Leading Your People and Organization Through COVID-19 (Part 5)

By Priya Kapila

Compensation Planning in Uncertain Times

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Payroll budgets account for one of the largest company costs. In times like these, it is as important as ever to pay careful attention to compensation planning and payouts.

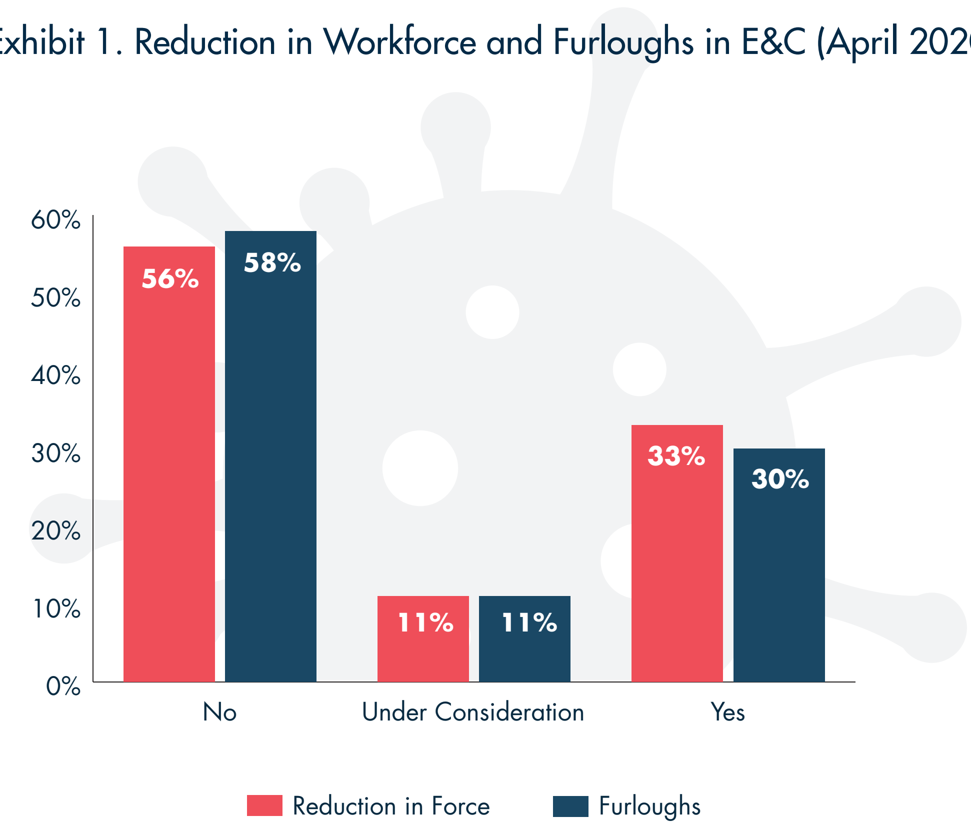
While most of us are already aware that business forecasts can change quickly and dramatically, recent months have been a harsh reminder of the cyclicality of markets. Many contractors began 2020 much the same as prior years, with strong backlogs, positive outlooks, tightened but still highly positive margins, and a continued search for skilled talent. The latter has been a pain point for companies across the engineering and construction (E&C) industries for some time, and initiatives to offer innovative and lucrative compensation packages have been commonplace.

Then the COVID-19 pandemic ensued.

To say everything changed for the worse would be a misnomer. For many contractors, business operations are classified as "essential" across the U.S., so work has continued despite more stringent safety protocols. Nonetheless, the uncertain outlook caused many firms to take prompt and decisive action. In a survey conducted by FMI in mid-April, more than 30% of the 140 responding companies reported a reduction in workforce had been implemented. Approximately the same number of companies furloughed employees (Exhibit 1).

Interestingly, the greatest prevalence of reductions and furloughs was observed among midsized to large general contractors (i.e., those with annual revenues of $500 million or more). It could be argued that to some extent, this is business as usual for contractors; staffing levels naturally ebb and flow with the seasonality of work and fluctuating industry spending. However, the uncertainty of the ongoing impact of COVID-19 on industry and individual business performance necessitates thoughtful contingency planning. While pundits speculate on the best letter of the alphabet to illustrate the economic recovery, contractors must take action that aligns

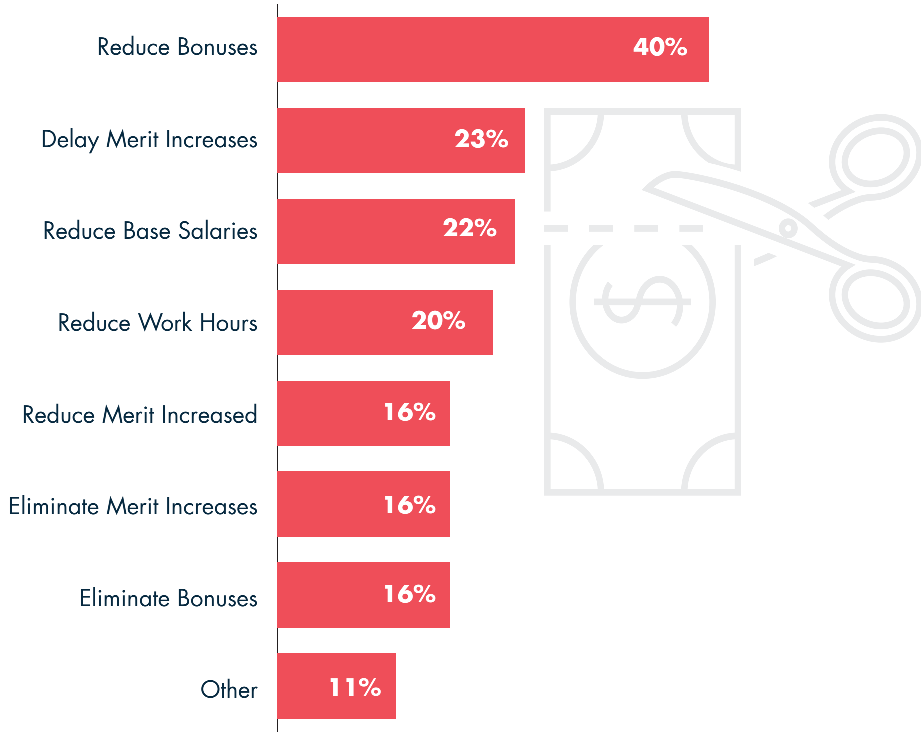
Exhibit 1. Reduction in Workforce and Furloughs in E&C (April 2020)



Source: FMI COVID-19 Compensation Impact Survey

Exhibit 2. Compensation Changes Under Consideration

(% of Companies Reporting)



Source: FMI COVID-19 Compensation Impact Survey

with market trends and expectations. For the vast majority of contractors, staying the course in 2020 and beyond is not viable; this holds true for employee compensation programs as well. As FMI's survey reveals, additional compensation adjustments are under ongoing consideration (Exhibit 2).

As with any critical business function, how employees are paid must be assessed and adapted with the times to ensure the ability to effectively attract, motivate and retain people. In Downright Dangerous Decisions: Developing Strategy Amid Uncertainty, FMI's Jay Bowman and Brian Strawberry offer three possible scenarios for how the E&C environment will be impacted by COVID-19:

1. **Current assumed trajectory—**FMI's current assumed trajectory (i.e., Q1 2020 Outlook) assumes two quarters of negative GDP growth (i.e., Q2 and Q3), ending the year between zero and 1%. This triggers an official recession.
2. **Extended economic disruption—**The extended economic disruption line assumes three quarters of negative GDP growth (i.e., through Q4 2020). Economic recovery would not occur prior to the presidential election.
3. **Disruption to disintegration—**This scenario assumes a minimum of six quarters of negative GDP growth (i.e., through Q2 2021) and would be equivalent to that of the Great Recession (i.e., from December 2007 to June 2009). Significant financial collapse must occur under this scenario.

While individual companies will be impacted differently under each of these scenarios, the suggested approaches below focus on establishing compensation practices that achieve (1) cash preservation to support business continuity and (2) ongoing recognition and reward for employees.

Current Assumed Trajectory (Zero 2020 GDP Growth)

The best-case scenario right now is that the U.S. economy will rebound in late 2020. In the event that recovery comes within this optimal time frame, compensation adjustments may be limited to 2020. Planning for future years then may be focused on longer-term strategies versus damage control or risk mitigation.

If better times appear on the horizon, immediate talent management activities should focus on stability and preparation. Specifically, this is a prime time to examine staffing needs for 2020 and beyond. In many instances, this means employee headcount may remain unchanged among contractors, as “essential service” classifications allow projects to continue. However, the decade-long bull market and high demand for E&C projects have undoubtedly resulted in overstaffing for some companies. Even if restructuring is not undertaken now, careful thought should be given to whether right-sizing—with an emphasis on the right people in the right jobs—would be beneficial.

Similar to the suggested status quo approach to staffing, consistent compensation practices should be maintained as much as possible in this scenario. This is particularly true for base pay, knowing that wage reductions tend to signal dire circumstances. In contrast to staffing reductions, discounting the pay of current employees breeds frustration and dissatisfaction. In combination with prevailing uncertainties, it is no surprise that many companies that enact wage reductions experience high employee turnover when economic conditions improve. If a company historically has paid at the extreme high end of the market, this may be a prudent time to evaluate realignment with market norms. This could mean wage freezes for very well-paid employees or shifting a portion of base wages to incentive compensation opportunity.

In contrast to pay cuts, contractors may actually be best served by strategically providing higher compensation. As long as company sustainability is not adversely affected, executives should consider resetting performance benchmarks, as needed, to offer high performers an opportunity to earn an incentive in 2020. On the other hand, if critical profit expectations are not met and incentives cannot be paid, leaders should communicate this to employees early on, versus simply assuming they will know or understand the situation at year-end. Exceptions should be addressed carefully, but companies may also want to award bonuses to a select few key players who were instrumental in 2020 performance improvements and who are essential to future success.

Extended Economic Disruption (Negative 2020 GDP Growth)

If a more extended downturn unfolds, significant action must be taken to ensure business continuity. For many contractors, layoffs that extend beyond just typical seasonal adjustments will be appropriate, and compensation decreases may be necessary. It is important to note that these changes should be evaluated closely if a contractor has taken advantage of federal aid through the CARES Act.

In this scenario, the concept of right-sizing is defined more narrowly. Initially, only the mission-critical roles and highest-performing incumbents are “safe.” At the other end of the spectrum, low performers and nonessential jobs may be eliminated. Then comes the more arduous task of assessing the rest of the organization, which generally includes the vast majority of the workforce. While the core focus must be weathering the current storm, leaders must also keep an eye toward the future. With this in mind, consider training current employees in “disappearing” roles for alternative positions or advancement. In times like these, employees are that much more inclined to take ownership of opportunities for professional development, especially if greater job security and transferable skills are gained.

In this more extended decline scenario, it goes without saying that every company will react and perform differently. Therefore, the sooner executives have some clarity on future expectations, the sooner corresponding action plans and communication should be implemented. That applies to future compensation practices as well; if wage freezes or reductions and bonus suspension are eminent, employees should be informed to reduce uncertainties and inappropriate expectations. Clear communication should occur in all circumstances; that is, if a contractor finds that the outlook is better than expected, employees should also be informed!

Disruption to Disintegration (Extended Negative GDP Growth)

With unemployment nearing historic highs and continued intense sensitivity to human welfare, a downturn akin to the Great Recession (if not worse) is possible. For the most part, the talent management decisions in this scenario are similar to those of an extended downturn, but more severe.

Given the legislation in place at the time of this article's publication, it is unlikely that federal aid will support the long-term retention of the workforce for most contractors. Therefore, an ultra-lean staffing approach—whereby only the employees deemed most needed for business survival are maintained—may be necessary. While by no means the ideal circumstance, extraordinary unemployment benefits currently make this prospect less detrimental for laid-off workers.

It is well documented that compensation is not the only method for encouraging employee motivation and retention and, in fact, is often not the primary driver of engagement. Accordingly, these challenging times provide an opportunity to explore non-monetary rewards for employees. The evolving remote workforce introduces new difficulties, but the value of recognition programs and culture-building activities should not be ignored.

What's Next?

Exactly which scenario is most likely to play out is largely guesswork at this point. Thus, the best planning begins with a strong understanding of current operations so that effective decisions can be made quickly as projections become clearer.

1. **Assess the Workforce**—Taking stock of staff is not limited simply to headcounts; it also includes the relevance of job roles as well as corresponding employee skills and abilities. If jobs are ill-defined, not structured to complete essential work, or if any mediocrity has been tolerated, then any right-sizing initiative to manage reductions appropriately will be very challenging. Identifying who and what is needed now, and in the future, will position a company to more effectively navigate what's to come.
2. **Evaluate Compensation Practices**—For obvious reasons, compensation is a highly sensitive topic. Therefore, the more consistent and transparent a firm's compensation practices are, the better. To the extent changes need to occur to protect the company, employee communication should be prompt and clear. In some cases, this may be an advantageous time to convey key tenants of compensation (i.e., the value of not overpaying or underpaying and the fact that incentive compensation isn't guaranteed).
3. **Determine "Breakeven"**—Business operations will be heavily impacted by geography, market segments and executive decision-making. Each company must review its own outlook to determine when to undertake the next steps regarding talent and compensation. For staffing and pay changes, knowledge of when and how much cost-cutting measures are needed to preserve the company is critical. It is also important to recall that this downturn, like others in history, is not expected to be permanent. Contractors should be cautious to not cut too deep and fail to rebound.

   As the authors point out in one of FMI's recent research studies, "Many leaders emphasized the hard lesson learned of cutting people-development efforts during the downturn." Our research confirms the impact it had and shows that those few leaders who did pursue "people efforts" despite a major drop in total project volume experienced higher profit margins post-recession compared to other groups.

As we move further into 2020 and beyond, it's important to take a step back and look to the future. This means setting long-term goals and using them as a north star. This is important in the midst of a potential recession, when it can be tempting to only focus on "battening down the hatches."

About the Author

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