HEALTH WEALTH CAREER

TALENT STRATEGY IN TIMES OF CURRENCY VOLATILITY AND INFLATION FLUCTUATION

MAKE TOMORROW, TODAY

MERCER

PROTECTING YOUR MOST IMPORTANT ASSET — YOUR PEOPLE — DURING TIMES OF CURRENCY RATE VOLATILITY AND HIGH INFLATION

Disruption has become an often-used buzzword in business lately — a moment that knocks an organisation off course and yet offers an opportunity to ask new questions, drive innovation, or confirm the strength of the status quo. The disruptions we have witnessed in the global financial markets over the past year as they relate to currency have definitely knocked organisations around, from stock price to c-suite to factory floor — in fact, many companies faced financial performance headwinds, causing them to miss earnings due to currency movement. Altogether these factors, in turn, have affected the people who work for these organisations. Thus, HR professionals have had to step into this disruption to understand the impact on their organisation's most important asset — their people.

From the Swiss National Bank's decision to no longer hold the Swiss franc at a fixed exchange rate with the euro, to the steep decline of the Russian ruble and Canadian dollar, to China's central bank's decision to devalue the yuan, the currency and exchange rate issues of the past year have circled the globe and had worldwide impact.

Currency volatility and lack of stability in foreign exchange rates have created a tough environment for companies no matter their home location, as the price of exporting and importing goods has been impacted. Many companies exporting into countries experiencing currency devaluations, for example, have seen decreased demand for their, now, more expensive exports and seen their stock prices fall, lowering their overall market value.

Of course, these organisations still need good, skilled labour, but now face greater difficulty in attracting and retaining premier, globally mobile talent. Because countries experiencing currency devaluation, for example, also tend to experience high inflation, companies are challenged with how to relocate employees to and from that location as well as hiring key talent from among the local employment pool.

It also raises questions about compensation policies as the cost of goods and services increase faster than wages. Beyond expatriates, local employees also feel the impact of higher inflation, as companies are constrained to consider temporary compensation as a way to retain top talent and critical employees.

Meanwhile, some expatriates, paid solely in home currency (rather than through a split payroll that provides both currencies for home and host purchases), now face a higher cost of living in the host country. At the same time, other employees question the validity — and desirability — of a future mobility plan that would boost them further along their career path.

These challenges require HR departments to remain engaged and responsive as they cope with employee concerns over compensation and decreased purchasing power, job stability, and future career growth. Through surveys and empirical evidence, Mercer has seen a number of emerging practices in response. At the same time, it is important to note that, historically, currency volatility has occurred continually, making the following strategies and best practices useful not just for today but likely tomorrow as well.

A currency's exchange rate is tied to economic performance. The more attractive the currency, the higher demand for it; thus, the market gives it a greater value. And, of course, the opposite is also true. The less attractive the currency, the less demand there is for it, which leads to the currency being devalued.

CURRENCY VOLATILITY: IMPACT ON MOBILITY POLICIES

A change in a currency's exchange rate has an instant impact on an expatriate's life if the employee earns in one currency and spends in another. Depending on what is happening, the change can be beneficial — they could find themselves saving significant money on their overseas assignment — or detrimental — they could suddenly find life more expensive then they planned for and see their savings erode in an effort to maintain a suitable quality of life.

Any negative impact on an expatriate will, in turn, adversely affect the mobility staff by making their tasks more complicated and their policies more difficult to address and explain.

Cost of Expatriate Packages

First and foremost, cost comes to mind. How do the currency fluctuations contribute to the cost of the organisation's expatriate package? In some cases, currency fluctuations may lower costs. For example, a strong US dollar generally means lower expatriate costs for US-based firms, while the weaker euro generally means the opposite for European-based firms.

Home Country – Balance Sheet

With the cost-of-living allowance (COLA), or differential, the home-country balance sheet stabilises and shields the expatriate from currency swings. The differential moves, up or down, to balance the cost of goods and services at home with those in the host country — thereby keeping the expatriate's purchasing power "whole." However, it may also create a morale issue if there is a misperception that some expatriates are "winners" and others "losers," and that the "winners" receive more pay.

As this idea is incorrect, employers must clearly explain the balance sheet approach so that all expatriates — whether or not affected by currency fluctuations — understand that it is not a matter of winners and losers; the balance sheet approach protects purchasing power for all expatriates, no matter their location.

HOW SPLIT PAY WORKS

Expatriates may receive compensation all in one currency (home or host) or in multiple currencies by way of the split payroll system, a methodology favoured by the balance sheet approach. Assignees paid solely in home or host currency may be at risk with regards to currency fluctuation. Employers that implement a balance sheet approach with split pay allocate some of the salary in the home country (funds not needed in the host country, such as incentive payments and savings), with the remainder — the COLA and host housing norm (the employee's contribution to host housing) amounts — in host currency.

The split pay approach offers advantages by:

- Neutralising the effect of currency volatility through limiting the need to transfer funds from the home country to host country for daily purchases of goods and services.

- Protecting the portion of base salary (spendable income, not total pay) to buy what is needed in the host country, which protects purchasing power and lifestyle.

- Ensuring a stable number of local currency units for the host-location portion (needed for daily living) and home-country currency units (for reserve and incentives).

- Removing worry about the hassles and fees of converting currency into local funds, particularly since this portion is not needed overseas.

Splitting pay protects employees and their savings from most currency issues — as long as the employer continues to update the package throughout the volatility. Monitoring exchange rate changes on a regular basis and reviewing allowances when the change reaches a specific threshold are essential steps in the methodology. This practice keeps expatriates "whole," while showing the company's concern for their monetary welfare.

Key Takeaways: Impact on Mobility Policies

- In economies where the currency is volatile, expatriates tend to start questioning their COLA and overseas purchasing power. It is important to maintain a high level of **communication** with these expatriates so that everyone understands how split pay protects compensation and maintains purchasing power.

- With strong **currency devaluation**, if the company does not follow the balance sheet approach and split pay system, expatriates lose out on the additional saving opportunity available when part of their salary is paid in home-country currency.

- Therefore, discussions with expatriates regarding changes in COL indexes may not be a true concern about their differentials, but rather a concern about their **additional savings opportunity.**

- **Monitoring volatile exchange rates**, and taking action to review (and adjust, where necessary) allowances, are proactive steps that go hand-in-hand with good communication about mobility policy.

CURRENCY VOLATILITY: IMPACT ON COMPENSATION AND STAFF RETENTION POLICIES

The negative impact of currency fluctuations on both employees, from a compensation perspective, and the business, from a profit perspective, is immediate. Caught in the middle? HR. On the one hand, employees earn the same salary in an environment in which it no longer has the same value. On the other hand, the business may be struggling with changing export prices, stock prices, and other volatile factors. Employees are looking for pay increases, while the c-suite is looking for cost savings. Meanwhile, HR seeks to retain — and, in some cases, recruit — key talent with limited budgets.

Salary Increases

Implementing devaluation-related salary increases or lump-sum compensation as a percentage of base salary to ease employees' financial pain is one policy organisations can consider. The cost of such an increase needs to include the administrative costs. But that's not all. Potential long-term costs may inadvertently emerge if HR sets expectations that the company will compensate for economic situations for which it is not responsible. Alternatively, maintaining pre-planned merit increases and implementing small, noncash rewards may be effective ways to remain an employer of choice and show concern for the workforce.

Employee Retention and Satisfaction

Key employee retention and satisfaction relies heavily on strong communication and transparency during this time. For example, sharing how the business is doing can reinforce a sense of job security in an unstable economy. HR should keep a close eye on the most important talent who may be attracted easily by other employers that may address the problem more proactively. Finally, an emphasis on the employee value proposition — the sum total of what employers offer to their employees — can build loyalty.

> Many companies are still monitoring global markets carefully before making decisions this year, as well as remaining cautious about setting a precedent that they, as employers, should compensate for economic ups and downs.

Key Takeaways: Impact on Compensation and Staff Retention Policies

- In economies where the currency is volatile, employees tend to start questioning their compensation and purchasing power. It is important to maintain a high level of **communication** with employees.

- Before instituting a **devaluation-based salary increase**, seriously consider the administrative cost and the implications of setting a precedent. By paying a one-time spot payment, rather than increasing the salary on a permanent basis, the company can avoid including the amount in bonus, pension, and other pay-related calculations.

- Consider **small cash or noncash rewards** to show you recognise the situation and care about employees' concerns.

- In economies where the currency has appreciated, **transferring overtime and shift work to less-expensive countries**, if possible, could help cut costs without having to lay off expatriates.

FUTURE VOLATILITY REQUIRES READINESS TO ACT — OR WAIT AND SEE

History has proven that currency adjustments are a necessary part of the economic cycle, sometimes creating havoc, while, at other times, barely noticeable. Therefore, HR's one known fact amidst all this recent disruption is to expect it — and be ready to address the situation with a response that best suits the company.

Mercer has observed through client conversation and survey that many organisations have taken a "wait and see" approach to many of these events. Their hesitation may be due to the fact that instituting a change in policy often means taking on administrative costs and setting a precedent of employee expectations for future economic events beyond the company's control.

Some firms, however, have cautiously stepped into the breach, either by issuing "devaluation" payments, reviewing or changing the currency by which expatriates are paid, or keeping an eye on key talent. But money is not the only answer. The employee value proposition — the sum total of the package offered to employees — may also provide part of the solution.

MERCER'S CURRENCY SNAPSHOT SURVEYS

What are the emerging practices, and how many companies have actually implemented anything to address recent currency issues?

Mercer's Snapshot Surveys on country-specific currency devaluations were designed to provide clients with information on additional local HR practices being implemented by companies in answer to devaluation and other currency-related measures. The Mercer Snapshot Surveys can be a useful source of information to support any current and future decision making.

Want to talk about currency volatility and your organisation's current or future talent strategy?

Email mobility@mercer.com to learn more about our currency Snapshot Surveys or if you would like to discuss how your own ogranisation's current or future talent strategy is adapting to currency changes.

ABOUT MERCER

Mercer is a global consulting leader in talent, health, retirement, and investments. Mercer helps clients around the world advance the health, wealth, and performance of their most vital asset — their people. Mercer's 20,500+ employees are based in more than 40 countries, and we operate in more than 140 countries. Mercer is a wholly owned subsidiary of Marsh & McLennan Companies (NYSE:MMC), a global team of professional services companies offering clients advice and solutions in the areas of risk, strategy, and human capital.

For further information, please contact
your local Mercer office or visit our website at:
www.mercer.com

MARSH & McLENNAN
COMPANIES