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Russia's Economy Has Stabilized, Affirming a Stay-the-Course Approach to Employee Pay

Technology companies that held off on taking permanent action to compensate employees in Russia for rising inflation are now being rewarded for their cautious approach.

If you're an employer with workers in volatile or economically unstable countries, you've likely thought about how real or perceived declines in earnings power might impact employee retention, productivity and engagement. And in moments of economic crisis, you've likely been tempted to take permanent action in response, such as tying local wages to a stable currency or setting salary increases to the rate of inflation. While actions of this nature are well-intentioned, and seem to make perfect sense on the surface, it's not always, or even usually, the right move. Recent events in Russia underscore the problems companies can run into by taking such extreme measures.

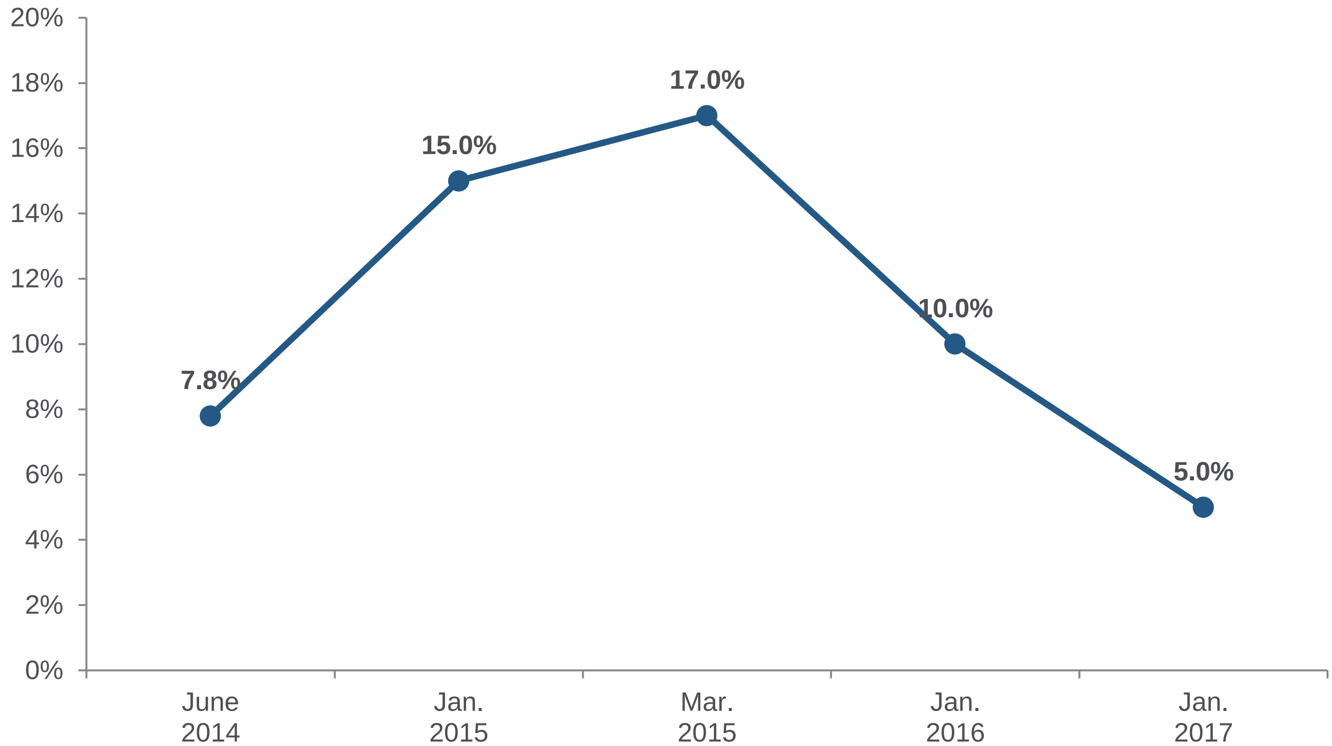
First, let's back up and discuss the conditions that existed in Russia up until a few months ago. Starting in mid-2014, oil prices dropped and economic sanctions caused a sudden and large decline in the value of the Russian ruble, triggering a spike in inflation. In both Januarys 2015 and 2016, we surveyed our technology clients with people in Russia to see how they intended to approach employee rewards in the midst of a volatile, inflationary business environment.

A majority of respondents said they were monitoring conditions in the country and how it impacted employees' salaries, but holding off on more permanent measures. At the time, the average annual salary increase for technology companies in Russia was 8.0%. While that percentage is certainly higher than most European countries, which hover around a 3.0% annual salary budget, it's not nearly as high as inflation was in Russia at the time. A small percentage of respondents said they were providing a "special measure" to boost pay, but this was generally temporary and modest in amount (e.g., two to four weeks of pay).

You can read more about the results of these surveys in our articles ***More Companies Are Taking Steps to Protect Employee Earnings in Uncertain Markets*** and ***Managing Compensation Programs in the Face of Russia's Sudden Currency Devaluation***.

Today, Russia's economy is much less volatile, and the country is expected to reverse its economic decline with a projected growth in GDP of 1.1% in 2017, according to the International Monetary Fund. Inflation has subsided to 5%, the lowest rate since 2012, and the currency has stabilized.

Annual Inflation Rate in Russia

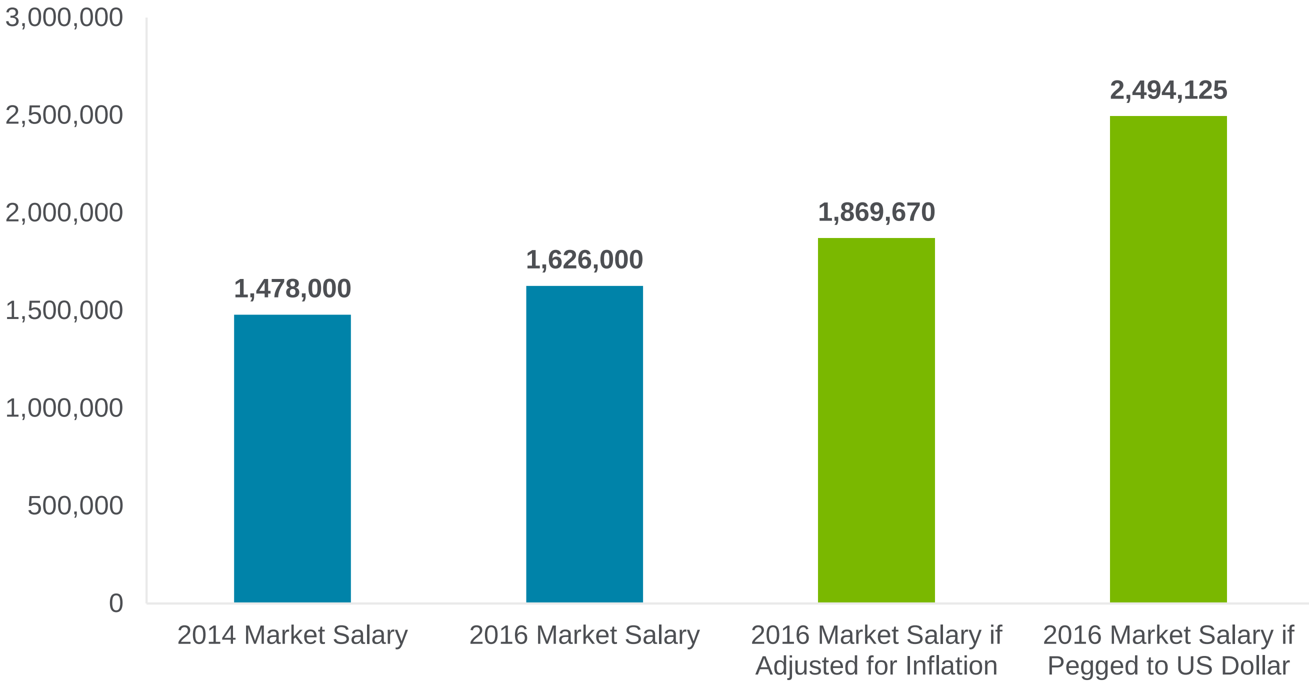


We see the results of Russia's economic turnaround in our workforce trends data as well. Among **Radford Global Technology Survey** clients with employees in Russia, median trailing 12-month voluntary employee turnover is once again trending higher, rising to 8.6% as of Q4 2016 compared to 6.8% as of Q4 2015. Additionally, while a majority of technology companies in Russia still expect their workforce to remain the same, 9.3% expect an increase in size, with only 6.5% forecasting a decrease, according to our latest Q4 2016 Radford Workforce Trends Report. In every case, our data points to a more active, less risk-averse job market.

So what do the improving economic conditions in Russia mean for the companies that took extraordinary measures to adjust employee pay in 2015 and 2016? Quite simply, there is a high likelihood they will be overpaying the market in those job roles for which they increased pay.

To illustrate this point, let's consider compensation levels for advanced software development engineers (Radford survey level P4). From 2014 to 2016, median base salaries for this role increased by 10% in Russia. However, if a company increased pay for this role to match inflation rates in Russia at the time, they would have exceeded the actual market median by at least 15%. The gap is even higher if pay was pegged to the United States dollar.

Potential Base Salary Outcomes for P4 Software Engineers in Russia (in Rubles)



Source: Radford Global Technology Survey Compensation Totals, 2016

Fortunately, the vast majority of companies follow the "cost of labor" model in setting local pay. This is based on supply-and-demand for talent in the local market against the backdrop of general economic and local business conditions. In other words, in most circumstances, you don't want to take extreme measures that will be difficult to unravel once a country recovers from a deep economic slump, such as permanently boosting salaries to match inflation, across-the-board salary increases above the market average, or tying wages to another currency.

Next Steps

Russia's stabilizing economy proves that employers who take a wait-and-see approach in countries that are suffering from relatively sudden economic jolts is a reasonable strategy, especially when economic downturns occur rapidly and may reverse themselves just as quickly.

While waiting, companies should monitor the facts on the ground to identify actual hardships employees are experiencing, including:

- **Do financial hardships vary by employee category?** For example, are lower-paid employees disproportionately impacted by a rapid rise in the price of basic necessities such as food or fuel vs. higher-paid employees?

- **Are the hardships situational?** For example, are they affecting only those employees with US loans or payments heavily influenced by sudden changes in exchange rates?

- **What do your HR metrics indicate?** Analyze employee turnover, hiring ability and internal pay equity metrics over time to see how they are interrelated and if they are connected to pay.

If an intervention is appropriate, make it temporary, separate from salary increases and characterize it to managers and employees as such. We caution against making adjustments to salaries by formulas tied directly to inflation, currency exchange rates or other volatile external measures, which will be difficult to unwind.

If you have questions about managing employee pay and want to speak with a member of our compensation consulting group, please write to consulting@radford.com.

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