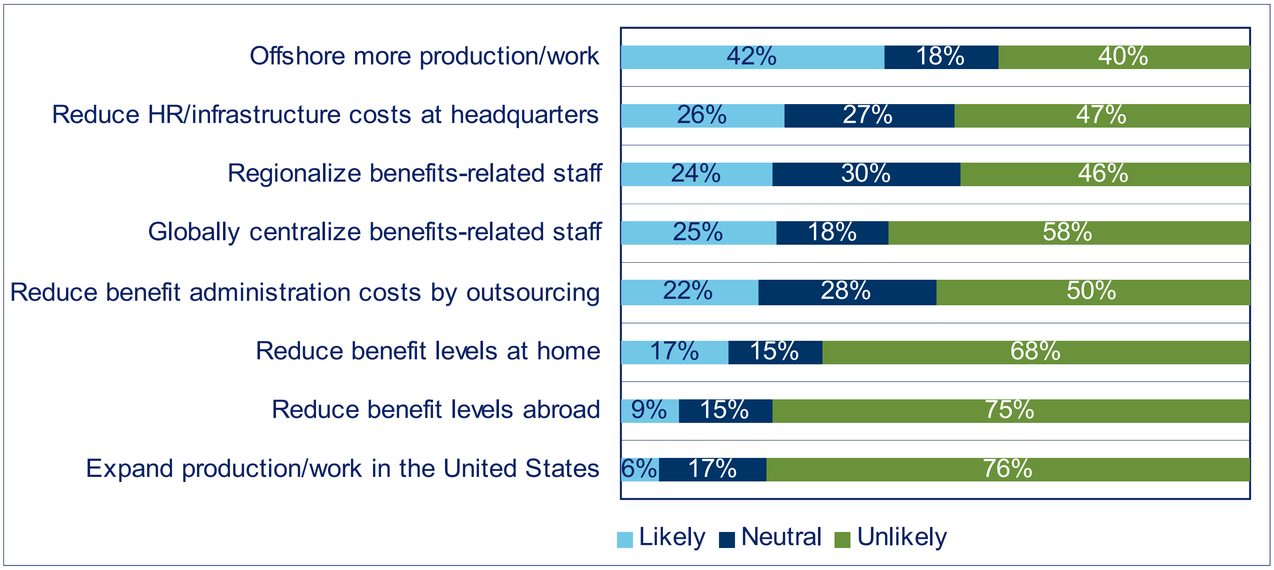



** Percent reporting item as one of the two most important issues concerning people costs within non-U.S. operations*

Despite turbulent market conditions, many organizations appear committed to reducing costs by establishing and shifting operations to lower-cost regions (Figure 3). In the next 12 months, 42 percent of multinationals plan to offshore more work, a strategy that has emerging economies growing robustly. Although the value of U.S. currency is declining, the majority of employers (76 percent) do not plan to expand production in the United States. These actions echo those of past economic crises and are in-line with current business models of expansion.

To manage their people costs during this economic slowdown, a number of senior HR leaders plan to reduce HR infrastructure costs at headquarters (26 percent) and benefit administration costs by outsourcing (22 percent). In addition, companies are considering actions to reorganize their HR function, either by globalizing (25 percent) or moving to a more regional structure (24 percent). Such actions would also address their governance and support costs. Very few companies plan to cut benefits at home (17 percent) or overseas (9 percent) in the next 12 months. There is, however, a greater tendency for cuts to occur in U.S. operations than in offshore locations, possibly in anticipation of a greater market slowdown in the United States. While the current market environment might require multinational organizations to streamline all aspects of their operations to reduce costs, the challenge is to avoid hampering the long-term strategic focus of the HR function.

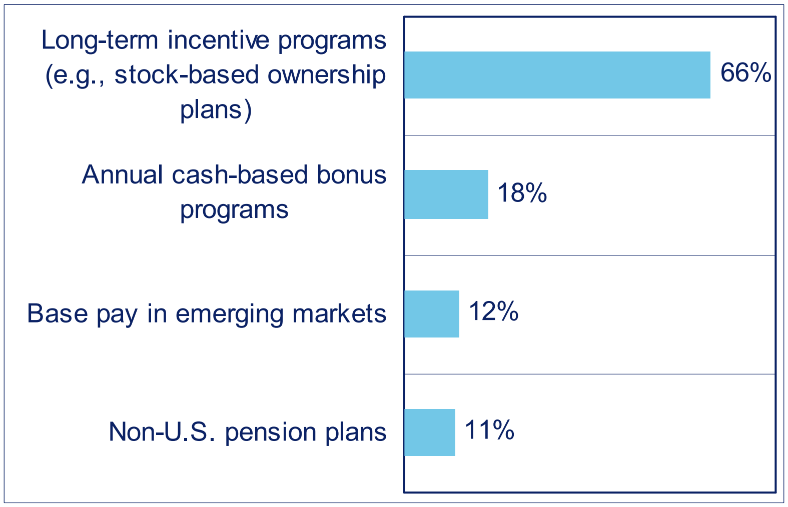
**Figure 3 |** Multinationals Are Turning to Offshoring in the Next 12 Months to Reduce Costs




## Managing Dollar-Denominated Benefits

The decline in the U.S. dollar in recent years is having a major effect on the reward structures of multinational organizations. Specifically, funding for international compensation and benefit programs that are pegged to the U.S. dollar are being squeezed by a significant drop in the value of the currency. In fact, 66 percent of companies have LTI programs, such as stock-based ownership plans, tied to the U.S. dollar (Figure 4). It is uncommon for merit and bonus programs (18 percent), base pay in emerging markets (12 percent) and non-U.S. pension plans (11 percent) to be dollar denominated.

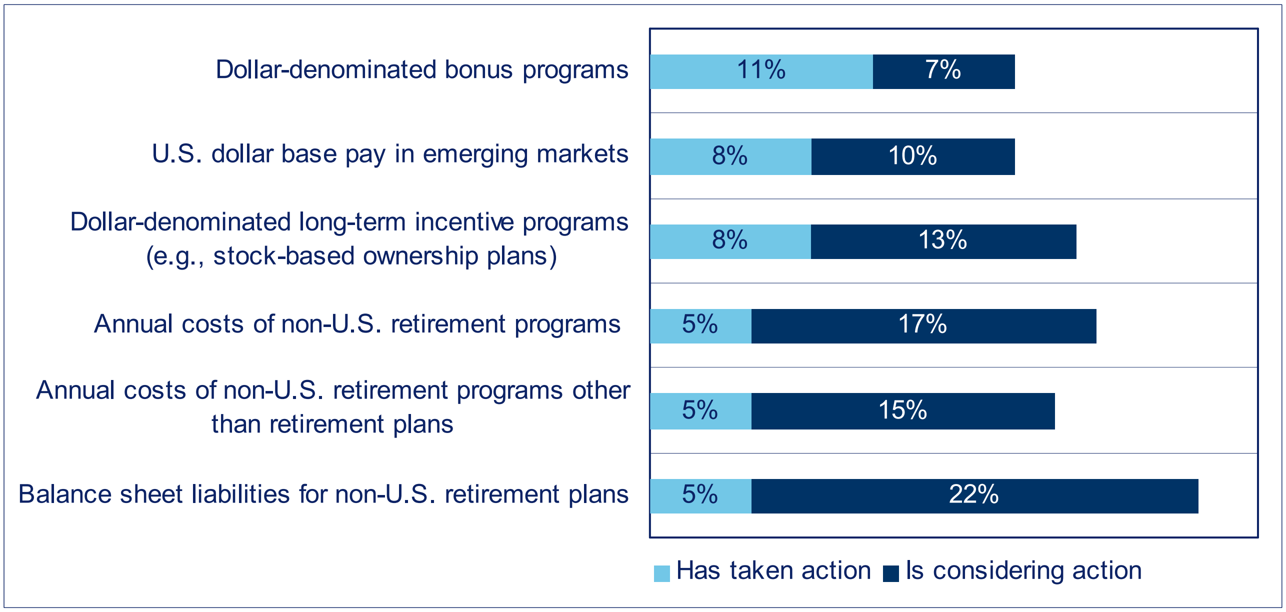
**Figure 4 |** Long-Term Incentive Programs Are Most Likely to Be Dollar Denominated



Despite the weak dollar, few companies are taking or considering action to manage currency risks associated with their compensation and benefit programs (Figure 5). In fact, even with a large number of LTI programs being pegged to the dollar, only a handful of companies have taken action (8 percent) or are considering changes (13 percent) to manage currency risk. This is consistent with generally accepted principles that suggest LTI programs should be viewed independently from short-term shifts in currency spreads. Likewise, few organizations have taken actions around their dollar-denominated bonus programs (11 percent), base pay in emerging markets (8 percent) or annual costs in their non-U.S. retirement (5 percent) and other benefit programs (5 percent).

Some multinationals, however, are considering steps to manage balance sheet liabilities (22 percent) and costs (17 percent) for non-U.S. retirement plans. These actions create opportunities for global HR managers to assess and implement strategies to mitigate the impact of future currency fluctuations.

**Figure 5 |** Few Companies Taking or Considering Action to Manage Currency Risks Linked to Compensation and Benefit Programs

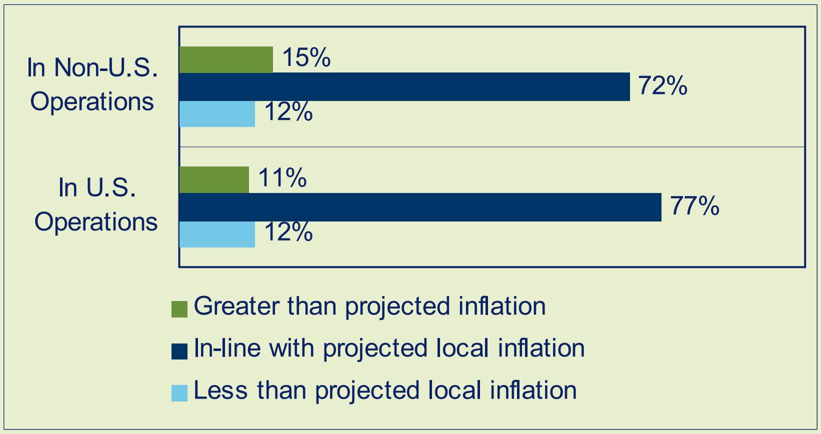


## Keeping Up With Inflation

Global commodity prices spiked in late 2007 and early 2008, reflecting the impact of rising energy and food prices. The International Monetary Fund reported that global inflation rose from 2.6 percent to 4.4 percent between February 2007 and February 2008,[1] and these trends have been consistent across all countries. Specifically, prices in the advanced economies increased from 1.9 percent to 3.2 percent between 2007 and 2008, whereas rates in the emerging economies rose from 3.8 percent to 6.5 percent during the same period.

For the upcoming accounting year, the majority of multinationals intend to align budgets for future compensation and benefit costs with projected local inflation for offices inside (77 percent) and outside (72 percent) the United States (Figure 6). Only about a quarter of organizations will budget for compensation increases at rates other than the pace of standard of living – split evenly between rates greater than and less than inflation.

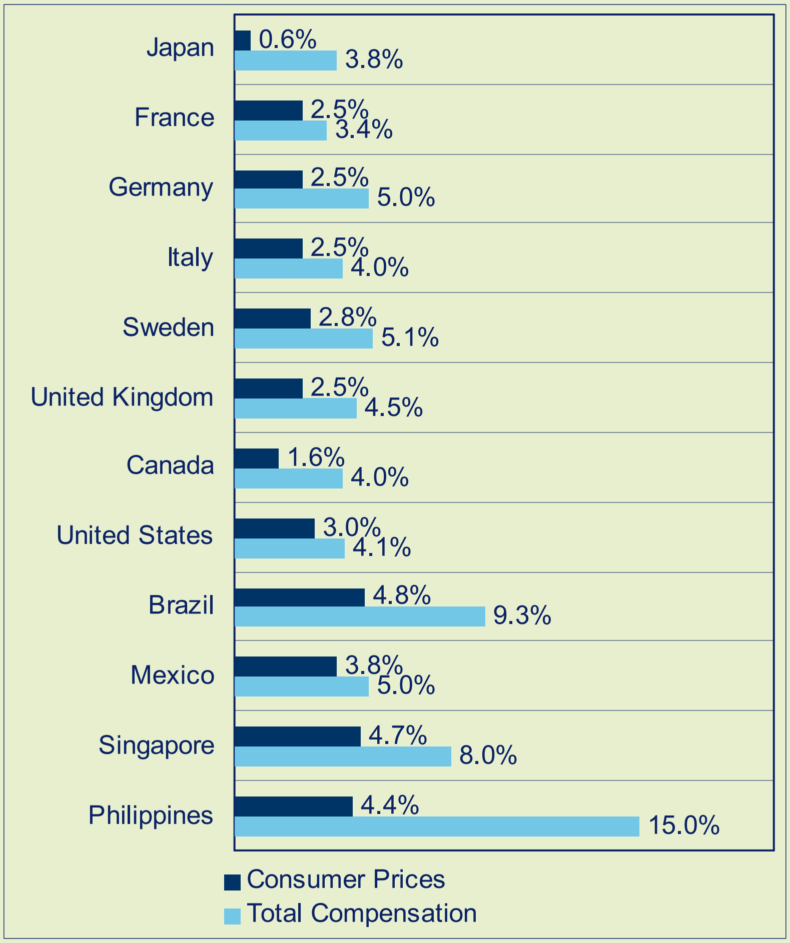
**Figure 6 |** Majority of Multinationals Target Compensation Increases That Are In-Line With Projected Local Inflation




Unstable commodity prices make it difficult for organizations to manage pay practices in-line with local market conditions. When compensation is too closely aligned to projections of inflation, there is evidence of "real" compensation growth that transcends local economic conditions (Figure 7). In essence, if volatile statistics drive compensation strategies, real earnings can grow faster than purchasing power requirements. There are also examples where overheated markets with skills shortages might require pay and

*1. International Monetary Fund, World Economic and Financial Surveys, World Economic Outlook, Housing and Business Cycle, April 2008. http://www.imf.org/external/pubs/ft/weo/2008/01/index.htm* reward budgets that are in excess of local inflation. The lesson here is that an employer's operating and financial plans, not inflation forecasts alone, should drive decisions regarding employee rewards and budgets. Organizations can maintain operational stability and achieve long-term business objectives by remaining flexible and unlinking certain markets from traditional approaches to managing pay and rewards.

**Figure 7 |** Total Compensation Increases Outpace Consumer Price Increases




*Source: Watson Wyatt's 2008/2009 Global Strategic Rewards, World Economic Outlook Database, April 2008.*

## Conclusion

As economic events unfold with breakneck speed, senior HR leaders are struggling to effectively manage people costs that, in turn, affect a multinational organization's bottom line. Multinationals need to rapidly assess the possible impact of market changes, such as rising inflation, and prioritize the pressures they will manage.

While cost savers such as offshoring and restructuring will help in the interim, HR should keep the company's long-term strategy in mind. For example, it is suggested that LTI programs be viewed independently of currency fluctuations. HR has an opportunity to add shareholder value by making strategic decisions that stabilize risk and maximize profitability.

## About Watson Wyatt Worldwide

Watson Wyatt is the trusted business partner to the world's leading organizations on people and financial issues.

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Our consultants bring fresh thinking to client issues, along with the experience and research to know what really works. They deliver practical, evidence-based solutions that are tailored to your organization's culture and goals.

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- Developing attraction, retention and reward strategies that help create competitive advantage
- Advising pension plan sponsors and other institutions on optimal investment strategies
- Providing strategic and financial advice to insurance and financial services companies
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