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Covid-19 + Compensation

Human Capital Management: Pandemic Challenges and Opportunities

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COVID-19 CONSIDERATIONS

Struggling with cash flow in the Covid-19 pandemic, boards and executives may be inclined to postpone investments in their workforce. But for most organizations, the pandemic is likely an important test of how they manage their human capital. When times are tight, do companies see employees and contractors more as partners whose talents are essential to long-term success? Or more as variable costs to be minimized when troubles arise?

Consider the perspective of employees. What are they saying about their employers during the pandemic, in social media, letters-to-the-editor, or in the streets? When the economy eventually reaches a post-pandemic normal, will they commit to their companies and support them by improving their own capabilities? Or will they look elsewhere for a better deal? For boards, the pandemic is a major opportunity to work with management to build a competitive advantage through human capital investment. Companies that decline to invest in their people—beyond health and safety—could take a long-term hit from their customers as well.

Companies in Different Situations

Companies face different challenges depending on how hard they've been hit in the pandemic. Those in the worst-off industries are carrying out minimal operations, while others are open but struggling with diminished supplies, logistics, or demand. A third group is holding its own or even benefitting from the crisis. All three groups can take steps to promote a culture of employee engagement and personal development. (Companies on the brink of failure are a separate group that we won't discuss here.)

Let's start with the most-challenged group. With the pandemic now into its third month, most companies in full or partial shutdown have sent home the bulk of their workforce. What kind of company will these employees return to?

Employers such as Best Buy, which has maintained benefits for furloughed workers, are likely to see more loyalty. Ongoing communication, and perhaps donations to the employee assistance fund, will also help. Don't take for granted that your talented employees will return, even with high unemployment.

Medium-hit companies may be weighing whether to reduce labor costs aggressively. If furloughs aren't essential for cash flow, the pandemic might be an opportunity to cross-train people or have them try out new duties. By investing in their capabilities, you'll gain not just future returns but also engagement. HCA, the largest manager of hospitals in the United States, was taking a hit from the cancellation of elective surgeries. But it guaranteed to employees they would get at least 70% of their base pay.

As for companies that are doing fine or even expanding, the crisis gives them a chance to try out employees in new situations. Many people are looking to step up, and organizations can use that energy for present and future success. Otherwise, after the crisis ends and exhausted employees take stock, they may go elsewhere for future career growth.

Where to Focus

Regardless of your market position, some HR investments such as general training can be safely postponed. But diversity and inclusion may be more important than ever, given how the pandemic has affected ethnic groups and classes differently. Leaders will benefit from a variety of perspectives. Succession planning also has a new importance, as boards will likely want to ensure multiple candidates for key positions. They should likewise examine their current benefit offerings, as the pandemic has frayed safety nets and left many workers on the edge financially.

Finally, boards can use the crisis to rethink their overall pay philosophy. Just as the Great Depression and World War II broadened compensation discussions beyond the executive ranks, so might the pandemic. The 2008 financial crisis focused attention on pay equity, leading to a few restrictions on executive compensation. The same might happen now if pay equity continues to be part of the dialogue with investors and among the public.

Scenarios and Questions

There's still enormous uncertainty on how the pandemic and the economic recovery will play out. Rather than assume a certain outcome, boards are better off overseeing management in considering a variety of scenarios. These will start with the familiar unknowns on public health—when can operations resume, or regain full capacity? When will people be comfortable transacting again? What if there's a second wave of infections this fall?

While tracking those areas, boards and executives need to consider matters that they can control. Should they invest in greater automation, or in operational adjustments for social distancing? Should they consider testing employees for antibodies or fever? Should they encourage people to work from home, or does telecommuting undermine key workplace dynamics?

The 2010s were a decade when many companies embraced leverage. They reduced working capital, expanded outsourcing, took on debt, and returned cash to shareholders. All of this made short-term economic sense at the time, but may have reduced their long-term resilience. The pandemic is an opportunity to rethink this balancing act. As boards consider changes to executive compensation and dividends, they might also adopt the principle of proportionality—matching those changes to what employees are facing.

Expanding the Board's Responsibilities

The pandemic is a fresh reminder that successful companies depend on a healthy, capable, and engaged workforce. Even before the crisis, investor groups were pressuring boards to add human capital management to their purview. BlackRock, for example, has said it favors companies with executive incentives around environmental and social issues—and it recently reiterated that stance despite the pandemic.

In August 2019, Semler Brossy co-hosted a workshop on human capital management with the Lowell-Milken Institute for Business Law and Policy at UCLA. Jim Barrall, a Senior Fellow-in-Residence at the institute and a retired partner of Latham & Watkins, organized and chaired the workshop. The resulting report takes only passing note of the pandemic, but it serves as a good introduction to the topic for interested directors and executives. See "HCM's Growing Importance" for the main takeaways from the report, and **download the report** itself.

Semler Brossy will continue to report on developments in human capital management for boards. But it's important for boards to get involved now, rather than wait for the current crisis to end. The pandemic itself is an opportunity to shift gears and help build the company for sustained success. ■

HCM's Growing Importance

1. Investors and proxy advisory firms are calling for greater disclosure from companies on how they manage their human capital.
2. Under the laws of Delaware and other states, directors have duties of care, loyalty and oversight that can apply to HCM matters and result in director liability.
3. The SEC has proposed requiring companies to describe their human capital resources as these are material to an understanding of the company's business as a whole.
4. Some public companies have already articulated board responsibilities for HCM oversight; some have renamed and expanded their compensation committee for HCM, and some have disclosed HCM policies and efforts in their filings and other publications.
5. Apart from legal requirements, boards have important business, governance, and reputational reasons for caring about HCM.
6. Areas for possible board attention include diversity and inclusion, employee satisfaction and engagement, succession and talent management, attrition and retention, and finally ethics, workplace culture, and risk.

From "Corporate Governance: The Growing Importance of Human Capital Management," a report from the Lowell Milken Institute for Business Law & Policy, UCLA School of Law, April 2020.

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