Incentive Research Foundation

ACADEMIC RESEARCH IN ACTION
Can You Recession-Proof Your Incentives?

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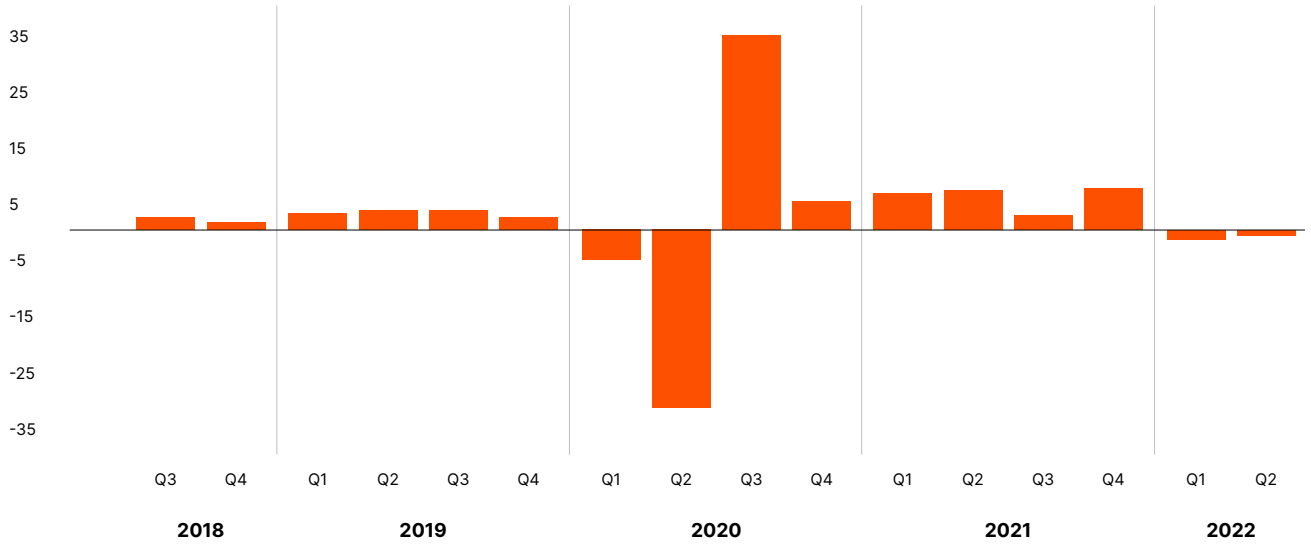
The definition of recession has evolved in recent years, largely to reflect a more dynamic and less predictable economy. Today, most economists and media outlets accept, more or less, the National Bureau of Economic Research (NBER) definition of recession as: *"A significant decline in economic activity that is spread across the economy and that lasts more than a few months."* [i] Some may still insist that whenever the economy experiences two consecutive quarters of negative GDP growth, it has entered recession. [ii] That happened in the first half of 2020, and again this year (Figure 1).

Figure 1: Real GDP change by QTR, 2018-2022



U.S. Bureau of Economic Analysis

Seasonally adjusted at annual rates

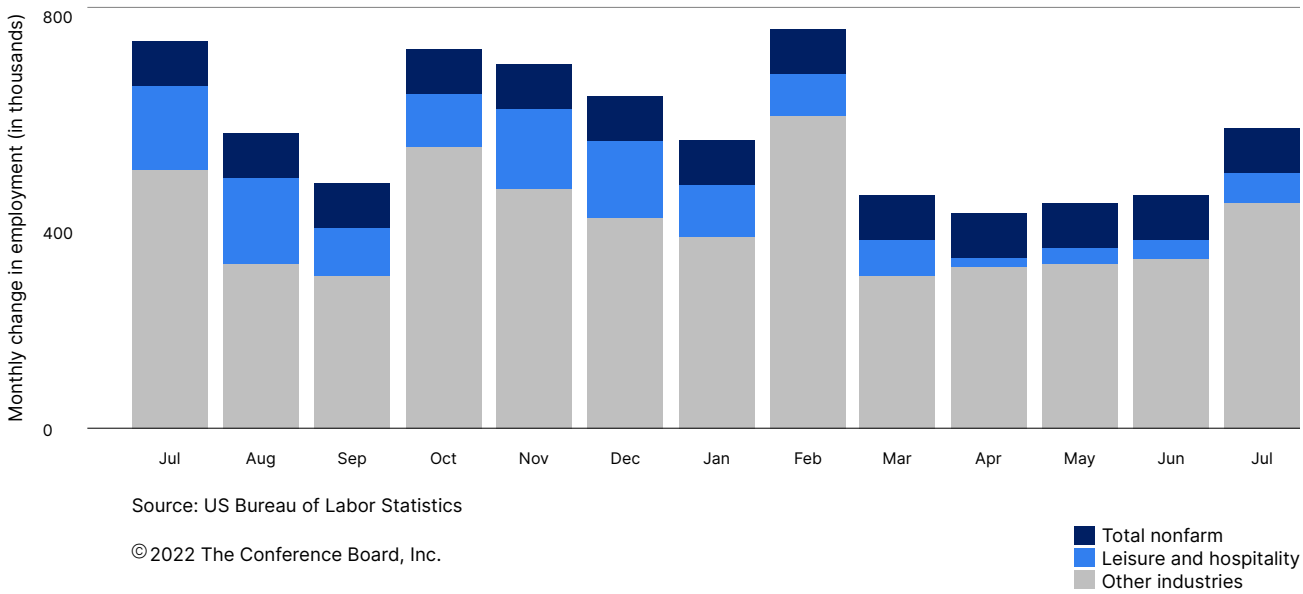
By most measures though, it still doesn't feel like we're in a recession. The US added over a million net new jobs between June and August this year alone. [iii] Demand for goods and services remains high, the competition for talent is still intense across many sectors of the economy, and wages are rising. [iv, v, vi] There is broad consensus, however, that the US economy is on the verge of recession (and that Europe is already there). [vii] The September 2022 report from the Labor Department's inflation report portends additional interest hikes to come; hikes that may very well depress spending and demand sufficiently to spark a recession. [viii, ix]

What should incentives and rewards designers prepare?

Various August 2022 surveys and reports point to the first signs of widespread job freezes and headcount reduction among US employers. [x] The upside may be that talent acquisition and retention struggles will ease, at least temporarily. At the same time, however, several of the industries that employ the most Americans – healthcare, hospitality, retail, and transportation – still face severe labor shortages (Figure 2). [xi]

Figure 2: Sustained growth in employment: leisure and hospitality

Monthly change in employment, leisure and hospitality and other industries (in thousands)



Source: US Bureau of Labor Statistics

No matter the industry, firms should maintain their efforts to create a better employee experience – including more flexibility, balance, purposeful work, DE&I initiatives, and incentives. Leaders who take advantage of a recession to roll back employee benefits, eliminate rewards, or force everyone back into the office full-time, won't likely be forgiven when the economy rebounds. And as airlines, hotels, and others have learned from the COVID-19 pandemic, ramping up to sudden demand following a recession proves extremely difficult and costly.

As we advised in an article earlier this year, firms should consider even greater use of non-cash incentives and rewards to motivate and retain employees when a near-term recession looks likely. Doing so in combination with modest pay raises keeps a lid on the overall wage floor, helping firms weather a recession. But are there some types of incentives that prove more "recession-proof" than others?

First, incentive programs should more than pay for themselves, even during recessions. In the expectation of a near-term recession especially, designers should make greater effort to predict the ROI of their programs and to link rewards to tangible (hard dollar) outcomes.

For sales, simply pegging incentives to quotas might make them recession-proof (assuming all sales result in profits that exceed the cost of the reward). For any incentive program, whether in recessionary times or not, use clear and credible metrics to demonstrate anticipated and actual returns. [xii]

It is also worth repeating that non-cash incentives and rewards are themselves a recession-proof means of recognizing employees, keeping them engaged, and retaining them. In a four-part study published in 2022, professors Willie Choi and Adam Presslee found that due to mental accounting biases, *"tangible (non-cash) rewards are more motivating than cash rewards because employees tend to view cash rewards as simply 'more salary."* [xiii] Choi and Presslee found in their experiments that the novelty and 'separate-from-salary' nature of non-cash rewards inspired greater effort. Non-cash rewards provide a flexible means of increasing an employees' total rewards package without incurring fixed costs or creating long-term expectations and "entitlement effects." [xiv]

An exploration of workers who receive profit shares – described in a study published in 2005 – found that expectations of remuneration formed in good times do not dissipate when recession strikes. The removal of profit shares during recessions, in other words, feels punitive and can negatively impact employee effort. [xv] Thus, smaller, more frequent non-cash rewards may be especially recession-proof relative to infrequent but significant cash rewards, such as pay raises, bonuses and profit shares. A large body of academic research suggests that employees are less sensitive to the withdrawal or reduction of smaller rewards than substantial ones – particularly cash rewards that they tend to lump in with salary. Even if frequent, small, non-cash rewards add up to substantial value, their reduction (even elimination) during recessionary times may not have the same negative impact as cash rewards.

Incentive program designers should also take care to lock-in prices for rewards, perhaps especially travel, accommodations, and catering where possible. So far, inflation show no signs of abating, and it has impacted the travel and hospitality sectors particularly hard in 2022. [xvii, xviii] Though the US dollar has appreciated versus most other currencies over the past two years, international travel exposes firms to downside currency and inflation risk. [xix] Inflation has increased the costs of reward merchandise as well, but a points program can manage inflation by simply adjusting redemption levels. And while a $50 gift card or $100 restaurant voucher might not buy as much as it did a year ago, the cost to the firm remains the same – as does the recognition and appreciation expressed in awarding it.

Don't let a recession or the threat of one derail your ongoing efforts at becoming or remaining an employer of choice. Fundamentals, such as the underlying strength of the US economy point to a brief recession followed, potentially, by a strong rebound. US and most international demographics predict long-term labor shortages impacting all sectors and industries and across most skill levels. [xx] Indeed, a recession may not even impact the demand for hospitality and healthcare industry workers, nor tradespeople, data scientists, cybersecurity experts, and a host of other in-demand workers.

Leaders show their true character when times are tough. Wise firms will take on a larger burden in down times as employees are likely to remember their actions when the tide turns.

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