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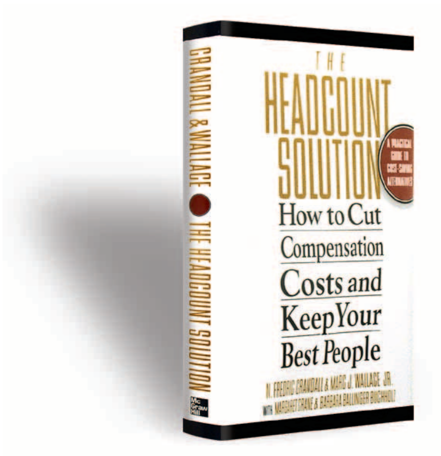

By N. Fredric Crandall & Marc J. Wallace Jr. with Margaret Crane and Barbara Ballinger Buchholz

How to Cut Compensation Costs and Keep Your Best People

THE HEADCOUNT SOLUTION

THE SUMMARY IN BRIEF

Almost every company will someday face a crisis that requires cost reductions that cannot be remedied by simply cutting back on office supplies. Real cost reductions often require drastic measures, and to many leaders, "drastic measures" equal "layoffs." In truth, layoffs should be the last resort of any company requiring deep cost-cutting measures.

The authors of The Headcount Solution *present a seven-step plan for cutting compensation costs. In this plan, summarized below and explained in detail in the following pages, layoffs are just the third of three cost-cutting strategies. If layoffs become necessary, the authors provide hints on treating employees with respect and dignity, and keeping valuable employees in the organization.*

The Headcount Solution *shows how to make cost-cutting decisions count, and quickly get your business on the road to recovery. Turn the page to begin the first of the seven steps to effective compensation cost reductions.*

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What You'll Learn In This Summary

The Headcount Solution involves the following seven steps:

✓ **Prepare** your organization for what's in store.

✓ **Plan** for three rounds of compensation cost cutting.

✓ **Decide** whom to cut and whom to keep, using objective criteria and real business data.

✓ **Implement across-the-board cuts** in several key areas in an effort to significantly reduce the number of layoffs.

✓ **Implement alternative work arrangements** — including job sharing, contracting arrangements, furloughed off-site net workers, and temporary assignments for strategic projects.

✓ **Implement layoffs** as a last resort, and do so in a way that preserves the workers' dignity and hireability, and sets your organization back on a path to success.

✓ **Help survivors cope** — move forward and get back to business as quickly as possible.

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Step 1: Prepare Your Organization For What's in Store

Once the senior leadership of a company recognizes the full extent of its business crisis and its associated cost-cutting measures, they must communicate the seriousness of the situation to the organization. Such communication requires time and effort, but it needs to be done quickly, thoroughly and accurately to counteract the rumors and distrust that typically accompany uncertainty.

Five Guidelines for Delivering the News

The following guidelines can make sharing bad news less stressful, for both managers and employees:

- **Communicate frequently,** to get employees in the habit of hearing about changes in the organization. Cost cutting is easiest if employees understand why the changes are necessary, how many will be affected, in which areas and departments, and at what levels. Some organizations find direct, one-on-one communication between management and employees to best serve their needs in these situations; others prefer broadcast options, such as e-mail; still others combine direct and indirect communications to provide employees with as much information as they can handle.
- **Devise a clear, consistent communications plan** to disseminate news to the entire organization, negating the spread and influence of rumors. Make sure your organization has an "official" news source—a single spokesperson or department—tasked with getting the right messages to the right people at the right time. You should also have a communications action plan that establishes the appropriate protocols and channels through which information is disseminated.
- **Decide whether a member of the Human Resources department or a company attorney should be present,** in the case of job cuts. Determine whether you require the expertise of a legal or HR professional when delivering bad news. Some companies swear by the practice, while others claim it sets the wrong tone.
- **Provide the facts needed** and never make a promise that cannot be kept 100 percent. Telling the truth to employees always works best, whether the news to be shared is good or bad. To exaggerate or understate the way things are can result in lost trust of leadership, disengagement from the company, low morale, and decreased productivity.
- **Follow up by periodically checking the pulse of employees** and seeing whether survivors continue to remain with the company. Walk around and speak with your employees, to find out how they feel not only on days when messages are delivered, but also afterward and on a continuing basis. ■

For Additional Information on what not to do when delivering bad news, go to: http://my.summary.com

For Additional Information on putting together a communications action plan, go to: http://my.summary.com

Step 2: Plan for Three Rounds Of Compensation Cost Cutting

Whether caused by a downturn in the economy or the need to turn around a troubled company, the single most pressing demand on managers is to cut costs quickly. While one knee-jerk reaction would be to initiate layoffs immediately, taking such action can be detrimental to an organization in many ways.

The headcount solution calls for a cost-cutting strategy that consists of three rounds:

Round 1: Across-the-board cuts (Cutting costs without laying off people).

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Find out more about the Headcount Solution at www.TheHeadcountSolution.com.

For Additional Information on the authors, go to: http://my.summary.com

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Step 2: Plan for Three Rounds Of Compensation Cost-Cutting

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Round 2: Alternative work arrangements (Finding alternatives to traditional employment that enable the company to cut compensation costs, yet hold onto mission-critical talent).

Round 3: Layoffs (If costs remain to be cut after the first two rounds, laying off those employees necessary to achieve the cost-cutting requirement).

Round 1: Across-the-Board Cuts

The first step in your cost-cutting strategy requires that you list your current compensation costs — such as salary costs, salary/benefits costs, overtime, and so forth. Determine then what cost-cutting steps you can take to avoid laying off people. This requires planning — it cannot be done overnight. You might, for example, offer an early retirement package to employees who meet certain criteria. You can cut out overtime, or reduce perquisites and annual salary increases and bonuses.

When making these Round 1 cuts, you must keep the following in mind:

- Be explicit about when costs will come out. Will it be all this year, or spread out over a longer period of time?
- Do not violate any employment laws, regulations or contracts when taking out the costs.
- Communicate why the costs are coming out, and what benefits the company will see as a result.
- Identify costs that will not only come out now, but ones that will stay out indefinitely.
- Establish conditions under which removed costs can be reinstated, when appropriate.

Round 2: Alternative Work Arrangements

The second step in cost-cutting requires that you look for alternatives to traditional employment that enable you to remove compensation costs, yet retain the talent you need to meet business objectives. You might implement job sharing (if people are willing); bring in employees on an independent contractor basis; move people off-site, or allow them to work from home; or get employees to agree to work on a temporary or special assignment basis.

Round 3: Layoffs

The last resort to reducing operating costs is a layoff. By laying off employees, you receive the benefit of compensation cost reduction, but you run the risk of losing the talent you need to run your business. Indeed, there are both short- and long-term costs and cost savings to balance:

Short-term savings and costs. There are immediate benefits as you save on salary, benefits, incentives, and bonuses. There is, however, a price to pay in the fulfillment of obligations to the laid off employee, such as accrued vacation, outplacement service costs, severance and benefit continuation, and other real costs.

Long-term savings and costs. When the cost crisis is over, layoffs diminish excessive employment costs, yet few companies that lay off employees experience long-term benefit as a result of the employment cost reduction.When you let employees leave, you let their experience and expertise leave as well. You lose the investment (in training, customer relationships, and so forth) that your company has made in the employee, and incur additional costs to replace their presence on your team.

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Best Practices for Downsizing

Following the seven steps in the headcount solution will not only reduce layoffs, it will also ensure that your company has gone through the appropriate actions required to retain critical human capital, and will lead you on the road to a healthy rebound and recovery.

Indeed, the companies researched by the authors who employed the headcount solution exhibited a number of best practices in times of cost cutting and downsizing. Among those practices are the following:

- Begin with a simple and direct plan. Clearly state where the company is headed and how it will resolve the crisis.
- Make sure senior leadership is capable and committed. Senior leadership must participate actively in the headcount solution, and must ante up sufficient resources to see it through.
- Create incentives to motivate and keep people through the crisis. Give people the incentive (cash, when available) to reach the goals of your recovery plan.
- Make any compensation cuts across-the-board. Sacrifices should not be relegated to staff; leadership must be willing to take a hit as well.
- Follow all legal and regulatory guidelines. Legal violations in corporate cost cutting are almost always caused by sloppiness. Be vigilant.
- Include employees in the cost-cutting process. They often will have great ideas that would not occur to management.
- Act boldly, quickly and decisively. You cannot avoid issues and succeed. Waste no time trying to get around the inevitable—face it and move forward as quickly and efficiently as possible.
- Motivate your survivors. Set a positive example for those who remain after a layoff.

Step 2: Plan for Three Rounds Of Compensation Cost-Cutting

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Think Before You Cut

As a manager and leader, you must recognize that, even in the short run, you will pay some cost to lay off staff; those costs could, however, pale in comparison to the long-term detriment your company sees as a result of letting people go. ■

Step 3: Decide Whom to Cut And Whom to Keep

The goal of the headcount solution is to remove costs while holding on to the talent needed to make the company thrive again. Thus, once you've planned for the three rounds of compensation cost-cutting, you must then decide whom to cut and whom to keep. The decision is best made in three steps:

Step 1: Establish Human Capital Priorities

When faced with the pressure to lay off staff, you must first consider the needs of your company and what is in its best interests. With regard to human capital, you must quickly determine who is needed to keep your organization up and running.

Compile a list of strategic competencies your organization needs, then define the critical activities needed to accomplish your objectives. For example, if your business is tasked with delivering technology solutions, the critical activities in which your employees engage may include programming, operating system maintenance, network administration and the like. Use these competencies to assess employees and to make the tough choices about who goes and who stays.

Decide first who has the skills needed to maintain your organization's mission; who, within that group are your best performers; and who are long-term contributors. From these lists, select the people who should be cut, and the ones who should be kept.

Step 2: Determine the Appropriate Combination Of Alternative Work Arrangements and Layoffs

Your second step is to determine what alternative work arrangements are practical, in conjunction with layoffs, to result in the needed cost reductions and retention of human capital. Alternative work arrangements include job sharing, contracting arrangements, telecommuting and part-time special/temporary assignments.

When considering alternative work arrangements, you must make several considerations:

- Determine whether you're free to implement such arrangements without needing to go through a lot of red tape.
- Determine whether you have sufficient resources to implement a given arrangement quickly.
- Determine whether there is significant cost savings associated with a given option.
- Prioritize the alternative arrangements in order of feasibility.

Step 3: Match People with Employment Choices

Once you've decided what alternative work arrangements might work for your company, the final step is to match each of your employees with one of six employment options: retain the person as a full-time employee; job share; contractor; telecommuter; special/temporary assignment; and layoff.

Consider the transaction cost associated with each option listed — what percentage of an employee's salary it will cost to place him or her in a specific alternative work option. For example, a layoff might cost a quarter of an employee's annual salary, to cover severance, accrued vacation, and so forth.

Next, determine the net cost savings for each action. You will need specific information about the employee (current pay, performance ratings, job assignment, etc.) and the action in question (the needs required of each, costs, and so on). Assess the employee's proficiency in needed skills, and determine from that bulk of data how much will be saved by placing specific employees into specific assignments.

Once you have an idea into which categories employees will fall, you are ready to implement the three rounds of compensation cost-cutting, beginning with across-the-board cuts. ■

Step 4: Implement Across-the-Board Cuts

When facing a need to reduce operating costs, the first round of compensation cost cutting should concentrate on areas that impact broad groups of employees, rather than target specific staff. Layoffs should not be part of the picture at this early stage—they are disruptive and take time to implement properly.

Instead, consider implementing one or more of the

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Step 4: Implement Across-the-Board Cuts

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following ten across-the-board cost-cutting measures:

- **Voluntary severance.** Perhaps some of your employees have considered leaving the company, but resisted the idea for lack of push and funds. Such an incentive would provide them with both, while saving your company some compensation costs. You must, however, be aware of legal and regulatory issues surrounding such an offer.
- **Early retirement.** Offering an "early out" accelerates an employee's benefits related to retirement.
- **Shorter work week.** Reduce hours to be worked, and reduce base pay accordingly.
- **Mandatory pay cut.** Require everyone—even senior and executive leadership—to take an across-the-board cut in pay.
- **Stock options in lieu of pay.** Stock options can offer an incentive to remain in a company, particularly if a rebound is expected.
- **Reduction of perquisites.** Cut out company cars, expense accounts, retreats, travel and so forth.
- **Reduction or elimination of 401(k) contribution.** Reduce the dollar contribution and/or match to qualified retirement plans.
- **Reduction or suspension of annual pay increases.** Cancel all or part of a planned merit or across-the-board pay increase.
- **Reduction or suspension of bonuses and incentives.** Replace planned bonuses with bonuses contingent on turning around the business.
- **Hiring freeze.** Suspend hiring, but keep your eyes out for good people, with the understanding that once the company's situation improves, applicants will be considered. ■

For Additional Information on regulatory issues, go to: http://my.summary.com

Engaging Employees In Cost Cutting

Jennifer Edwards, director of human resources for World Now (a provider of Internet technology and revenue solutions) notes that her firm asked employees for cost-cutting ideas. Management felt that engaging employees in the decision-making process would result in changes with greater buy-in across the board. Teams of employees went off-site and brainstormed ideas to either generate more revenue or to reduce costs. Initial ideas were then researched, and the best 15 were sent to management and put into place immediately.

For example, the company had been outsourcing projects such as printing collateral materials. Because the firm designs Web sites, staff reasoned, why not leverage the expertise of the in-house creative team and manage the process internally? Savings were also shaved from off-site team-building retreats. Rather than spend thousands of dollars on such meetings, the company found less expensive, creative ways to get everyone together and maintain its culture, on a less expensive scale.

Because World Now engaged its employees in initial rounds of cost cutting, their solutions generated interest, motivation, and buy-in from the people most capable of putting those strategies into action.

Step 5: Implement Alternative Work Arrangements

Alternative work arrangements allow a company to retain critical human capital and at the same time reduce compensation costs. The results of such arrangements can be very rewarding and motivating to employees; it also helps the employer maintain its skill base and avoid separation transaction costs.

As stated earlier, alternative work arrangements tend to fall under four categories: job sharing, contracting arrangements, telecommuters, and special/temporary assignments.

Job/Skill Sharing

Job sharing and/or skill sharing involves reducing staff members to part-time status with the sharing of responsibilities and duties for a single job function. Job sharers must collaborate and communicate with one another, and can complete work on a common site or through telecommuting. Job sharing works best in any position or department, where work can be split between two or more individuals in a reasonable way.

The company benefits because the people and their skill sets remain in the company, while reducing the costs of compensation. Employees get to continue their income (at a reduced level) and maintain the relationship with their employer. They also get to learn new skill sets and post for other, full-time assignments, as those assignments become available. The cost to the employee is a reduction in salary.

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Step 5: Implement Alternative Work Arrangements

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Contracting Arrangements

Companies use contracting arrangements where there is a service that can be provided to an organization by an independent person, agency, or organization, more economically than employing the resources directly. Contracting arrangements are reasonable for services in areas such as accounting, human resources, marketing, or any other function where expertise is specialized and can be externally supplied.

Companies like contracting arrangements because they provide continuity of important services and maintenance of company-specific knowledge. Employees benefit because they continue to draw income from the company while maintaining their skill sets. Costs for employees, however, include loss of regular employment status and the expenses incurred when running a contract business.

Furloughed Off-Site Net Workers (Part-time Telecommuters)

Telecommunications technology makes it possible for staff to telecommute from home, checking in from time to time and remaining on call for short-term assignments or consultations. When not working, the employee is free to pursue other work assignments outside the company, within the boundaries of a noncompetition agreement.

The company benefits because it gets to retain critical skills and competencies, at the cost of an "on call employee" and some basic setup expenses, to get the employee "connected" from home. Employees, while dealing with reduced income, maintain the relationship with the company and are able to expand their professional networks by performing work for others.

Temporary Assignments

Companies can staff for strategic projects with employees with specialized skills, all on an "assignment" basis. Employees lose their regular jobs, but not their employment; in essence, "employment" becomes a series of part-time project assignments, with the employee filling the role of in-house consultant.

Once again, the company retains critical human capital at a reduced cost, and their important projects do not fall by the wayside. Employees replace their previous job with assignment status and reduced income, but they get to maintain their relationship with the company.

What to Expect

Alternative work arrangements should soften the blow of reductions and keep key people and skills needed for the company to thrive in the future. Some improvements you should expect include the following:

Sharp reduction in short-term separation costs. Every job saved will reduce separation costs by as much as 25 percent of annual salary.

Higher morale replacing fear and anxiety. You stand a much better chance of "rallying the troops" when you display the desire to maintain a core collection of people to succeed in the short and long term.

Reduction in future hiring and staffing costs. By keeping key people and skills now, future ramp-up costs drop significantly. ■

Accenture Innovates With FlexLeave

The consulting firm Accenture offered its employees an alternative work arrangement when it needed to cut costs. Workers had the chance to take a sabbatical at a nonprofit organization of their choice. For the company, this idea (dubbed "FlexLeave") was an innovative but risky way to cut costs and retain employee talent. The program began as a pilot for U.S. employees who had been with the company for at least 12 months. Roughly 1,200 of 17,000 eligible employees signed on for the opportunity. Although they received only 20 percent of their salary, they continued to receive benefits and have use of company laptops.

Step 6: Implement Layoffs

When all other cost-cutting measures have been taken and there are still financial problems to address, layoffs become a necessary evil.

Layoffs do not have to be acrimonious, if companies are upfront and honest about the reasons they are necessary, and if they follow all effective procedural rules and legal regulations. The company should lay off staff in such a way that the employees severed are not embarrassed in front of colleagues when they have to pack up and walk out of their offices and the company with their belongings.

Aside from these considerations, mishandling a layoff can result in huge costs to the company, both tangible and intangible. These may include expensive lawsuits, sabotage, and even violence in the workplace among disgruntled employees.

To deal with terminated employees in a humane, straightforward and effective way, observe the following rules:

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Step 6: Implement Layoffs

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Rule 1: Communicate in a Dignified and Respectful Way

Laying off an employee should be done with tact and dignity, to show that the company values its employees in bad times as well as in good times. Managers should make every attempt to not burn bridges; when it's time to ramp up again, the company might want to re-hire some of the staff it laid off. This means, in addition to offering a reasonable severance package, management should not bad-mouth a terminated worker, do anything that can be construed as illegal, or close the door to future employment.

Planning is also key. Companies that do not perform adequate planning for layoffs run the risk of letting essential personnel walk out the door. This could render that talent gone for good, or it could require the company to rehire or bring employees back on a contract basis, often costing the organization even more in compensation than it was paying previously.

Rule 2: Carefully Choose the Place and Time To Conduct the Layoff

Choosing the place and time for the termination discussion is a critical factor in the lasting impression made on those who will leave, and it contributes to the quality and dignity of the experience. Some companies prefer to tackle layoffs in one-to-one sessions; others prefer to communicate with a group of employees.

There are pros and cons inherent to both approaches. Individual meetings enable you to effectively and directly communicate with an employee, if the person communicating the news has the skill and presence of mind to keep the discussion on track and professional. Many companies have human resources or legal representatives present at such meetings, to avoid future claims. Also, the potential for confrontation increases considerably in one-on-one situations.

Group meetings enable you to deliver a consistent message to a number of people; they don't, however, provide for one-on-one contact. The more impersonal the setting, the greater the likelihood affected employees will experience distaste and sense of disrespect for the proceedings, and for the company in general.

Timing is important, as well. Timing can range from immediate notification with the requirement to leave the premises, to providing days to weeks of advance notice. There is no hard-and-fast rule for advance notice timing—much depends on the culture of the company, its current situation and its prior experience. A company that has a close and personal relationship with its employees should carefully consider the long-term implications of changing its "face" to employees in a layoff situation.

Proactive Damage Control

After a company conducts a layoff, the fallout can be damaging to the corporate image, notably with customers, suppliers, the community, and other persons and entities near and dear to the company's business. Companies that decide to deal head-on with the fallout from a layoff must explain to the public at large what is happening, by sending out press releases to all available wire services, newspapers, magazines, trade associations, customers, and any other appropriate sources. The release should cover the following:

✓ Why the layoff is needed
✓ When it will happen
✓ What the affect will be on revenue, profits, and new products and services
✓ How many employees will be cut (now and in the future)
✓ Whether management will undergo a change
✓ What other repercussions will result (hiring freezes, pay cuts, etc.)
✓ What the morale is of management and staff, and what will be done to improve it

Rule 3: Be Careful What You Say in a One-on-One Discussion

Most companies script their layoff discussion, or have professional staff present the news to employees. The reason for this is simple — the organization must ensure nothing is said that would haunt the company later. Managers involved in these discussions should not make promises they can't keep, such as hinting at hopes to rehire employees if the company has made no known provision for such a thing. They should not answer questions off-the-cuff, if they are unsure of the answers. They should also, at all costs, avoid confrontation with employees.

Rule 4: Abide by Legal and Regulatory Guidelines

There are definite ways to avoid legal pitfalls. Before conducting layoffs, compile a list of who is to be laid off, secure personal evaluations and other relevant data regarding those on the list, determine final severance packages far in advance, know and abide by federal and state regulations, and be sure the criteria used to prepare for the layoffs are uniform throughout the company. In other words, construct a plan that benefits rather than

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Step 6: Implement Layoffs

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hurts the company. Be fair, open, and honest toward employees, keeping your organization's reputation intact and avoiding the pitfalls of costly legal battles. Among these pitfalls are the following:

- **Worker Adjustment and Retraining Act (WARN).** If a plant closing is imminent and involves layoffs, the federal WARN act protects employees from plant closings and layoffs without notice. You must give at least 60 days notice to affected employees, their representatives, and state and local officials, if you intend to shut down your facility, resulting in unemployment during any 30-day period for 50 or more employees. You are covered under WARN if you employ at least 100 full-time workers on staff.
- **Employee discrimination.** The Equal Employment Opportunity Commission (EEOC) protects employees against unlawful discrimination in cases of layoffs and terminations. Regardless of how many employees are laid off, your company must use uniform criteria and be able to defend those criteria in making layoff selections. If your layoff affects one group more than others disproportionately, you should scrutinize its provisions under the regulations set forth by the EEOC.
- **Older Workers Benefit Protection Act (OWBPA).** This provision requires companies to communicate with older employees regarding their rights when offering severance or early retirement packages. When employees are offered these special severance arrangements, they should be asked to sign a waiver absolving your company from future claim on employment discrimination.
- **Unions.** Federal laws protect unions and their collective bargaining agreements. Employers cannot nullify valid contracts, and must follow the provisions specified in those contracts for layoffs. Most collective bargaining agreements require layoffs in reverse seniority, resulting in the inability on the company's part to retain workers with superior skills but less seniority.

Rule 5: Immediately Attend to Survivors

The patience of top performing employees who remain after the layoffs can wear thin if they are subjected to successive additional layoffs after the initial one. Retaining talented survivors is likely to be more difficult with each successive cut. Good employees will see the writing on the wall, and will address their insecurity by finding work elsewhere.

To build credibility after a layoff or a second or third round of cuts, company leaders should take three steps:

- Continue frequent communications regarding progress the company is making.
- Support the communication with rewards and recognition for top performers.
- Begin rebuilding on the valued knowledge and skill remaining in the company. ■

Step 7: Help Survivors Cope And Get Back to Business

Companies will be shocked and shaken by cost cutting and reductions in force, but there are steps to take to regain momentum and rebuild. After conducting cost-cutting measures, take control of the situation and turn the corner to recovery by doing the following:

- Do not forget the needs of the survivors. Offer your survivors outlets to express their feelings and treat them with honesty and integrity. Make sure they know they're valuable to your business.
- Concentrate on rebuilding employee loyalty and morale. Continue to communicate with your employees, provide incentives, and reward your top performers, even after the crisis is over.
- Be creative with work assignments. Emphasize new opportunities that have the potential for long-term profitable growth. Focus on your organization's strengths and bolster them with human capital.
- Create ways to keep laid-off employees connected to the company. Try to bring back those laid off as soon as possible, once the company turns around financially. Massive layoffs translate to lost sales if demand ramps up quickly and you do not have the personnel to meet that demand. ■

How to Bolster Human Capital

When searching for creative ways to keep employees engaged through alternative work assignments, consider the following:

✓ **Take the opportunity to cross-train employees.** Allow employees new opportunities to learn and test their skills, building on the foundation of their existing knowledge by providing training and experience in a new area.

✓ **Shift the focus to results.** Alternative work arrangements shift from paying people for their time at a desk to paying for what is produced. Employees don't have to be visible or working a 40-hour week to do what needs to be done; they can produce on their own, if properly motivated.

✓ **Jump-start projects.** Put creative people in teams to tackle a development or improvement project.

✓ **Lead with optimism.** Senior leadership should balance current problems against the future for the company and anticipate a successful turnaround.