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Introduction

INTRODUCTION – WHY SHOULD WAGES BE FLEXIBLE?

Small and medium establishments (SMEs) are an integral part of our economy, employing almost half of the total workforce in Singapore. SMEs are subject to the same pressures and challenges as larger companies and they must be able to weather the ups and downs of business cycles in order to survive and grow.

In the past two recessions, both MNCs and SMEs, relied on CPF cuts to reduce wage costs in order to remain viable. With the lowering of the employer's CPF contribution rates, there is little room left for further CPF cuts in future economic downturns. A wage system that is flexible is better able to meet the specific needs of individual companies as it would allow companies to adjust wage costs more quickly in response to a volatile business environment.

Much effort has been put in since January 2004 to drive wage restructuring. As at December 2005, some 68% of employees in SMEs have some form of flexible wages as compared to 90% in larger companies. While the results are encouraging, SMEs could do more.

This handbook is produced with the aim of guiding SMEs in implementing the key wage restructuring recommendations.

WHAT IS A FLEXIBLE WAGE SYSTEM?

A flexible wage is one that has a sizeable variable component that allows companies to adjust wage costs quickly in severe business downturns. A flexible and performance-based wage system would enable companies to:-

i) reward employees with bigger bonuses in good times; and
ii) adjust and better manage its wage costs in bad times.

WHY DO COMPANIES NEED A FLEXIBLE WAGE SYSTEM?

Companies, big and small, will find the flexible wage system useful. With globalisation and rapid technological advances, companies face shorter business cycles and also intense business competition. To survive, they must be able to respond quickly to changing business conditions including making quick adjustments to wage costs. With a flexible wage system, companies can be nimble in managing wage costs to stay viable and this in turn enables employees to enjoy greater job security.

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Three Key Recommendations of the Wage Restructuring Task Force

Key Recommendation 1

THREE KEY RECOMMENDATIONS OF THE WAGE RESTRUCTURING TASKFORCE

The 3 key recommendations to bring about a flexible, competitive and performance-based wage system are as follows:

a) enlarge the Annual Variable Component (AVC) and identify key performance indicators to link the AVC payment closely to company's and/or individual's performance (details on pages 8 - 12);

b) introduce/build up the Monthly Variable Component (MVC) (details on pages 14 - 18); and

c) move away from seniority–based wage system by narrowing the salary maximum-minimum ratio to 1.5 times or less (details on pages 20 - 22).

KEY RECOMMENDATION 1

ENLARGE THE ANNUAL VARIABLE COMPONENT (AVC) AND IDENTIFY KEY PERFORMANCE INDICATORS (KPIS) TO LINK THE AVC PAYMENT CLOSELY TO PERFORMANCE

What is Annual Variable Component (AVC) ?

Annual variable component (AVC) usually comprises variable bonus and/or Annual Wage Supplement (AWS). AVC is usually paid on a yearly basis to reward employees for their contributions and motivate them for higher performance.

What is the desirable level of AVC ?

Recommended Level of AVC: 20% of annual wages for rank-and-file employees and higher percentage for middle and senior management as managerial staff has a higher responsibility in shaping the business outcome of the company.

What is Key Performance Indicator (KPI) ?

KPI is essentially a performance management tool that helps a company to track and measure its performance. It provides the link between the AVC payment and company and/or individual performance, hence giving employees concrete goals and shaping their behaviour.

The KPIs for each company may be different depending on the company's nature of business and operating environment. The two common categories of KPIs are **Financial Indicators** and **Operational Indicators**.

What are the common KPIs that companies can consider?

KPIs should be clearly defined, measurable and achievable. Some suggested KPIs that companies can consider are listed below:

Financial Indicators - include profit-related indicators, revenue-related indicators, and indicators that measure asset productivity

- profit level
- sales volume
- market share
- growth rate
- return on equity (ROE)
- return on investment (ROI)

Operational Indicators - measure the performance of departments, teams and individuals on a day-to-day basis

- safety records
- customer satisfaction
- number of units produced by a production line

How to link the payment of AVC to performance through KPIs?

Clear targets are essential for the implementation of KPIs. They will help engage and motivate employees towards achieving the set targets. While companies are expected to set challenging targets on KPIs, they must ensure that these targets are realistic and achievable. Companies could set staggered targets that provide different levels of rewards. The maximum point could be a stretched target with a corresponding reward that commensurates with the higher level of achievements. An example is given in the following table:

Gross Operating Profits ($)	AVC Budget (Months' of basic salary)	Payment based on individual performance
> $100,000 & =<$150,000	0.5	Employees will be ranked A to E based on their performance. Payment will be made as follows: A performers – 150% of AVC budget B performers – 125% C performers – 100% D performers – 75% E performers – 0%
> $150,000 & =<$250,000	1.0	
> $250,000 & =<$500,000	2.0	
> $500,000**	3.0	

*** Achieving the stretched target would allow employees to obtain a higher payout of variable bonus*

Case Examples

Case Example 1

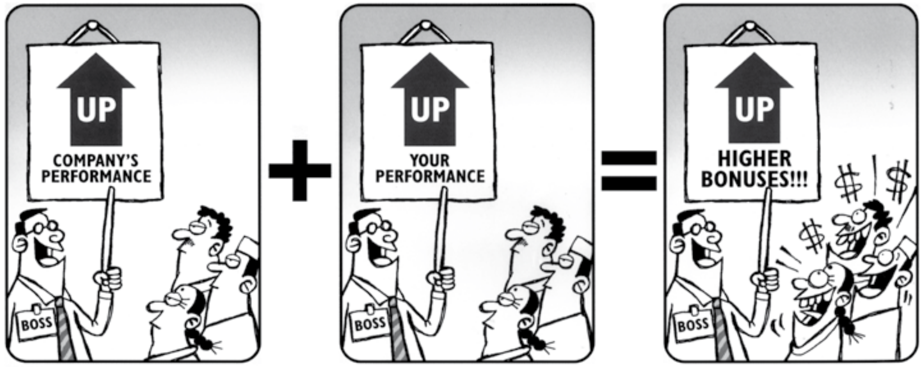
A chemical company pays variable bonus based on the company's profitability and individual performance. The following targets and bonus payment are set :

Profit before Tax	Variable Performance Bonus (Months' of basic salary)
Loss	Nil
< $500,000	0.75
> $500,000 to $1 million	1
> $1 million to $1.5 million	1.25
> $1.5 million	1.50

Case Example 2

A food manufacturing company uses Real Internal Growth (RIG) as the KPI to link the payment of various performance bonus. The target of RIG is set for every year.

Real Internal Growth (RIG) Percentage Achievement of Set Target	**Variable Performance Bonus (Months' of Basic Salary)**
100%	0.75
110%	1.00
120%	1.25
130%	1.50



Three Key Recommendations of the Wage Restructuring Task Force

Key Recommendation 2

KEY RECOMMENDATION 2

INTRODUCE/BUILD UP THE MONTHLY VARIABLE COMPONENT (MVC)

What is Monthly Variable Component (MVC) and why do employers need to build up MVC?

MVC is a **"standby" component** to be used by employers to bring down wage costs in sudden and severe business downturns to survive and save jobs.

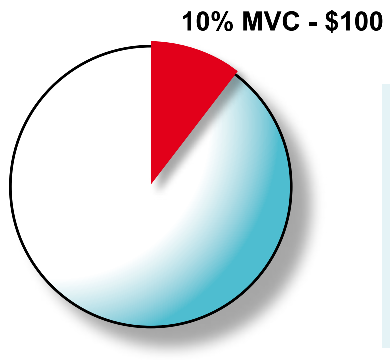
With the reduction in CPF contribution rate, there is little room in future to further cut CPF contribution as a way to reduce labour cost. Employers therefore should get ready by setting aside a portion of the salary as MVC which can serve as an **"emergency lever"** in bad times.

What is the desirable level of MVC?

MVC is part of monthly basic salary and should be included in computing overtime payment and CPF contribution. For MVC to be an effective mechanism for wage adjustment, it is recommended that MVC should form **10% of monthly basic salary**. The percentage of MVC should be the same for all levels of employees.

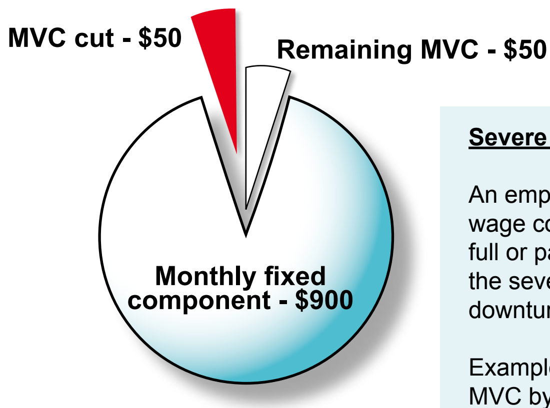
In offering salary to new employees, employers should incorporate the same percentage of MVC as in the case of existing employees.

How will the introduction of MVC affect my employees?



Normal times:

There is no change in an employee's take home pay. As shown in the example (left), an employee takes home $1,000, comprising $900 monthly fixed component and $100 MVC.



Severe business downturn:

An employer can bring down wage costs by cutting MVC in full or partially depending on the severity of the business downturn.

Example: If an employer cuts MVC by 5%, an employee will take home $950, comprising $900 monthly fixed component and the MVC reduced to $50.

$950 will be used for computing CPF contribution and overtime payment.

How to build up MVC?

About 40% of our workforce has MVC as one of their wage components

Employers can build up MVC from:

1) wage increase; or
2) wage increase and existing monthly basic salary for existing employees;
3) monthly basic salary for new employees by structuring MVC into their pay scale.

Example 1: building up MVC gradually from wage increase

A company sets aside the full amount of wage increase to build MVC.

Year	Basic Salary	Wage Increase	New Salary	MVC	MVC Amount
Y1	$1000	3.5%	$1035	3%	$1035 x 3% =$31
Y2	$1035	3.5%	$1071	6%	$1071 x 6% =$64
Y3	$1071	4.5%	$1119	10%	$1119 x 10%=$112

Example 2: Building up MVC from wage increase and existing monthly basic salary

A company sets aside the wage increase and reclassify a portion of existing basic wage to build up 10% MVC.

Basic Salary	Wage Increase	New Salary	Reclassify from Existing Salary	MVC	Amount of MVC
$1000	3%	$1030	7% (to reach 10% MVC)	10%	$1030 x 10% = $103

When can you use the MVC to adjust wage costs?

Employers should identify parameters or performance indicators, which are relevant to their business operations, to trigger MVC cut/restoration. Alternatively, they can define certain situations or scenarios to initiate the MVC cut.

Two broad parameters that can be considered as triggering indicators for an MVC cut:

a) the company is suffering from extremely poor business performance and cost-cutting measures are needed; and
b) the job security of employees is threatened.

The indicators, parameters or circumstances leading to MVC cut or restoration should be communicated to and understood by all employees.

CASE EXAMPLES

Case Example 1

An aero engineering company built up MVC to 7% in 2003. When the company's business was badly affected by the SARS outbreak, it had to cut MVC to save jobs. After a series of communication with staff, MVC was cut by 4% in May 2003 followed by another 3% a few months later. When business picked up in end 2003, the company adjusted salaries back to the pre-crisis level by restoring the MVC cuts. In appreciation of the workers' sacrifices, the company also paid a variable bonus of 1.6 months in addition to the 1 month's AWS payment.

Case Example 2

A logistics company had built up 5% MVC. In mid 2003, the company in consultation with the employees, decided to cut the MVC in the following manner when it suffered substantial losses due to a severe business downturn:

- 5% to 12.5% for senior management and executives
- 3.5% for employees earning $1800 & above
- 2% for employees earning above $1000 but less than $1800
- no cut for employees earning less than $1000

By July 2004, the company's business improved. Employees were rewarded with a 3% wage increase and the MVC was rebuilt

Three Key Recommendations of the Wage Restructuring Task Force

Key Recommendation 3

KEY RECOMMENDATION 3

MOVE AWAY FROM SENIORITY–BASED WAGE SYSTEM BY NARROWING THE SALARY MAXIMUM-MINIMUM RATIO TO 1.5 TIMES OR LESS

What is Seniority-Based Wage System?

Under the Seniority-Based Wage System, wage increases are given to employees primarily on their lengths of service with the company, with little or no regard to their performance. Such a system is usually characterised by a long salary range and a large differential between the minimum (i.e. starting salary) and the maximum point.

What is Salary Maximum-Minimum (Max-Min) Ratio?

$$\text{Salary Max-Min Ratio} = \frac{\text{Maximum Salary Point}}{\text{Minimum Salary Point}}$$

For example, the starting salary of a clerical officer is $1200 and the maximum salary is $1800.

Hence, the max-min ratio = ($1800/$1200) = 1.5

How should the appropriate salary max-min ratio be decided?

The Wage Restructuring Taskforce recommends an average max-min ratio of **1.5 times or less**. However, the actual salary max-min ratio for individual jobs should be decided at the company level. This could be done through job evaluation based on:

i) Nature and scope of the job;
ii) Knowledge, skills and experience required;
iii) Complexity of duties and the time needed to learn the job;
iv) Level of accountabilities and responsibilities; and
v) Level of the jobs in the company's hierarchy.

There can be different ratios for different jobs but ratios should not deviate too far from the industry norm and should reflect the value of the job.

How can the salary max-min ratio be narrowed?

Companies can consider the following options:

a) **Raise the salary minimum and/or lower or hold the salary maximum constant.** Some options are:
- Raise the salary maximum and minimum by the same dollar quantum;
- Adjust salary minimum by a higher percentage/quantum than the adjustment given to the salary maximum; and
- Raise the salary minimum but cap the maximum.

b) **Reduce the salary maximum.** The following measures can be considered:
- Give a once-off lump sum payment for employees who are at the salary maximum in lieu of built-in wage increment;
- Allow retention of salary points on a personal-to-holder basis;
- Reward the worker through productivity or performance-related bonuses; or
- For employees who are currently paid beyond the new salary maximum, pay the excess portion of the salary in one lump-sum.

c) **Truncate long salary range into 2 or 3 shorter ranges.** Employees affected by the truncating salary scale can be moved from one salary range to another through assignment of higher responsibilities or promotion.

CASE EXAMPLES

Case Example 1

A foreign bank has successfully reduced its salary max-min ratio of clerical staff further to 1.7. This was done by increasing the salary minimum by a greater dollar quantum than the increase in salary maximum.

Case Example 2

In the 1980s, the average salary ratio in the insurance industry was 2.6. Following the National Wages Council Wage Reform Committee's recommendations, the industry truncated the salary ranges for three clerical grades to form five grades. Employees could move between grades upon being promoted. Employees at the salary maximum of a grade could be upgraded to the next (thereby enjoying a higher maximum salary point, but without a promotional wage increase) on a case-by-case basis if they met performance expectations. Employees at the salary maximum were given once-off lump sum payments if their performance were good. The average salary ratio for the clerical grade is now about 1.6.

Quotes

Chua Thian Poh
President
Singapore Chinese Chamber of Commerce & Industry

A flexible wage system provides companies the means of adjusting costs expeditiously when needed. It gives employees reassurance that they would be able to retain their jobs even when the economy is not doing well. Economic shocks such as in the aftermath of the 9/11 attacks or the SARS health scare can happen in a blink of an eye, and it is important for companies to push on with wage reform now so as to better respond to future challenges.

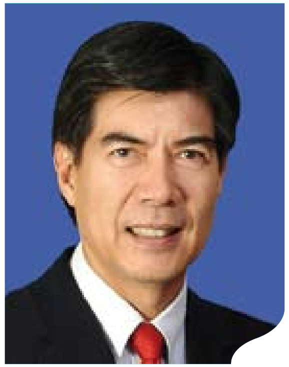
Mr Stephen Lee
Chairman
Singapore Business Federation
President
Singapore National Employers Federation

SMEs should also implement wage restructuring so that they can pay competitive wages to attract and retain talent. At the same time their wage systems can respond quickly to crisis.

Mr Lawrence Leow
President
Association of Small & Medium Enterprises

In response to the challenges that may surface in difficult times, a business must adopt an organisational structure that is flexible and nimble and that would include the implementation of a competitive wage structure that allows for flexibility in wage adjustment in times of need.

A flexible wage system will also help a business stay competitive and relevant in today's volatile business environment and serve to cushion the impact of future economic upheavals.



Mr Edwin Khew
Chairman
Singapore Manufacturers Association

The changing landscape in the global and local economic, commercial and business environment necessitates a corresponding shift in human resource practices, including wages and compensation. It is heartening to note that MOM is working in partnership with business associations to actively promote the flexible wage system. Implementation of flexible wages would enable businesses to compete in a global environment. Only then will Singapore be able to attract investments and create more jobs for Singaporeans. "