Before the Next Storm: Wage Restructuring at the Raffles Hotel[1]

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Wage Restructuring in Singapore

Wage restructuring has had a long history in Singapore. Following the recession in 1985, the Economic Committee of the government published a report on wage restructuring, which was expected to have three main aims: to moderate the system of seniority-based pay; to link wages more closely with the performance of the individual worker; and finally to link wages to the profitability of the company and to business conditions. By 1998, though many businesses had taken steps in the correct direction, the effects of the Asian crisis on industry demonstrated that the wage restructuring had not gone far enough.

The Hotel Industry in Singapore

The industry consists of a number of locally-managed and locally-owned hotels, on the one hand, and other properties that are managed by foreign multinationals, on the other hand. The large players in the hotels sector include Shangri-La, Raffles International (hereafter RIL) and Millenium and Copthorne..

A number of large hotels in Singapore are managed by chains such as the Ritz-Carlton, Four Seasons, Conrad, Hyatt and InterContinental, with an expatriate assuming the role of the chief decision maker. There were expressed concerns in the industry that this scenario did not help the development of the industry since a primary concern of the foreign hotel operators was often the management fees, rather than a stakeholder interest. Furthermore, the expatriate managers in charge of these hotels often served short stints, a typical life-cycle of about three years, which was not the most conducive for implementing change and development. During the SARs crisis, seven major hotel groups (RIL, Shangri La, CDL, Far East, Goodwood,, Mandarin Meritus, Pontiac Marina)

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[1] This case was written by Dr Nitin Pangarkar and Dr Chung Yuen Kay of the NUS Business School based on interviews with Mr Tommy Ng of Raffles International and Mr Jamal of the Food, Drink and Allied Workers' Union. The following additional sources of information were also consulted: Memorandum of Agreement on Wage Restructuring; Report of the Tripartite Taskforce on Wage Restructuring; and Wage Restructuring Information Kit compiled by the NTUC IR Department.

formed the Service Transformation Task Force, a tripartite body, aimed at service transformation of the industry.

The economic recession in 1998 demonstrated the need for greater flexibility in wage systems that would enable companies to make swift adjustments to their wage costs in the event of a sharp business downturn. Thus, the National Wages Council (NWC) recommended that a monthly variable component (MVC) be introduced. The NWC further recommended that the MVC be built up progressively, with part of it coming from wage increases, to reach a buffer of about 10% of total wages. In difficult times, this could be activated instead of resorting to cuts in employers' CPF contributions which most employees depend on to service mortgages, and to cover medical expenses and retirement needs.

Flexible wages are important to the hotel industry for two key reasons. First, wages constitute a major cost component and would account for between 30 and 40% of the revenue earned—thus, inflexibility could hurt results significantly. Secondly, the industry can also experience sharp swings in demand due to local (e.g., the eruption of SARS) or global (e.g., the threat of terrorism following the September 11th attacks) crises which might impact the volume of tourism, and thus, room occupancy. Despite having a higher need for flexible wages, the industry in Singapore was lagging other industries in this respect. For instance, a Singapore government survey revealed that only 5.2% of the firms in Hotels and Restaurants sector had adopted the usage of the Monthly Variable Component (MVC) by 2002. This figure was a large improvement over 2.4%--the proportion in 2001. Though the industry lagged other industries such as Manufacturing and Financial Services in the adoption of the MVC, it could be attributable to a lower proportion of Unionized firms in the industry (37.7% in 2002 versus 44.5% and 45.7% for Manufacturing and Financial Services respectively).

Many East Asian economies, which had experienced uninterrupted growth for more than 10 years starting with the second half of the 1980s, were jolted by the Asian crisis which erupted in 1997. The Asian crisis, as well as the subsequent SARS crisis, impacted some sectors more severely with the tourism related industries (such as hotels) facing a particularly steep drop in demand. One measure resorted to by some hotels was to arrange for staff to go on unpaid leave. The collective unpaid leave, which amounted to a few million dollars, moderated the need for retrenchments. Overall, the sector was able to handle the SARS crisis in 2003 without major retrenchments.[2] Subsequently, and as a result of this experience, the large locally owned hotels and FDAWU committed themselves to implementing flexible wages.

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[2] At a major hotel in Singapore, employees earning less than $2000 were asked to take 4 days no-pay leave each month for May and June 2000 and employees earning more than $2000 were asked to take 5 days of no-pay leave (Report of the Tripartite taskforce on wage restructuring, p. 34)

A Historical Perspective of Raffles Holdings/Raffles International and its Incentive Systems

Prior to 1991, DBS land, which owned the Raffles City Complex (including the two Westin Hotels in the complex) but lacked expertise in hotel management, had signed a fifteen year management contract for the Hotels to be managed by the Westin brand. Ms Jennie Chua who had joined the Westin Hotels in the mid-80s, became involved in the redevelopment of the Raffles Hotel in the late '80s. From 1995 onwards, RIL adopted a more expansionist strategy, and had started acquiring hotels in other countries such as Cambodia, Germany and the United Kingdom by 1997. By 2000, the company was listed on the stock exchange and took back the management of hotels from Westin, at the end of 2001. Soon afterwards, the company acquired the Swissotel hotels, leading to a significant increase in hotel operations and adding a new brand to its stable.

Originally the company had adopted a geographic structure with HQ in Singapore and separate divisions for the Americas, Europe, and the Asia Pacific. Each geographic unit would manage the portfolio of brands in its territory. After 2 years, and for reasons of organizational development, economies of scale and enhanced efficiency, the company decided to manage by brands, with HQs based in different geographic regions (e.g., Swissotel Hotels and Resort based out of Zurich; Raffles Hotels and Resort based out of Singapore). The company also decided to set up a wholly owned subsidiary and training arm to leverage on its core business competencies, and thus, Raffles Knowledge came into being, with Mr Tommy Ng moving over from Corporate Human Resources to become Executive Director of Raffles Knowledge.

Wage Restructuring at Raffles Hotel in 2004

In 2004, Raffles Hotel became a pioneer in the hotel sector with regard to the implementation of wage restructuring. A key objective of the undertaking was to work towards a wage structure that would offer flexibility. Wage restructuring was viewed as a proactive step to be implemented before the onset of the next SARS-like crisis. It was also expected to allow wage adjustment in a timely and responsive fashion in accordance with the agreed upon trigger points and avoid a situation where the flexibility of the new wage structure was negated by time-consuming negotiations. The company was also clear that all measures would apply equally to both management and employees. The company also believed that retention of staff was important.

The wage restructuring formula was aimed at achieving a clear and tight relationship between company performance and employee contribution. The management approached Ministry of Manpower first to get the Ministry's views before presenting to the Union—essentially signaling to the Union that management was serious and sincere about the reform.

The company, which had cultivated good labour-management relations over many years, did not anticipate too many problems in convincing the unions about the restructuring initiative. It was the Management Committee. which had more concerns., in particular pertaining to the financial aspects of the proposed model. The management committee also wrestled with the relevance and impact of the KPIs, whether they were right for the company, since the same set of KPIs would now impact on all the hotels in the group. Thus, many internal meetings were convened to go over the issues, and much simulation work was undertaken.

The union and management agreed that the existing Monthly Variable Component in the wage structure was not substantial enough to provide flexibility for adjustment of wages "in times of sudden and severe business downturn." Both agreed to raise the proportion of MVC in the total wages to 10% as recommended by the National Wages Council guidelines. According to Mr Jamal "The 10% MVC is a buffer. It puts in place a mechanism which can be adjusted as we go along."

In terms of process, the Raffles management adopted several policies. A high degree of emphasis was placed on consistency and adhering to certain principles, meant to guide the hotel sector in its wage restructuring. These were:

- Sustainable growth: the wage system should enable both employees to achieve best possible compensation linked to individual and company performance, and employers to earn a competitive return on their capital.
- Competitiveness: employees' remuneration must reflect the value of the job, their skills and performance to enable employers stay competitive in the global marketplace.
- Flexibility: the need for employers to respond to changing business conditions via flexibility in wages should be balanced with employees' need for income stability.
- Motivation: there should be incentives for employees to give off their best. Thus, while wages may be made more flexible to enable companies to respond to changing economic conditions, employers should also remember employees' sacrifices when times are good, and compensate accordingly. At the same time, management should take the lead in bad times, and bear the same sacrifices.

In addition to these broad principles of wage restructuring, RIL also adopted their own set of principles to guide the wage restructuring exercise. These were to:

- Be responsive to various situational needs in a crisis
- Be fair and equitable to all parties
- Promote tripartite relationship and team cohesiveness
- Be as complete as feasible in coverage in definitive terms, and less specificity in quantifiable terms to avoid misunderstanding
- Function as effective remedy to withstand the crisis, and extend operational functionality to outlast the crisis
- Be time – relevant
- Commonly apply indicators in every situation, and

- Counter any imminent loss of jobs as the overriding consideration for its application in any crisis that is financial in nature at the property level (and need not be a crisis at the national or industry level).

Much time was spent at the beginning of the negotiations going through the principles, and achieving buy-in from all parties. As Mr Tommy Ng stressed, "*The underlying philosophy must be understood and accepted*"." Initially, there was some bemusement as to why there should so much focus on the underpinning principles, with people wanting to go straight to the specifics. As the negotiations progressed however, it could be seen that the principles were important as reference points whenever disagreement arose, and helped significantly in moving the process on. Whenever a stalemate was reached, either side could, and would, hark back to the relevance of a particular principle, and this usually helped in reaching a decision.

Equally, time was also spent on explaining the wage structure to the (Union) branches, specifically in terms of how the numbers would translate into actual wages. The figures were plotted and all the numbers were given—in an open information sharing manner. There were two formal meetings between the management and the bargainable employees—the first being a communication session and the second a simulation session. According to Mr Tommy Ng, Mr Jamal's appointment as the IRO helped since he brought his legal background and expertise into the negotiation process.

Among alternative KPIs, the company decided to go with EBITDA (Earnings Before Interest, Tax, Depreciation and Amortization) rather than GOP (Gross Operating Profit) or NPAT (Net Profit After Tax). Management took pains to explain to employees that identifying the KPIs had to be an executive decision as it pertained to the economic survival of the company.

Proposed Formula for Wage Restructuring

At the point of negotiation, the MVC was built in at 3%. Management proposed that the 10% MVC be made up from the following components: 3% from the existing MVC, 3% from the Annual Increment for the year 2004 and 4% from the basic salary. The Union was rather worried at the prospect of 4% being accounted for by the base wage, but finally agreed, hoping that the 4% to be shifted from the basic wage to the MVC would be covered by future Annual Increments (AIs) for the next two years. Some union leaders were also concerned that older workers would be disadvantaged, in particular, a group of about 35 employees who had reached the maximum point in their pay scales (raising issues about the AIs). This issue was resolved by the assurance that there would be no cuts (they would not lose 2% of their basic salary due to the shift to MVC). Instead, employees who had reached the maximum in their range would get a lump sum instead of the 2% AI. In the longer term, within two collective agreements, the aim was to move the max-min ratio of salary ranges to 1.5 from about 1.8

The management proposed using EBITDA and Labor Productivity as the relevant KPIs.

EBITDA fitness test was based on the following criteria:

- EBITDA is sufficient to meet operating cash requirements including tax and interest payments;

- there is sufficient operating cash flow to meet all monthly financial obligations including loan repayment and
- it is financially beneficial to operate the hotel, rather than partially, or fully, closing it.

The Labor Productivity Balance test was defined as follows:

- Labor costs do not exceed all other operating expenses and cost of sales and exclude interest, tax and depreciation;
- the Gross Operating Revenue is sufficient to meet monthly salary and related payments and temporary labor

Instead of determining the Annual Variable component through annual negotiations, the parties agreed to tie the calculation of the AVC to the achievement of KPIs—essentially linking the AVC to the annual performance of the hotel. It was hoped that this would make the reward system transparent and consistent. **Table 1** shows the formula for adjusting the MVC and calculating the AVC. However, the MVC can only be activated after adverse conditions have persisted for six months.

The management and the union further agreed that the setting of KPI, MVC and AVC would be reviewed on the 1st of January each year and the MVC and the AVC would be set by the 28th February of the relevant year.

Both sides also agreed to review the situation when the AVC reached a level of two months of basic salary with a view to consider ex-gratia payment without altering major components like KPIs and provided that it is consistent with the NWC or other competent government agencies' recommendations.

Concluding Remarks

Being in the hotels sector, the Raffles International Group of hotels clearly needed a flexible wage structure. Despite being a pioneer in the implementation of such an undertaking, with no insights from the experience of predecessors to fall back on, the exercise went off smoothly for the hotel. Speaking about the learning points, Mr. Jamal had the following comment: *"It is important to find the right KPIs. Communication to the members is also very important. And this should be done before signing! Members need to know the whole picture."* Mr. Tommy Ng had the following comment about the role of HR in achieving success: *"HR practitioners need to understand finances better to know the balance sheet, P&L, what the implications on labour costs are, say, so that management can then see what the exercise would mean in dollars and cents, and be convinced"*

How has this exercise affected performance in Raffles Hotel? Mr Ng opined that while a performance driven culture had already been instituted previously, with the implementation of the Balanced Scorecard, it was nonetheless, difficult for rank and file employees to internalize the rationale for a performance-based system . The wage restructuring exercise, which showed the linkage between EBITDA and KPIs, highlighted the need for employees to demonstrate their contribution to company performance. Agreeing with this, Mr Jamal pointed out that the configuration in the exercise is, in itself, "modest". But it serves the purpose of manifesting the KPIs throughout the organization. For the short term, the wage restructuring exercise has

proved to be beneficial to the employees. The year 2005 will see the hotel paying a bonus equivalent to 1.28 months of salary.

TABLE 1

WAGE RESTRUCTURING FORMULAE

Basis of calculation

- Labor costs include basic salary, overtime, service charge recoveries, casual labor, contract labor, annual wage supplement, one month's bonus provision and exclude any write backs of provision
- EBITDA is the Gross Operating profit less insurance, management fee, property tax and capital reserve

Panel A: The Monthly Variable Component Adjustment

EBITDA Benchmark	Labour Productivity	MVC	Remarks
< $xxxk	>= xx%	-10%	MVC is capped at 10% of Basic Salary
< $xxxk	>= xx% < xx%	-7.5%	
< $xxxk	>= xx% < xx%	-5%	
>= $xxxk	< xx%	0%	

Panel B: The Annual Variable Component Adjustment Table

EBITDA Benchmark	AVC	Remark
Below 70% of Benchmark	0 Month	AVC is capped at Maximum of 2 Months of Basic Salary
Between 70% and 100% of Benchmark	0 to 1 Month	
Above 100% of Benchmark	10% of incremental EBITDA above Benchmark to be shared, capped at up to 1 Month of Basic Salary	