April 30, 2020

By Dan Simovic and Sandy Turba

Adapting Compensation Strategy in an Economic Crisis

And just like that, the Goldilocks Economy ended. GDP growth was a healthy 2.9% in 2019. The Dow Jones hit 29,000 in January, 2020, and a record high in February. The 3.5% unemployment rate was the lowest we had seen since 1969. In a few short weeks, that's all changed.

Absent a magic bullet, the only solution is to adapt. As we weather the impact to the global economy, significant disruption to business and weakening of many sectors, one thing is sure: businesses still need to retain key talent – not just the top performers, but workers who perform critical jobs.

We recently posted an article outlining the importance of recalibrating your human capital strategy and we identified four core areas to assess:

- Strategic planning
- Leading during a time of crisis
- Employer branding and communications
- Compensation and total rewards

Our focus in this article is compensation and total rewards.

Coronavirus Economy Impacts Variable Pay

The economic downturn – and possible recession – won't impact all sectors to the same degree. In fact, growth is expected in retail grocery/non-durable essential goods, ecommerce, shipping-related subsectors in the transportation industry, and medical supply manufacturing. But many other organizations will have little option other than to reduce staff and the remaining staff will experience lower wage growth – if any at all.

Let's face it – base pay increases are already stagnant, having hovered between 2.9% and 3.1% annually since 2013. Regardless, there will always be a need to keep and attract strong talent. This is especially true for organizations poised to thrive in the Coronavirus Economy. There are strategies you can begin to employ to increase your opportunity to do so – as long as you remain focused on *total rewards*: the value of base pay, variable pay, and benefits and ancillary programs.

Historically, non-fixed pay (variable pay) has provided an opportunity for an upside and has been an important tool for closing the gap between relatively flat growth in base wages and the need to achieve market-competitive total cash.

The majority of for-profit organizations – as many as 84%, according to WorldatWork - offer at least one kind of variable pay program and variable pay for salaried exempt employees has averaged 12%-13% of payroll over the past 10 years. Executives and senior leadership have the highest percentage of variable pay opportunities, followed by middle management and then professional exempt employees. Many organizations also provide variable pay to non-exempt employees.

Allocate Increase Dollars Where Needed Most

Because variable pay is, well, variable, most plans not only have targets, but also thresholds and maximums. Even in a year when overall performance doesn't hit the target, many employees receive some payout. And in a great year, the payout will exceed the target percentage.

The beauty of variable pay is that it isn't fixed. Unlike base pay adjustments, variable pay doesn't increase the cost of base payroll year over year. Plan funding is directly tied to performance, so in a well-constructed plan, the payout occurs only if the performance goals are achieved. In short, the plan pays out if the organization can afford it.

For many companies, that won't happen this year.

If your organization has been providing the same percentage increase to all employees regardless of performance – independent of whether or not you have an incentive plan – you're missing a critical opportunity to focus the increase dollars where they're needed most.

If you've managed a merit-based increase process, you understand the challenge of having a 3% budget and trying to adequately award increases that differentiate between a good performer and a great performer. The math isn't difficult: You've got a good employee who meets expectations and you award them 3%. You give the top performing employee one and half times the 3% target. Assuming each of those employees earns $75,000 annually, that additional 1.5% merit increase means your top performing employee gets an extra $0.54 per hour.

What message does that send, especially when the opportunity for incentive pay disappears?

Compensation Hurdles to Overcome in Coronavirus Economy

Given the current economic crisis, there are a couple of key stumbling blocks on the compensation front:

- **Many businesses won't hit the targets for incentive payouts this year** – even if they're able to recalibrate performance measures and goals. Without the incentives that previously boosted the market competitiveness of *total cash*, the focus will shift exclusively to base pay and benefits programs. If your base pay isn't market competitive, you've lost use of an important tool for competing on the total cash front, and you've also lost one of the other advantages of variable pay: its ability to drive retention. Most variable pay plans require an employee to be actively employed to receive the year-end award.

- **Base pay increases plateaued and many employees became accustomed to receiving some level of variable pay.** While we know employees shouldn't expect receiving variable pay, they do and have factored that into their anticipated compensation. Even if those employees aren't top performers, most are likely meeting job expectations and many may be performing jobs that are key to the operation of your business. If the base pay is competitive, it's a little easier to manage employee expectations, engagement and morale.

It's time to do things differently – because the real danger would be doing things the same way.

Coronavirus Economy Calls for New Base Pay Strategies

It would be naïve to suggest that in the absence of a meaningful incentive opportunity the solution is to simply increase the funding of the base pay or merit increase pool. It won't be that easy. And you won't be able to make all of the fixes at once. But there are some actionable strategies organizations should take.

Six Strategies for Managing Compensation in a Business Downturn

1. Evaluate the competitiveness of your current base pay structure
2. Determine which jobs are more critical and warrant additional pay – even temporarily
3. Identify key employees and assess the potential impact of not being able to retain them
4. Analyze employee pay to determine risk (employees paid too low given their experience and performance; pay equity issues)
5. Consider using your increase or merit pool differently in order to maximize the budget
6. Leverage other types of award, retention or recognition programs

There is no singular, easy fix to what's ahead. It will take a multifaceted approach and healthy dose of tenacity and resilience. But as the old expression goes, adapting is a game of singles, not home runs.

FINDLEY perspective

For more information about adapting compensation strategies, contact Dan Simovic at *dan.simovic@findley.com* or *216.875.1917*, or Sandy Turba at *Sandy.Turba@findley.com* or *216.875.1937*