Texas: Successful Compensation Strategies for Navigating Market Cyclicality

By Priya Kapila

Weathering down markets and cyclical work, Texas holds steady in construction employee compensation.

A strong first quarter in the Texas oil and gas industry has some hopeful that 2017 is the year that the industry recovers from the debilitating three-year-long downturn. "We still have a long way to go, but 2017 is going to be a year of recovery and expansion in the Texas statewide oil and gas exploration and production economy," petroleum economist Karr Ingham told the Times Record News. "Activity levels will continue to expand, jobs will continue to be added, and the industry will support the broader state economy again, rather than acting as a drag on growth as it has for the prior two years."

Despite the recent fluctuations in the oil and gas market, Texas continues to generate employment opportunities that flag the state as an attractive location for workers within the engineering and construction (E&C) industry. In fact, Texas' job creation exceeded the nation's pace for the year ending in March 2017, according to Corridor News. In all, the state gained 249,000 nonagricultural jobs, an annual growth rate of 2.1%, higher than the nation's rate of 1.5%. The transportation, warehousing and utilities industries ranked first in job creation, followed by professional and business services, education and health services, construction, financial activities, and leisure and hospitality.

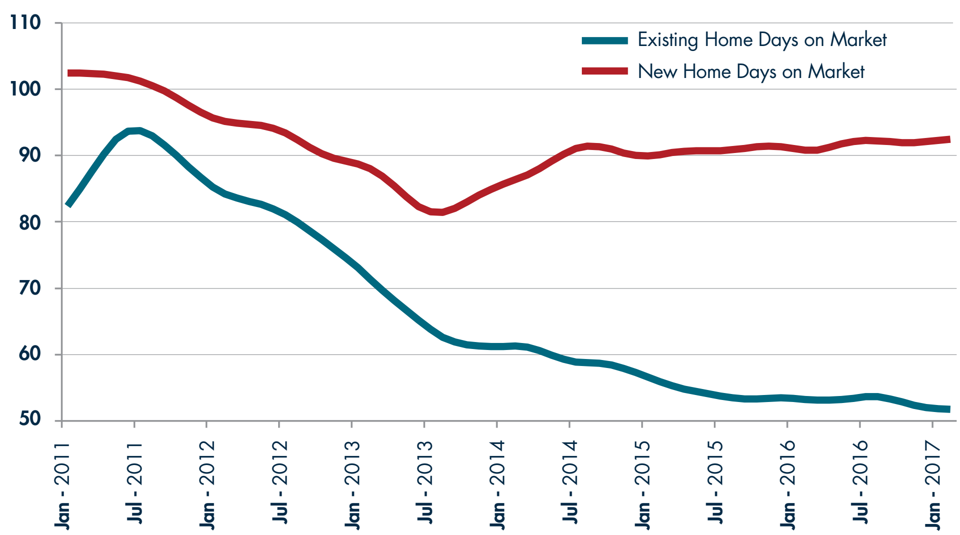
Houston: The Oil and Gas Industrial Center

The rig count is up 80% in Texas over the first quarter of 2016, and drilling permits have doubled to 1,300, the Houston Chronicle reports. In addition, state oil and gas employment has risen by 9,000 from the trough in September 2016, according to Texas Petro Index, a monthly report on the state's oil and gas activity.

A high concentration of oil and gas jobs is centered in Houston, where the most recent employment growth rates for the area from the Texas Workforce Commission and Bureau of Labor Statistics confirmed what many energy sector experts already knew: The Houston metropolitan area, along with the rest of the state, had little to no growth throughout 2015 and much of 2016. However, as noted earlier, the current outlook is more optimistic. In the early months of 2017, jobs were added to the market, and the labor force participation rate increased.

The positive view of Texas' future has far-reaching effects. For example, Dallas was the top destination in the country last year for domestic relocations, and Austin and Houston also ranked in the top 10. Such migration has put a strain on the Texas housing market, as shown in Exhibit 1. Days on market for existing homes have fallen to nearly half the 2011 average number of days. The population influx has been understandably beneficial to the residential construction market, which has seen a majority of the job growth recognized within the construction industry since 2015, according to the Texas Workforce Commission.

Exhibit 1. Texas Home Days on Market (Days)



Note: Seasonally adjusted and detrended. For single-family homes.
Source: Real Estate Center at Texas A&M University

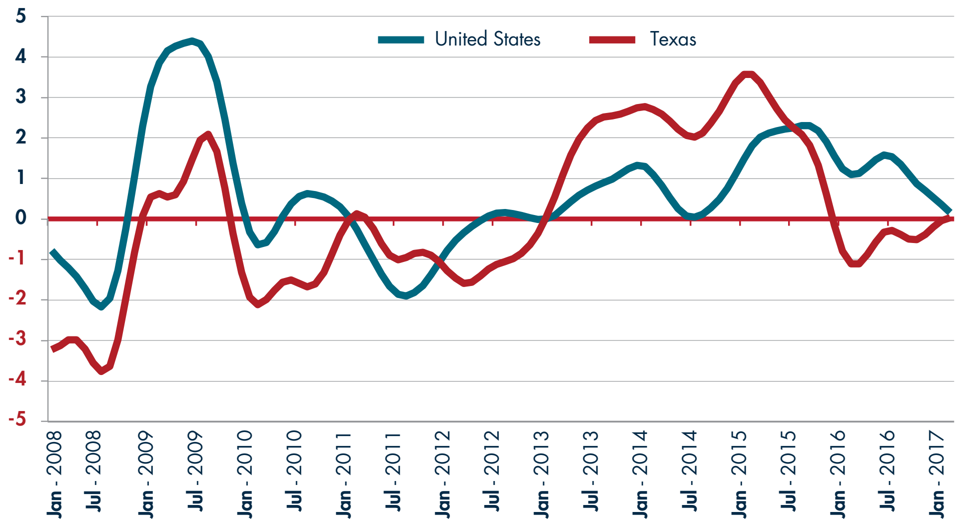
Tracking Labor Growth

Labor growth has had a mitigating effect on Texas' compensation growth. With supply being met in some key fields by new workers, there is less pressure on employers to provide aggressive compensation. The Bureau of Labor Statistics reports show that, following a rapid decline in earnings throughout 2015, worker compensation has slowly improved during the last year.

FMI's latest compensation surveys support this observation and indicate modest growth in recent years that only slightly exceeds the national average in many cases. During the same time frame, the average national earning growth rate has receded (see Exhibit 2), thus underscoring the rationale for relocation to Texas. Even with conservative job growth and compensation increases, Texas remains more attractive than many other areas of the nation.

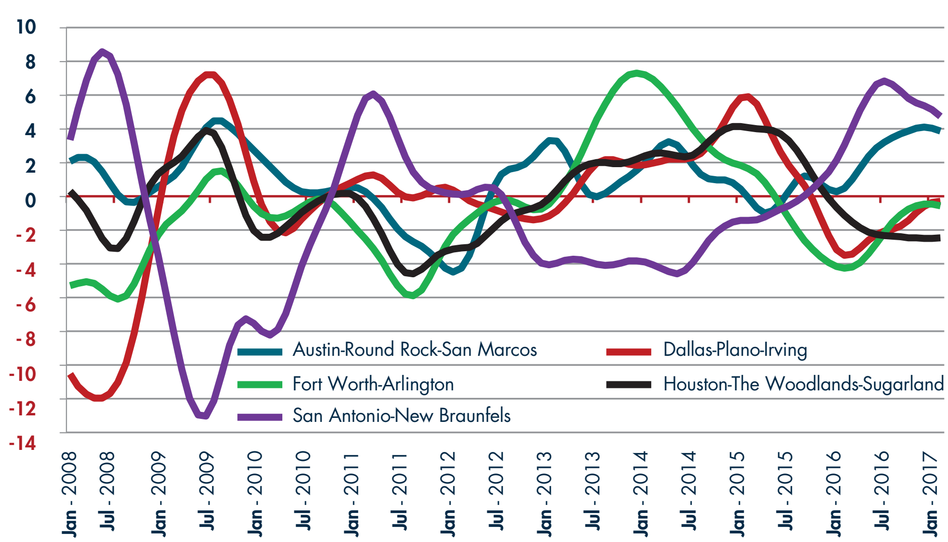
It is also important to recognize that the state's major metropolitan areas have experienced different degrees of compensation growth. San Antonio and Austin, for example, reported the greatest improvement in annual compensation growth from 2014, while Dallas-Fort Worth and Houston had slowing increases and then declines during that same time frame (Exhibit 3).

Exhibit 2. Total Private Employee Hourly Earnings (Year-over-Year Percent Change)



Notes: Inflation adjusted, seasonally adjusted and detrended. December 2016 is preliminary.
For more information, see Total Private Employee Hourly Earnings.
Source: Bureau of Labor Statistics

Exhibit 3. Major Metros Total Private Employee Hourly Earnings (Year-over-Year Percent Change)



Notes: Inflation adjusted, seasonally adjusted and detrended. February 2017 is preliminary.
For more information, see Total Private Employee Hourly Earnings.
Source: Bureau of Labor Statistics

We're seeing a similar trend in the E&C industries, although the Dallas and Houston markets are reporting small pay increases (as opposed to actual reductions). Interestingly, while Austin's average salary increases are above-market, San Antonio is well-aligned with the national average, and the increases for Houston and Dallas fall notably below market (Exhibit 4). Salary increases tend to reflect market forecasts and expectations, particularly for the coming year. Accordingly, lower pay growth may suggest that employers are proceeding cautiously and anticipate slower economic growth overall.

Exhibit 4. Average Annual Salary Increases for Select Texas Metropolitan Areas

Texas Metropolitan Area	Average Annual Salary Increases 2014 – 2016
Austin	3.3%
San Antonio	2.9%
Houston	1.3%
Dallas	0.6%

Source: FMI Construction Professional Compensation Survey

The rates of annual increase are highest right now for construction operations jobs. According to FMIs' "Construction Professional Compensation Survey", the jobs with the largest annual increases in Texas—project controls, superintendent and project manager—mirror nationwide compensation trends for these roles. Conversely, market-competitive pay levels for select support roles have fallen over the last two years (Exhibit 5).

Exhibit 5. Average Annual Salary Increase by Job Function

Job Function	Average Annual Salary Increases 2014 – 2016
Project Controls	5.0%
Project Superintendent	2.6%
Project Manager	2.1%
Purchasing	-1.2%
Quality Assurance	-1.3%
Business Development	-3.4%

Source: FMI Construction Professional Compensation Survey

Successful Compensation Strategies in a Tight Labor Market

It's no secret that the labor market for skilled workers is tight right now, with companies utilizing a wide range of strategies to find, recruit and retain workers in the engineering and construction fields. With broad fluctuations in compensation across the major metropolitan areas and job functions, firms must plan for future employment needs and take steps to assess their own competitive environments.

Once a company's leaders develop an accurate outlook of the type of talent necessary for ongoing operations and success, they can then determine just how aggressive their employee recruiting and retention strategies must be. While compensation is by no means the only consideration for effective talent management, pay has tremendous influence on attracting individuals to a company and can be used to encourage high performance and company loyalty. With that in mind, here are several approaches that Texas-based firms (and others) can use to best position themselves during turbulent times:

1. **Create a consistent compensation philosophy.** Companies are often tempted to make big changes to salary levels or offer very individualized compensation packages based on perceptions about the job market and talent quality. No organization should maintain compensation policies that are indefinitely set in stone; but on the other hand, adjustments that are discretionary or differ significantly from past practices may have negative consequences over time.

   First, there is a possibility of legal risk if employees who are performing similarly receive compensation that differs. Other effects of individualized compensation packages include greater administrative burden and negative employee perceptions of pay (and eventually, the company in general).

   To avoid the pitfalls inherent in discretionary compensation plans, companies should establish and maintain an overall compensation philosophy. Typically, the compensation philosophy should be applied consistently across all positions within the company. However, on occasion, there may be justification for different philosophies for "hot" jobs or select mission-critical jobs. If a company determines that an especially strong compensation package is needed to attract a top candidate, for example, written documentation should be used to explain the basis for the deviation from the corporate compensation philosophy. In addition, executives should also identify methods for adjusting pay accordingly for existing employees in the same job.

2. **Develop long-term incentives.** Long-term incentives are similar to formalized stay bonuses in that both are focused on key employee retention. Stay bonuses are common because they can be determined subjectively and then tracked and paid without in-depth recordkeeping. They can also be awarded as desired by the company's leadership. But just as individualized compensation packages can create unintended consequences, stay bonuses tend to cause confusion around how and why such awards are made. In fact, they may even place the company in hardship, should costly payouts be required in the future when performance is down.

   While long-term incentive plans also enable flexibility regarding plan participants, timing and amounts of awards and payout schedules, there are clear differences between long-term incentives and stay bonuses. One overt distinction is that long-term incentives are generally performance-based, as opposed to stay bonuses (which are usually tenure-based). Recipients are more likely to understand long-term incentives because the metrics determining such awards have been communicated to them. The awards are generally viewed more favorably because they reward contributions to organizational performance instead of simply recognizing an employee's ongoing presence within the company. Finally, a company can better ensure that the cost of future long-term incentive award payouts aligns with firm performance goals and success.

3. **Explore non-compensation recruitment and retention approaches.** Effective strategies for talent management extend beyond compensation. In uncertain times, for instance, programs that result in less direct cost increases may be more appropriate and financially prudent. Providing attractive benefit offerings, like flexible scheduling, telecommuting and extended paid time off, can foster positive views of the firm among current and prospective employees.

   In addition, a corporate culture and values system that identifies a dedication to staff well-being and development, if continuously reinforced by senior management, can have marked impact on attraction and retention efforts. For example, one employee at Camden Property Trust, which is ranked fourth in Fortune's 2017 "50 Best Places to Work in Texas", said, "There truly is a family environment here, and I feel valued, respected, appreciated and cared for." Reflecting a similar mindset, David Weekly Homes, ranked seventh, reports that, "Our mission is to build dreams and enhance lives, and we put our team members' lives as first on the list."

Focus on Maintaining Consistency

Although the Texas economy is certainly not alone in experiencing ups and downs, the variances within the state's numerous economies are pushing companies to stay apprised of market trends and future outlooks in a very proactive manner. When it comes to talent management, firms should assess and confirm staff resources on an ongoing basis to take full advantage of opportunities and address challenges during both strong economic times and downturns.

While the most direct strategy may be to accommodate all requests with customized compensation packages, we recommend maintaining consistency in employee pay practices, developing an overall compensation philosophy, and establishing programs aimed at attracting and retaining high performers.

Priya Kapila is the compensation practice leader with FMI Corporation. Priya is responsible for leading the compensation consulting practice of FMI Compensation. Services provided to clients are primarily focused on the areas of executive compensation, organizationwide salary structure development, and short-term and long-term incentive plan design. She can be reached at *pkapila@fminet.com.*

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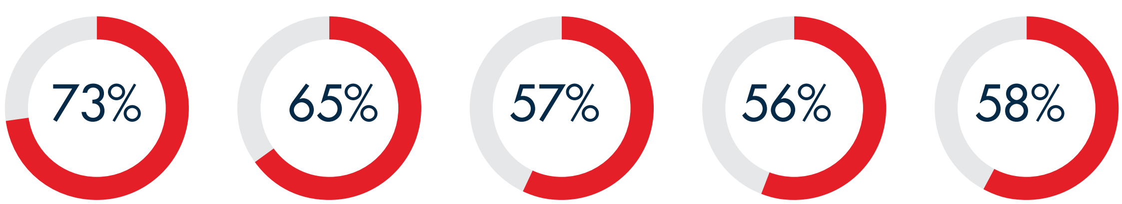
FMI Client Highlights



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