Managing Costs

in the Midst of COVID-19 Uncertainty

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INSIGHTORY
CONSULTING

The current COVID-19 pandemic is creating challenges for business and human resources leaders that are unprecedented within our lifetimes. And while certain past crises can be informative in managing through the current situation, there really is no playbook for managing through anything near the magnitude of what we are now facing. The need for a well thought out and comprehensive plan and approach for managing business costs to ensure long-term survival and continuity has never been greater. It is also safe to say that senior leaders have rarely, if ever, been forced to make such difficult and immediate decisions with such profound impacts on their employees.

We constantly get questions from our clients about ideas for aggressively addressing costs in this environment. And while such brainstorming can be useful, we consistently counsel them that the overall decision-making framework and employee communication strategy are absolutely critical and can be extremely useful in guiding tactical decision making - including which cost levers to pull and how to execute.

The decisions made in this time period will have a lasting impact on your employees and how they perceive your company. So while difficult decisions are a must, they should be made very thoughtfully to preserve the long-term health of the company and its relationship with employees.

We have identified a number of best practices with respect to communications, decision making, and execution of emergency labor cost actions. We conclude by evaluating a common set of cost actions typically considered in extreme situations.

Communications

- **Be Transparent** and help your employees understand the challenges you are facing in no uncertain terms, else the considered actions will always come off as excessive and draconian. There are clearly special considerations for public companies in that any employee messaging must be consistent with what you are telling the street.
- **Help the team understand trade-off decisions** – short-term versus long-term, maintaining employees versus preserving existing rewards programs, etc.
- **Don’t Wait** to communicate until you have all decisions completely made and planned. Otherwise you run the risk of losing control of the messaging and having the rumor-mill fill the void.
- **Engage Your Leaders** and ensure they are more visible to their teams than ever, even when they do not have all the answers.

Decision Making

- **Establish a “Crisis Room”** with cross-functional teams in position to identify appropriate cost actions. While labor will be an enormous part of the challenge for most companies, it can be extremely beneficial to engage creativity of other teams to identify temporary and permanent cost solutions that could potentially alleviate some of the people impacts.
- **Build a Clear and Simple Decision-Making Framework** to enable critical evaluation of all ideas, including an objective/ subjective evaluation of each element of the decision. This typically includes total cost benefit, degree of business risk, and the impact to employees.

- **Include Labor Counsel Representation** in the “Crisis Room” to very quickly evaluate the legal feasibility of potential and proposed actions. There are many seemingly attractive ideas that would create extensive labor implications (FLSA, ERISA, etc.) that quickly render the idea infeasible.
- **Evaluate “Temporary” and “Permanent” Cost Structure Actions** that map to your projections of future business and the resulting work force plan. Longer projected revenue lags generally imply more significant permanent job cuts in lieu of more temporary actions.
- **Manage Optics** by constantly evaluating the shared impact across the company. Most companies will be fighting a perception that the senior staff is being preserved and protected while the masses are bearing the brunt of the cost actions. Consider both real and symbolic actions for more senior staff which display a common sacrifice even for items that don’t generate massive cost savings.

Execution

- **Avoid Death by a Thousand Cuts** as it is better to identify and announce a comprehensive plan earlier in the process versus communicating and executing a constant stream of new actions.
- **Ensure Competitive Rewards Programs** on the other side of the crisis. It can be tempting to deplete competitiveness in order to maintain a larger employee base. While that could be a very viable short-term strategy to work through the crisis, it is generally not the best long-term strategy to maintain the talent needed to be successful.
- **Be Thoughtful on Employee Terminations** by reflecting employee performance and considering diversity implications in the identification of affected employees. Rarely do you have significant opportunities to either move forward or backward with respect to talent levels and workforce diversity as when significant job cuts are enacted.
- **Engage Labor Counsel** throughout the process to navigate potential land mines (e.g. WARN Act, disparate impact, etc.)

Potential Actions – Employee Rewards Programs

While each company plan will likely be unique based on their specific challenges, there are a number of common levers evaluated by most. Below is a list of the largest rewards programs and some general considerations for managing each in the current environment.

Rewards Programs	Considerations
Base Salaries	Only in the most extreme cases would companies consider salary reductions unless they are temporary in nature and limited to more senior leadership positions. In most cases, voluntary or involuntary furloughs would be more palatable versus expecting the same work for less pay. To the extent there are upcoming salary cycles, it would be prudent to postpone or cancel the upcoming salary cycle until the economic uncertainty has passed.

Bonuses	In most cases companies should consider simply letting their incentive programs continue on existing terms and paying out according to original schedule. To the extent these plans are not funded by underlying business results, the company should consider suspending any future payouts until the economic uncertainty has passed.
Sales Incentives	Sales incentives can potentially be more complicated in determining the best future course of action. In general, the plans should continue on existing terms with a couple of notable exceptions. In cases where the sales force is extremely highly leveraged (more than 50% of total cash compensation) it may be appropriate to consider a "floor" where a portion of the incentive is paid out assuming a minimal level of performance. Resetting goals should be considered when it has a positive ROI i.e. the additional motivation to the sales force makes up for lower goals. Retention of the sales force should not be a major factor in these situations.
Long-Term Incentives	There generally aren't too many near-term actions to be taken with respect to long-term incentives and any potential actions would generally not help with cash flow in any case. Best practice would be to let existing stock option and/or other long-term programs continue in force per the original plan terms. If a company's typical annual cycle falls during this crisis, they face a difficult choice between either deferring new grants or making grants at reduced target values. If stock options are typically granted as part of annual plan, there can be backlash for executives getting options at low prices, especially if the market improves significantly and quickly. Also when the stock price is significantly depressed, making the normal competitive level grants can greatly reduce your plan reserve and can have a dilutive effect. The Compensation Committee needs to carefully evaluate several alternatives before making a decision in this type of situation.
Employee Benefits	Few employee benefits provide for the flexibility to generate short-term cost savings with the exception of 401(k) program matches. While suspension of employee matches is very uncommon, it can be considered in times of extreme financial stress. Perks such as subsidized food, gym memberships etc. can be dropped relatively quickly, but their cost impact is low. Cost-savings from other benefits – especially healthcare – can be significant, but are typically attempted in the next plan year. Employers should also consider if they really want to increase cost or reduce access to healthcare in a crisis that is essentially all about health.

Potential Actions – Employment

In many cases in the current environment, rewards actions alone will be insufficient to meet the impending cost challenges and more dramatic and impactful actions will need to be considered. Some of these cost levers are commonly deployed during economic or business downturns while others (like involuntary furlough) are used infrequently and would be generally considered for businesses most significantly affected like airlines, energy, hospitality etc. While these employment actions can be deployed independently, the best solution would coordinate a portfolio of these actions to achieve required cost reductions.

Employment Actions	Considerations
New Hire Freeze	This tends to be one of the most popular actions since it enables the labor cost structure to drift downward without affecting current employees. This should be one of the first actions taken with very few exceptions awarded in cases where the roles are mission-critical or are in a business unit that is growing. Even then, companies should explore setting up an internal talent "clearinghouse" to try and place otherwise displaced current employees before extending any external only offers. One downside is that hiring freezes tend to achieve (future) cost avoidance rather than (current) cost reduction. The degree of savings generated is highly dependent on employee voluntary termination rates.
Voluntary Furlough* (i.e. unpaid time off)	Voluntary furlough can be a popular option for employees to take additional unpaid time off while saving the company costs that could enable less draconian actions in other places. This option becomes less feasible if broad involuntary furloughs are being considered. If this option is selected, the company should structure the program in a way that will not interfere with their current employee FLSA designations.
Involuntary Furlough	Involuntary furlough is generally considered to be a drastic yet necessary action in times of extreme financial crisis. It is common in cyclical industries like oil and gas and airlines, but less so in general industry. It can help offset the need for permanent headcount reductions and then eventual rehire when times improve. Labor counsel should be consulted in crafting any such program to ensure compliance with all employee obligations and to preserve existing FLSA designations.

Voluntary Termination	Voluntary terminations (which may include Early Retirement or other Voluntary Programs) are a less attractive alternative in most cases since companies would prefer to select the talent which stays versus leaves. The best practice in managing voluntary severance is to be very selective in determining the groups to offer the opportunity, and then maintain the right of refusal in extreme cases where an employee is key to business continuity. Unfortunately, the sign-up rate tends to be relatively modest in times of broad economic hardship, and especially where the company has a large employment presence in a given location and other employment options are scarce.
Involuntary Termination	In most cases where extreme financial challenges arise, involuntary terminations tend to be the largest cost lever, although effective management of the other levers can potentially reduce the amount of cost savings needed here. The depth of involuntary terminations should obviously contemplate the expected shape of the recovery, balancing out severance cost obligations with carrying under-productive salary costs. A quicker expected recovery or higher severance costs will make the involuntary termination route less feasible relative to other cost levers.

**Furlough is essentially unpaid time off. Companies can define terms as they wish, but the most common version includes benefits continuation but not salary continuation.*

Crafting the right plan for your company requires a deep and honest assessment of your business situation. Since there is no level of certainty on the epidemiological – and hence business – impact of COVID-19, most companies will need to build different scenarios and execute them in sequence. No leader ever asked for this role, but it is one they're being asked to play nonetheless.