



MANAGING AMID MARKET TURMOIL: TOP PRIORITIES FOR BUSINESS AND HR LEADERS

While the dust has yet to clear, the dramatic and unsettling recent events in the financial markets already seem certain to be transformational — and not only for the financial services sector. Corporate icons are disappearing overnight, credit for businesses and consumers is drying up, economies around the world are reeling from one market close to the next, and the U.S., U.K. and other governments have embarked on the most ambitious financial rescue effort in history.

The financial crisis has spawned a great sense of urgency for companies to respond — across all industry sectors. Those in the midst of finalizing budgets for 2009 are reconsidering their revenue projections and expense and investment assumptions. And some are wrestling with serious issues of survival.

WHITE PAPER

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Rarely have corporate leaders faced such enormous challenges — or risks — in balancing the need for decisive short-term action with the need for calm and measured steps to reassure customers, shareholders and employees. Clearly, the market meltdown has spread the pain broadly. Periodic rebounds notwithstanding, investors are unsure if, when or how to invest; consumers are hesitant to spend, and employees are fearful about the future. Many are worried about their jobs and their ability to retire. They're looking to company leaders to set the right tone and make the tough — but thoughtful — decisions necessary to stabilize their organizations and speed recovery.

In this volatile and uncertain environment, it's never been more important for leaders to find what we call “the power of *and*” — addressing short-term issues *and* also maintaining a strong foundation for the future. The power of *and* is about finding ways to conserve cash now without sacrificing strategic investments in talent, technology, marketing and R&D. It's about taking immediate actions to bolster sales in key markets without undercutting product or service quality, reputational equity or longer-term pricing strategies. And it's about remembering that, in an increasingly interwoven global economy, cost-cutting decisions you make today in your production facility in Mexico may have unexpected implications for your marketing strategy tomorrow in Germany.

In short, while the primary focus right now may be on the bottom line and the balance sheet, it's equally critical to address your long-term people and HR agenda. As we work with organizations around the world to develop preliminary responses to the current situation, we've identified three immediate areas of focus for companies and their leaders to ride out — and rise above — today's turbulence.

STABILIZE, SET CONTEXT AND BE PRESENT: *THE KEY ROLE FOR LEADERS*

In times of crisis, it's especially critical for leaders to be thoughtful and deliberate about where and how they “show up” in the organization. People look to their company's leaders for reassurance that is meaningful and candid, and clarity about business priorities and the actions the company is undertaking to deal with uncertainty and position itself for continued growth.

Our research with employees around the world confirms that in both good and tough times, effective leadership is one of the top drivers of employee engagement, and high engagement, in turn, helps ensure that people are focused, committed and taking the right actions to help the organization succeed. How leaders at all levels respond to periods of uncertainty and transition sets the tone for the entire organization and can make — or break — a company's ability to ride out a rough patch.

What defines an effective leadership response? We'd highlight three things. First is the ability to see both the forest and the trees, and set a context and tone for employees that defuses anxiety without providing false reassurance. Partly, this involves keeping a cool head under fire. But even more important, it's about balancing short- and long-term priorities and needs, and remaining focused on long-term, strategic objectives while addressing critical short-term needs head on.

The second area is visibility and communication. In times of stress, employees need and want a closer connection to their leaders, and need to see and hear from them more than ever. This means opening channels of communication up, down and across an organization. Top executives can't physically be everywhere, but if they are communicating as frequently and openly as possible, they can project their presence and their messages throughout the organization. And when local leadership then follows through with face-to-face discussions and information sharing, the overall positive impact on employees can be heightened considerably.

The third area for leadership focus is top talent. Even your best performers and high-potential, emerging leaders can feel insecure during uncertain times. These individuals may be even more vulnerable to feelers from competitors, who may see market turmoil as an opportunity to lure away your stars. Now more than ever, leaders need to invest time and energy in ensuring that their best people are connected to leadership's agenda, and feel valued and positive about the organization's long-term prospects.

Understanding where and how people fit from a skills and contribution perspective provides important insights to guide decisions about the extent and nature of staff cuts, as well as the people or functions you will need to focus on retaining and engaging.

Our Global Workforce Study* has consistently shown that the number one driver of employee engagement, both globally and in a number of countries, is employees' belief that senior leadership is genuinely interested in their well-being. Demonstrating that interest means providing resources, showing empathy, taking the time to listen and, ultimately, caring about what people are going through and finding ways to help them, when possible.

DEAL WITH COST AND RISK ISSUES: A TARGETED APPROACH

In many instances, of course, setting the context for employees involves communicating some tough messages about staff or cost reductions. With both financial and broader markets changing so rapidly and unexpectedly, it's the rare organization that won't have to at least revisit its cost structure, especially labor costs. Some companies will need to cut spending in the face of declining sales to reduce borrowing needs in a difficult credit market. Others may have to delay the launch of a new product or entry into a new market, or spin off a troubled division.

These and other operational decisions all have an impact on the workforce, not only in terms of potential cutbacks in staffing or job freezes, but also in the nature, scope and investment in various workforce programs. While it's tempting to make across-the-board changes — for instance, cutting all budgets by 10% — thoughtful, targeted

reductions are almost always preferable to blunt cuts. Some points to consider:

- If head count cuts are required, start by defining different roles in the organization and the relative importance of those roles in meeting key financial or strategic goals. Which pivotal jobs are critical to a turnaround or continued growth? Which jobs support the core operations of the organization? Which may no longer be critical, and can some or all of those be redesigned or deployed differently? Who are the strongest performers and those that demonstrate the greatest potential? Understanding where and how people fit from a skills and contribution perspective provides important insights to guide decisions about the extent and nature of staff cuts, as well as the people or functions you will need to focus on retaining and engaging.

- Before making painful program cuts, consider eliminating programs that have either a low real or perceived value to the workforce and the business. Consider, also, what matters most to different segments of the workforce — it's often possible to shift focus from a high-cost program to a less costly but more highly valued benefit, such as flexible working arrangements. Yet another key finding from our current Global Workforce Study is that some of the elements of the work environment that employees value most have less to do with a monetary outlay on the part of the organization than with the nature of an employee's day-to-day experience at work. These include the ability to balance work and personal life, a sense of security and stability in one's career, and meaningful challenges on the job.

- Training and development programs are another tempting target in periods of financial pressure. But resist the temptation to cut them too far. Eliminating such programs for the wrong groups of people can not only spur added attrition of key talent, but can also create significant capability gaps in the future and make it harder for the organization to right itself when the economy starts to recover.

- Finally, keep in mind that there are likely to be some cost increases that you won't be able to change or control — for example, increases in health care costs that typically accompany higher stress, and absenteeism or rising disability claims that often come with reductions in force. It's important to anticipate the unexpected because there's little tolerance for departures from budget projections during periods of financial uncertainty.

Of course, one of the most volatile budget items for many companies right now is pension and other postretirement costs (e.g., retiree medical). Despite the recent roller coaster in share prices, equity markets are down from the end of last year, which will reduce pension assets and 401(k) balances. This will mean a lower funded status for most plans, which will result in the need for larger cash contributions and higher costs on the P&L. As financial markets continue to fluctuate on a daily (even hourly) basis, the likely funded status for plans is far from clear.

*Towers Perrin has conducted several studies of employee attitudes and views around the world over the last decade. The most recent study, *Closing the Engagement Gap: A Road Map for Driving Superior Performance*, is available on www.towersperrin.com.

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These financial risks coincide with new pension funding requirements under the Pension Protection Act (PPA). Under the PPA, when a plan's funded status drops below certain levels, employee payouts can be affected, and benefit accruals may need to cease, potentially affecting employees' retirement patterns. Now more than ever, understanding all of the risks embedded in pension plans — and having a clear strategy for mitigating those risks — is critical to sound corporate financial management. Here are some specific suggestions for managing pension plan financial risk.

- Make sure you understand all of the investments in your pension portfolio to properly assess where you have any credit or subprime exposure. Then evaluate the implications of the current market conditions for your company's cash flows, P&L costs and balance sheet entries, both near and long term.

- Test a range of alternative scenarios, and look at your cash requirements in an overall business context, as cash and credit are now scarce everywhere.

- Consider employee perceptions and the broader implications of declining pension and 401(k) assets. Will employees in the retirement zone continue working? Is your pension plan at risk of falling below the key PPA funding thresholds?

- Finally, communicate frequently about the financial condition of your pension plans to senior management and the board. Make sure you have a risk assessment program in place that includes clear risk mitigation action steps. Reaching a leadership consensus on pension plan risk mitigation is often difficult, so it's best to start educating the management team now.

KEEP EMPLOYEES FOCUSED AND ENGAGED

Given the many issues highlighted here, virtually all of which touch employees directly, is it realistic to believe companies can keep employees engaged? The answer is yes. It is not only realistic but, in fact, essential. There are significant opportunities to engage the workforce around a sharper sense of organizational priorities, and significant risks for failing to attend to engagement head on.

To a great extent, engaging employees ties back to leadership's messages and behavior, not only at the outset of a crisis, but over time as well. For leaders, whether those at the top of the house or divisional and departmental heads, visibility and communication remain vital to sustaining engagement, especially if the company faces an extended period of uncertainty and change.

In addition, leaders have to clarify what the organization expects from employees and what employees can expect in return. Call it the deal, or the employment value proposition, but it needs to be well defined, well understood, visibly supported by leaders and managers, and delivered consistently across the organization via key programs and policies.

Among the steps to consider in sustaining engagement:

- Ensure that all leaders are working from the same "playbook" in terms of what they say, and when and how they say it, both around short-term priorities and long-term strategies. This consistency is essential to align the rest of the workforce with priorities and actions that will help the company succeed. The last thing you want in an economic crisis is to have members of the management team sending mixed messages.

- Reexamine the capabilities that leaders need to effectively manage change and inspire outstanding performance in a challenging business environment. The skills that made some leaders successful in less volatile times may not be sufficient for the current situation. If so, it may be the right time to provide leaders with practical action steps and tools for the short term, and sharpen key skills such as communication, active listening and managing through change.

- Focus on differentiation, in terms of truly distinguishing people's role, impact, contribution and potential. Doing this requires a clear understanding of pivotal roles in the organization — those most critical to delivering the business strategy — the critical competencies required for these roles, and the pool of high-performing, high-potential talent. Equally importantly, it requires that leaders hold people accountable and make tough decisions about which individuals truly add the greatest value to the organization. Sometimes these decisions require reallocating salary or bonus dollars to top performers and high potentials. But differentiation should also come into play in allocating development dollars, career opportunities, special assignments, leadership's attention and a host of other "rewards." True differentiation remains a difficult goal in many corporate and national cultures, particularly those that emphasize egalitarianism. Ultimately, however, it's where leaders really earn their stripes.

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■ Finally, continue to monitor workforce engagement levels and respond quickly to any erosion in them. The key here is to understand what's really behind a drop in engagement since it's not always the obvious cause, like greater stress, longer hours or a bigger workload. Engagement involves a complex mix of rational, emotional and motivational factors that connect people to their work and their employers, and the nature and depth of that connection is sensitive to a wide array of elements in the work experience. Understanding those connections is critical in maintaining energy and focus, especially in a tough and volatile climate.

THE BOTTOM LINE

Clearly, the coming weeks and months are going to be difficult — if not downright painful — for people at all levels in many organizations. Leaders are likely to be challenged with tough decisions. Managers will feel pressured to maintain momentum or do more with fewer resources. And employees will feel anxious and perhaps helpless to do anything concrete.

It's a time for tough decisions, but it's not a time to succumb to a bunker mentality and make expedient decisions just to show you're "doing something." In a survey of more than 400 senior HR executives earlier this year, as the economy was beginning to slow, we found most companies were committed to pursuing a dual agenda of cost management and growth in an uncertain economic climate. Now that uncertainty has deteriorated into doubt and

Executive Pay: A Lightning Rod in the Storm?

In today's environment of full disclosure, one area that's sure to be closely scrutinized by shareholders and employees is how companies pay their senior executives — especially in the most distressed businesses. Shareholders who have taken a haircut, and employees who have seen their colleagues laid off, their pay restrained (or reduced) and their retirement savings decimated will expect company leaders to share their pain. Executive pay in this climate becomes a very visible symbol of a company's priorities and values.

At the same time, however, companies also need to retain and motivate their top talent, and will want to keep leaders focused on making the right decisions for the business. These priorities will be especially challenging for companies whose performance goals in long-term incentive plans no longer seem realistic and whose shares have lost a significant portion of their value, leaving executives with stock options that are deeply underwater. Getting the balance right in executive pay programs will be a key area of focus for many corporate boards as the economic crisis unfolds.

In the past few years, many boards and compensation committees have devoted considerable attention to "getting the upside" right — appropriately aligning executive incentives with performance when the business and the company's stock perform well. Today's realities will force more companies to come to terms with the downside of executive pay and the proper alignment of rewards and risk. No company wants to be seen as "paying for failure" in this environment.

fear, we would hope that companies continue to temper their near-term response to external forces with a clear long-range vision and thoughtful decisions about the future.

To learn more about the work we're doing in these areas to help address critical workforce and reward issues, please contact your local Towers Perrin office or visit www.towersperrin.com.

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Towers Perrin has offices and alliance partners in the world's major markets. More information about Towers Perrin is available at www.towersperrin.com.