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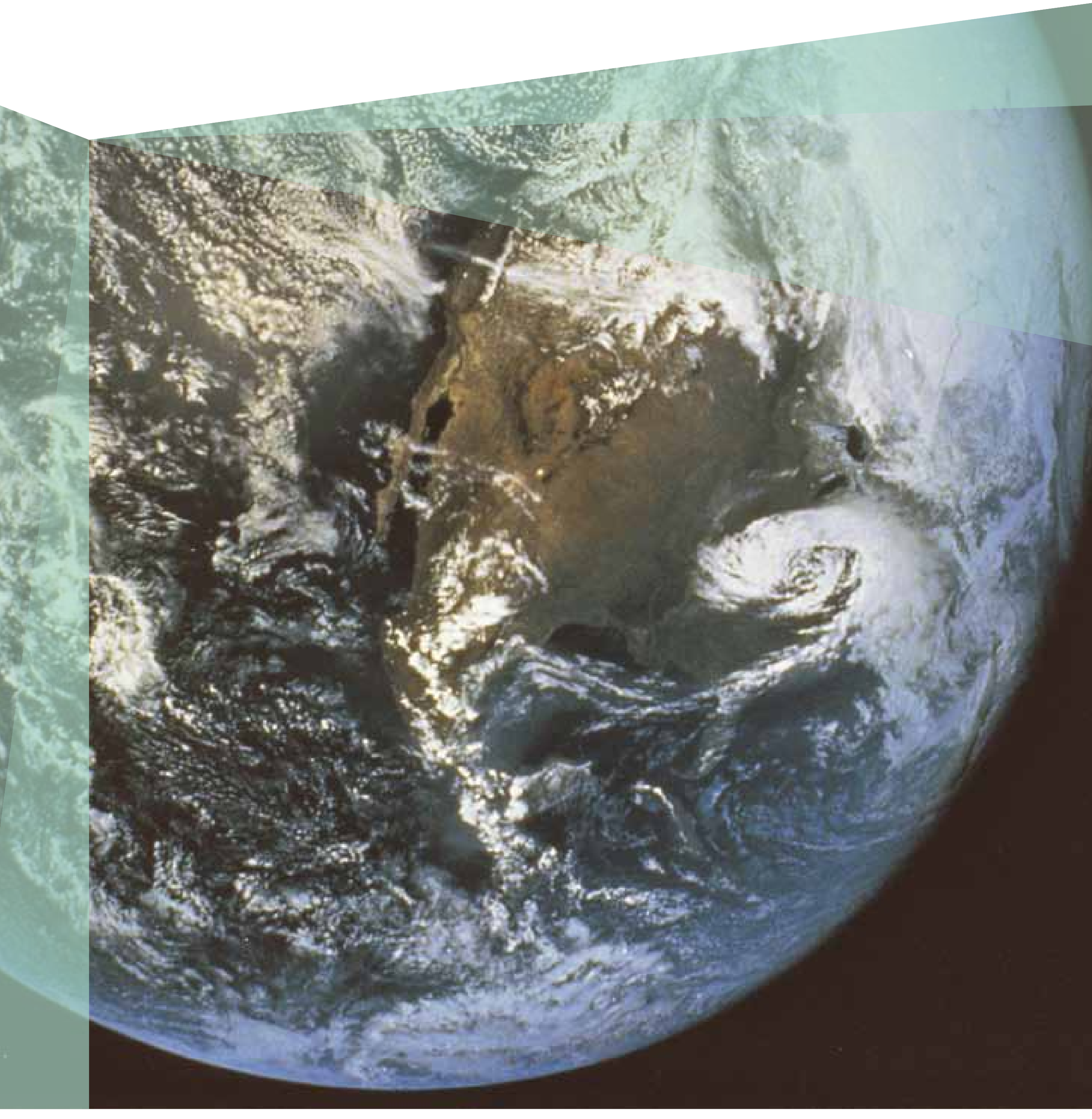
2013 COMPENSATION AND BENEFIT TRENDS IN EUROPE



MARSH & McLENNAN COMPANIES

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NAVIGATING THROUGH THE CURRENT ECONOMIC CLIMATE

The ongoing financial downturn and uncertainty about how the global economy will fare in 2013 have had a significant impact on salary and benefit trends across the Europe, Middle East and Africa (EMEA) region. In October 2012, the International Monetary Fund revised its forecast for global growth downward, projecting it to be 3.3% for 2012. Sluggish growth of 3.6% is projected for 2013, and the combined pressures of slower expansion in emerging markets, a fall in the volume of world trade, slashed public spending and the impending "fiscal cliff" in the US are increasing risks worldwide.

The general level of uncertainty in the world economy has made it hard for managers to know how to allocate salary budgets. This is certainly borne out if we look at organisational hiring intentions across the European region. Caution is very much the watchword: 25% of organisations intend to recruit in 2013 (compared with 27% in 2012). Fewer organisations intend to reduce their headcount in the coming year (10%, compared with 15% in 2012), but the vast majority plan to maintain the status quo (65% compared with 58% in 2012).[1]

COST CONTAINMENT

To meet these challenging economic circumstances, cost containment is still very prevalent. Cost cuts have been implemented across all functions but commonly manifest in the termination of temporary contracts, recruitment freezes (or at least limits on new hires), decreased working hours and reductions in use of outside services. Training opportunities also tend to be reduced, as do the number of talent- and development-related projects. E-learning training modules are gaining in popularity, just as expensive, classroom-based learning is on the wane.

These cost-cutting measures do, however, have a knock-on effect, namely that staff engagement is at an all-time low. When training is provided, it is important for employers to emphasise upskilling

[1] International Monetary Fund. "IMF Sees Heightened Risks Sapping Slower Global Recovery" (9 October 2012), available at http://www.imf.org/external/pubs/ft/survey/so/2012/res100812a.htm.

opportunities, so that people feel as if they are being provided with somewhere to go in their career: being perceived as "employable" is now valued more highly than safety and security.

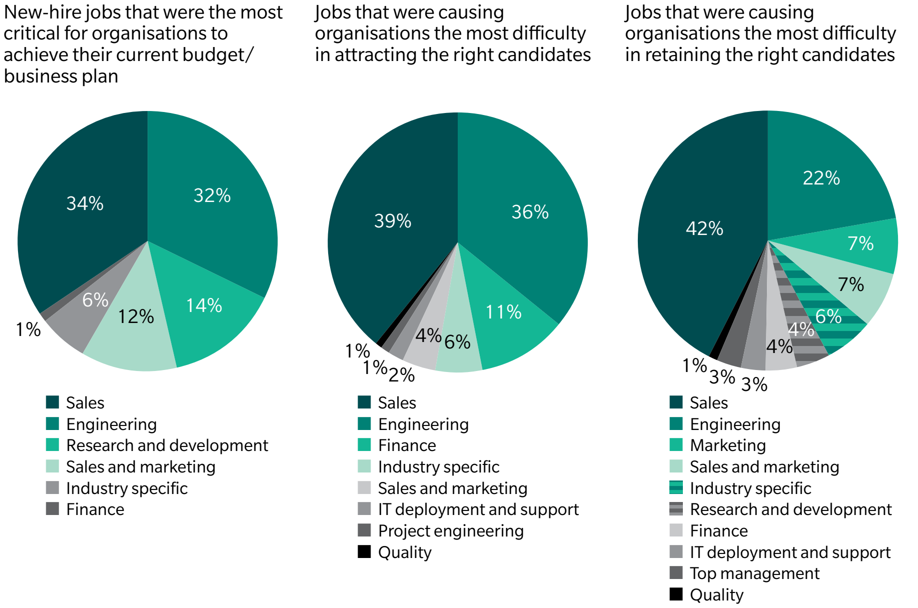
'HOT' JOBS

Across Europe, the picture is strikingly similar regarding the top four "hot" jobs:

1. Sales
2. Engineering
3. Research and development (R&D)
4. Finance

Figure 1

Critical Skills, Difficult to Attract and Retain



Source: Mercer Total Remuneration Survey (TRS) 2012 data

Professionals in sales and finance (which account for many key business functions) are always in demand in the job market. However, research conducted recently for The Conference Board[2] found that CEOs currently value innovation the most as they look to the future, hence the high ranking of R&D in the "hot" jobs league.

Sales jobs constituted 34% of the critical new hires required by organisations to achieve their current year budget or business plan; engineering jobs came a close second, with 32%, and R&D was third, with 14%.

[2] For more information, see *The Conference Board CEO Challenge® 2012: Risky Business – Focusing on Innovation and Talent in a Volatile World* (March 2012), available at http://www.conference-board.org.

Despite unemployment levels remaining high, some organisations were having difficulty recruiting candidates with the right skills and expertise in some functions. In effect, demand is up, but supply is low.

High-calibre sales people were proving particularly elusive (39%), followed by engineers (36%) and finance specialists (11%). Retaining good staff is also essential for company stability and growth, but organisations were struggling to keep their sales staff (42%) and engineers (22%) in particular. Hanging on to the latter will prove to be a problem over the coming years, as the numbers of graduate engineers is falling consistently across Europe.

CURRENT PAY TRENDS AND DEVELOPMENT IN EUROPE

SALARY FREEZES

The impact of salary freezes on European companies is now significant, and they affect all segments of the workforce. As companies are now becoming accustomed to implementing salary freezes, it is likely that freezes will be here to stay even if the global economy improves.

Western European companies in particular have been focusing strongly on cost and expense management during the downturn, and 12% of them have frozen their employees' salaries in recent years. The trend has affected 18% of managers and 30% of all CEOs in those companies. Salary freezes have been used to a slightly smaller extent in Central and Eastern Europe, where 9% of companies have resorted to them. Up to 12% of executives and 4% of blue-collar workers have been affected by them (in a reversal of the 2009 position).

SALARY INCREASES

Several countries from the EMEA region have seen their salary increases remain static for two years (2011–2012), and this trend is forecast to continue in 2013 – examples include Ireland (2%), Italy (3%), Poland (4%) and the UK (3%).

Western Europe

Among executives in Western Europe, a recent Mercer survey has revealed typical salary increases of 2%–3% broadly speaking, but considerable differences become apparent when the data are interrogated more fully.

Indeed, Germany and Scandinavia are relatively stable and have seen solid and steady salary rises. The UK is also improving after having experienced difficult times up to the first quarter of 2012. In Ireland, Italy and Portugal, however, salary increases are, overall, below inflation.

Figure 2a

Pulse Survey Results – Western Europe

Para-Professional "White Collar"

Source: Mercer EMEA Salary Movement Snapshot survey 2011; 2012 data, Eurostat

Figure 2b

Pulse Survey Results – Western Europe

Para-Professional "Blue Collar"

Source: Mercer EMEA Salary Movement Snapshot survey 2011; 2012 data, Eurostat

Across the board, the region has seen a greater use of salary freezes once more. While there is a slightly increased level of salary divergence between different employee categories in Western Europe, the main message remains that conservatism still rules.

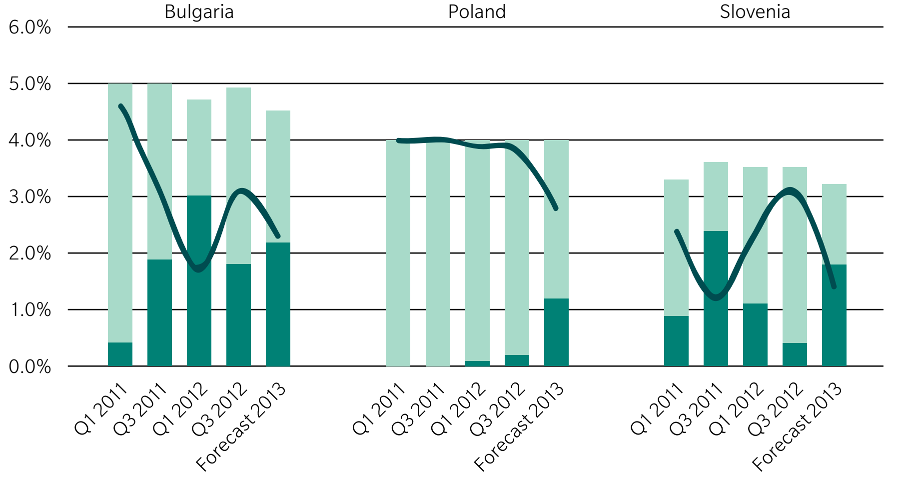
Central and Eastern Europe

Executives in this region have been receiving slightly higher salary increases than their Western European counterparts. Bulgaria, the country with the lowest salaries in Europe, has seen headline increases of between 4.5% and 5%. Poland has remained stable with increases of 4%, while Slovenia has seen much more of a rollercoaster pattern, which illustrates the overall theme of there being a larger discrepancy in salaries between countries in this region than in Western Europe. The Baltic countries (Latvia, Lithuania and Estonia) have made a swift recovery from the ongoing financial downturn.

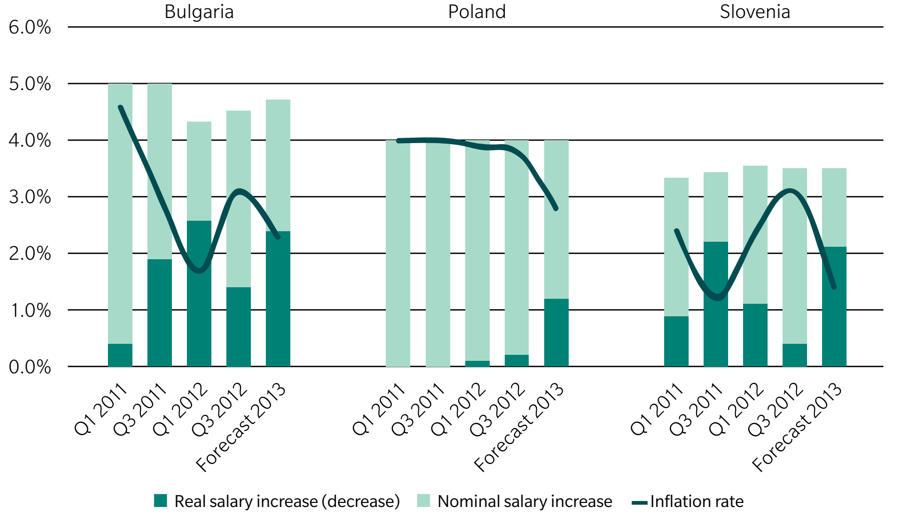
Figure 3

Pulse Survey Results – Central and Eastern Europe

Para-Professional "White Collar"



Para-Professional "Blue Collar"



Source: Mercer EMEA Salary Movement Snapshot survey 2011; 2012 data, Eurostat

Again, salary freezes are prevalent in Central and Eastern Europe, but they are used less frequently than in the West. Some roles in this region are faring better than others salary-wise; however, non-sales professionals (for example, those in finance positions) are receiving slightly higher salary increases than their colleagues in sales.

Industry-Specific Results

In Western Europe, 2012 salary increases are, on average, higher among companies in the durable and non-durable sectors (excluding consumer goods) and in "other sector" industries, such as pulp, paper and packaging. In 2013, a salary rise of 4% for workers in this region's energy sector (including oil, gas and renewable energy) is expected. These trends are mirrored in Central and Eastern Europe, where 2012 salary increases are typically higher among companies in the durable, energy and consumer goods sectors as well as "other sector" industries.

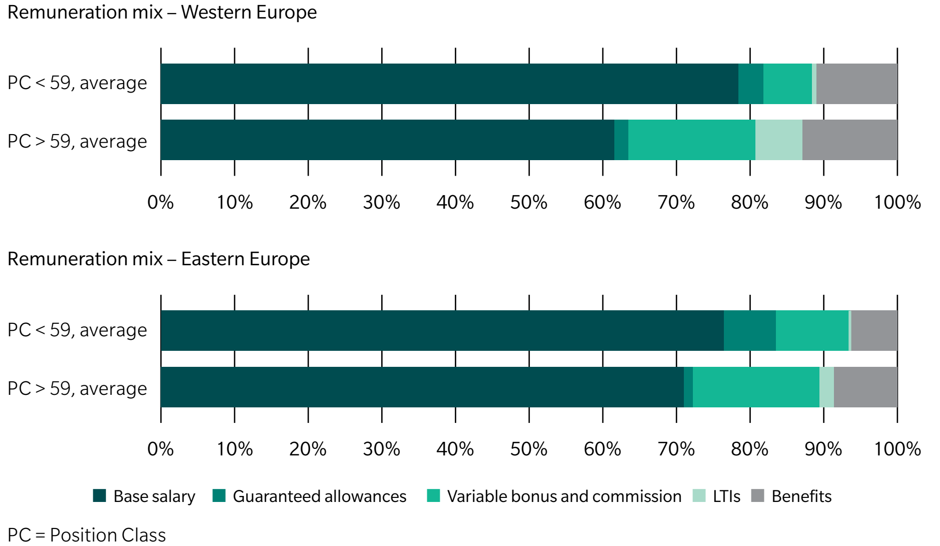
Looking ahead, salary increases are budgeted to be lower (around the 1.5% mark) in the finance and banking sector in Western Europe, in a reversal of 2011 trends. In Eastern Europe, lower salary increases are expected in the services and retail/warehouse trade sector.

INCENTIVES AND BENEFITS

Comparing the remuneration mix between the two regions (Western and Central/Eastern Europe), base pay is still the largest component for more than 70% of all employees surveyed. Benefits play the biggest role for executive positions in Western Europe and are least significant for non-executives in Eastern Europe. Variable bonuses and commission are roughly the same for executives in both regions. Long-term incentives (LTIs) appear to be negligible for all non-executive positions but are most prevalent among the executive population in Western Europe.

Figure 4

Western European Versus Central and Eastern Europe – Remuneration Mix 2012



PC = Position Class

Source: TRS 2012 data

Overall, payout levels in Europe have been stable across 2011 and 2012. This is certainly the case for target bonuses (as a percentage of annual base salary), an area in which executives and professional non-sales people have seen an increase in some cases. Increases have also been afforded to management. When target bonuses for these three groups are compared with maximum bonuses (as a percentage of annual base salary), it is evident that pay increases are based on performance, rather than an employee's length of service in a particular role.

While there may be a change to the vehicles used in incentive schemes – a change of focus from stock options to cash payments, for example – the use of LTIs has seen a year-on-year increase. The perceived value of LTI plans is linked to employees' expectations of staying with their current employer, and the plans are effective only if engagement levels are high – a good incentive plan is very unlikely to stop employees from leaving if they are unhappy.

COMPENSATION AND BENEFIT TRENDS

SHORT- AND LONG-TERM INCENTIVE SCHEMES

In terms of an annual short-term incentive (STI), target opportunities have increased slightly. The maximum STI opportunity has been increased across each region, as has total cash compensation. On average, for this region actual payouts were similar for STIs in 2011 and 2012, again signalling an atmosphere of caution. Performance metrics are starting to be reviewed, however, and "soft" parameters are being de-emphasised.

LTI plans are prevalent across the region, and six of the 10 countries profiled (namely Belgium, France, Italy, the Netherlands, Poland and the UK) have increased their use of them between 2011 and 2012. They are most popular in Ireland, where 70% of companies offer LTIs, while more than 60% of companies make use of them in the UK and the Netherlands. In general, employee retention and long-term sustainable performance are still the most commonly cited reasons for LTI use among companies.

Across the European region, LTI plan eligibility increased slightly from 2010–2011 and from 2011–2012. As with STI performance metrics, financial parameters are increasingly an area of focus.

Shares are another growing component of LTI provision, and companies continue to move away from stock options. A "portfolio approach" is becoming more popular for LTI plans, and different vehicles are being used for different segments of the workforce, as appropriate.

BENEFITS

Across the whole European region, interest in corporate governance has increased and companies have shifted towards centralised decision making regarding benefits: in short, top management teams at corporate headquarters – rather than individual strategic business units – are now making the final decisions. (This is a reversal of the trend seen before the 2008 downturn.)

The move from defined benefit to defined contribution plans continues, and organisations are showing greater interest in flexible benefits, particularly in the Netherlands and Poland. Company cars are being scrutinised ever more closely from a cost and expense perspective. For example, smaller cars are being provided, vehicles are being replaced less often and so on. Tax implications are key, and in some countries within Europe (such as the UK), the company car is much less of a desirable benefit than it was in years gone by.

FORECAST TRENDS FOR 2013

A recent Mercer Salary Movement Snapshot survey (September 2012) has revealed a mixed picture across the EMEA region regarding salary forecasts for 2013.

In Western Europe, countries such as Austria, Germany, Norway and the UK are forecasting salary increases of 3%. (In the UK, this will mean above-inflation salary rises for the first time in several years.) Unsurprisingly, the peripheral markets – especially those around the Mediterranean – are more troubled. Greece, Portugal and Ireland are expecting increases of between 2% and 2.4%. As we can see, the eurozone crisis is still weighing heavily on the economies of the European Union.

Forecasts for 2013 have remained reasonably positive at the time of this writing and are ahead of 2012 actual increases. Salary freezes are on the increase again, however, and are predicted to be slightly more prevalent at the executive level in 2013.

The forecasts for Central and Eastern Europe show much greater variance, as Belarus predicts salary increases of 11.3% and Cyprus only 2.9%. Salary freezes are again on the upswing but to a lesser extent than in Western Europe in general.

Overall, forecasts for this region are more conservative than for Western Europe and are typically at or below the 2012 forecast level.

In terms of industry differentials, both regions are predicting lower salary increases for the banking and finance sector. The energy and insurance sectors are forecasting higher salary increases across both regions, and in Central Europe specifically, the highest increases are expected in the consumer goods industry.

CONCLUSION

Employers looking at compensation and benefit trends should consider the following:

- Segmentation is vital for effective compensation and benefit plans.
- Manage risk and cost, but bear in mind that some cost-cutting measures can result in a lack of staff engagement. Engaging employees successfully will lead to greater retention.
- Embrace total rewards and make sure that limited budgets are directed in the right way.
- The talent war continues: demand is high but supply remains weak; this misalignment of skills in the jobs market will have an impact on the economy.

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