Severance Package Design: Considerations for COVID-19

Gartner for HR
Overview

The economic impact of COVID-19 is being felt across industries and regions and forcing organizations to make difficult cost optimization decisions.

Although organizations are modeling alternatives to layoffs, workforce reductions are and will become an unfortunate reality for many. As such, organizations must address the offering and design of severance packages.

While there are no federal laws mandating the deployment of severance packages during workforce reductions, many companies will offer severance to make layoffs more bearable. The gesture can also have a lasting brand and reputational impact for the organization and its current and future employees.

In this article, we discuss the impact of offering severance and provide guidance on components of severance packages and potential modifications that organizations should consider during COVID-19.
Severance package considerations during COVID-19

The situation we are in now is unique, and guidance on severance package design needs to be contextualized for this new reality. The financial impact of COVID-19 is significant. However, unlike the last economic downturn, COVID-19 is a health crisis directly impacting employees across all industries.

Organizations can and should consider how to update severance packages to reflect this. For instance, rather than focusing on outplacement services like resume development (which can often be accessed for free online today), incorporate extended access to healthcare benefits, which will be more relevant and needed by departing employees. This could be executed as a blanket policy, or employers could ask employees if they would prefer extended healthcare or the original offering, as employees’ preferences may vary (i.e., can access benefits through a partner’s employer).

Finally, it is important to stay abreast of ongoing legislation that provides benefits to recently furloughed and severed employees. Understand areas where employees may be covered by federal or state healthcare policies and use that to inform organizational severance plan design to avoid any potential redundancy.

Impact of offering severance packages

Offering severance pay as part of employee termination can have a positive impact on the departing employee, as well as surviving and future employees.

For the departing employee, it shows that the organization wants to provide financial assistance to make the layoff more bearable and maintain a positive relationship for a potential return to the organization following the economic downturn. For surviving employees, it signals that the organization cares about its workforce and may help to boost well-being and morale.

In fact, 59% of organizations believe that the greatest risk to a reduction in workforce would be “damage to morale of remaining employees.” Offering and communicating severance packages can positively impact perceptions of pay fairness and provide a sense of security for the remaining workforce. Finally, offering severance packages displays a humanitarian quality for the employer, positively impacting the brand in the marketplace, which will prove important for future employees. Once the economy recovers and the labor market becomes competitive, candidates may ask, “How did you treat your employees during COVID-19?” Providing assistance through severance package design may help the organization compete for talent in the future.
Design components of severance packages

There are many things to consider when designing a severance package, including:

- Who is eligible for severance
- What to include in the severance package
- How to calculate severance payouts
- What method to use for payouts (e.g., lump sum or normal payroll schedule)

Eligibility

As of 2019, all employees at most organizations (80%) were eligible to receive severance pay, while the rest differentiate eligibility by level e.g., full-time vs part-time salaried employees, full-time vs part-time hourly employees, temporary or seasonal employees, and contract employees.

What to offer

There are several features to consider including in a severance package. The most common is the pay itself, which 95% of companies offer (see Figure 1). Outplacement services like resume development, job searching techniques and interview coaching are another popular feature in severance packages today, with 91% of companies offering the services. Less prevalent severance benefits include health benefits, which are offered by 57% of organizations and unused PTO reimbursement, which is offered by 48% or organizations. Other options include stock acceleration (33% of companies offering), bonus acceleration (33% of companies) and tuition assistance.
Calculation of severance payouts

Almost all organizations (95%) use length of service to calculate severance payouts, and half (50%) also include salary/grade level in the determination — an increase from 2017, when only 29% of organizations used salary/grade level in their calculations (see Figure 2). The number of organizations that negotiate severance individually with employees has decreased 14% since 2017, with only 10% negotiating payouts individually in 2019.
Almost half (45%) of organizations’ severance pay includes two weeks of pay for every year of service, an increase from 29% in 2017 (see Figure 3). Only 10% of organizations offered more than four weeks of pay for every year of service, a decrease from 24% in 2017.

Q – “How Many Weeks of Pay Do Most Employees Receive?”
Percentage of Organizations

Source: 2019 Pulse on Severance, 2017 Severance Quick Poll
ID: 725809
Method for determining payouts

Organizations can either use lump-sum payments for severance payouts (60% of companies) or incorporate them in their payroll schedule (40% of companies). A rare third option is to offer employees the choice of continuation of payroll schedule or a lump sum.

Conclusion

Severance package design is something that many organizations will address during the COVID-19 outbreak. Although it is an unfortunate reality, organizations can develop offerings that will make the layoff more bearable, impact the morale of surviving employees and positively influence perceptions of future candidates.
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