Managing an Organization's Biggest Cost: The Workforce

Key insights delivered through a familiar tool, the organization chart

Introduction and Background:

Today's economy has <u>finance professionals and CFOs</u> in organizations large and small focused on efficiencies and costs. When revenue growth flattens or even declines, profit maintenance and increases must come from cost efficiencies. In most organizations, including large organizations such as the Fortune 500™, **total human capital costs, also known as total cost of workforce, average nearly 70% of operating expenses.**[1] *(see total cost of workforce defined*[2]*)*. While an organization's total cost of workforce percentage may vary, with few exceptions these costs remain the single biggest organizational expense. Given their fluid and rapidly changing nature, workforce costs are extremely difficult costs to manage and control.

There are a number of reasons why effectively controlling or managing the total cost of workforce is difficult. When growing, a typical organization's primary workforce cost management tools usually consist of the rather archaic annual budget and new hire signature approval requisition processes. When an organization is shrinking, they frequently turn directly to layoffs. Neither is a particularly attractive option. Simply put, organizations lack tools with which to surgically manage, tune or optimize their workforce.

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In dynamic rapidly changing businesses, annual budgets can quickly become obsolete and therefore become more of a bureaucratic obstacle than effective cost control tool. Also, while finance may like to believe otherwise, expecting line managers to accurately predict full time equivalent headcount (FTE) and workforce cost across multiple scenarios at least a year in advance, seems unrealistic. Particularly in complex, service driven, technical and professional functions, line managers may not know exactly how many workforce resources they will need and are even less likely to know exactly what such resources will cost in the market.

The typical organization's next line of defense in workforce cost control is the new hire signature approval, or requisition process, or else the use of "position control" in organizations with large enterprise resource planning systems. Again, neither of these are particularly attractive options. For hiring, tools to evaluate a new hire or replacement often point back to the problematic budget process, or entail the politically and bureaucratically challenged "justification for signoff" process. For example, while an executive or CFO can demand a strong justification for a newly created position, executives championing the new position learn to use recent CEO initiatives such as business risk mitigation, customer service level improvement and other justifications. These typically work for the task at hand and secure the justification, but lack a clear return. Position control in complex organizations often requires adding significant headcount and workload such that the cost and complexity of the controls mitigates any savings from its use.

More troubling is the replacement hire for a position recently vacated. Instead of a simple one-to-one replacement, the position now may be argued requires a significantly more experienced and expensive replacement or must be split into two or more separate positions. The cost implications are difficult to manage in the traditional process.

Additionally, neither the budget nor the new hire requisition processes adequately manage or control contingent labor costs such as temporary or contractor costs. In fact, executives can use the budget process to justify the cost of temporary hires to cover for open or delayed hiring of positions and also use all the elements of the "justification process" for acquiring contract resources.

The net result of these inefficient cost controls in the hiring process is often a general inability to effectively control and manage workforce costs throughout growth periods. Over time, costs get out of control and management is forced to turn to their last line of defense - directives such as a "hiring freeze" or "reduction in force" or "layoff."

In today's economy, using layoff's and re-organizations to reduce workforce costs is commonplace. The problem with layoffs it that is they are both expensive in the short term (termination costs), and potentially even more expensive in the long term if either the wrong amount of labor is cut or if the wrong positions or individuals are cut.

For example, a technology organization looking to cut workforce costs by 10% that lacks workforce insight into critical job roles[3] *(see definition of critical job roles)*, optimal manager span of control, and visibility into replacement costs is unlikely to make wise cost reduction decisions. A company, in trying to be fair and "share the pain" could end up cutting critical job roles, such as engineers, who are essential to company growth when business improves again. The fact that an engineer costing $100k annually was cut and later replaced by a new engineer costing $130k annually is invisible to the organization. If this scenario is repeated many times, CFOS will actually be losing ground in the struggle to control workforce costs on both a per headcount and total cost basis.

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What seems missing from this picture is the capability of top management, finance and HR to systematically assess and surgically implement workforce cost management practices at a level below the company wide mandate but above the individual manager level.

While the CFO or finance department may indicate that they know what the total cost of the workforce is, it is highly unlikely that they know how costs relate to the most valuable segments such as high performers, critical job roles, and tenured employees. More shocking, they do not know how much of workforce costs are sub-optimized on low performers, non-critical job roles, low tenured employees not yet fully productive, or are tied up in the cost of vacant positions. For most organizations, it is a struggle to identify both number and total cost of the contingent temporary or contract workforce within an organization.
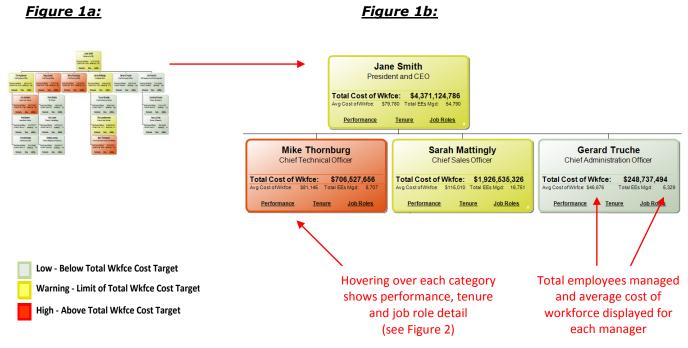
What organizations need is a straightforward way to manage workforce costs. What gets measured gets managed, therefore if there were a simple way to review, evaluate and adjust workforce headcount and cost information frequently or on a near real-time basis, perhaps finance and HR could truly control workforce costs. General ledger systems and budget tools manage cost centers, not people and spreadsheets. Finance's tool of choice, complex workforce spreadsheets are difficult to update and fail to keep up with constantly shifting organization structures. As a former accountant and finance executive, I can

attest to those in accounting and finance who spend many late nights poring over detailed spreadsheets attempting to do just that.

While there is justifiable reluctance to add yet another tool to the organization, what if it were possible to use or expand the use of an existing tool that every organization already has and which is specifically created to focus on and clearly illuminate workforce issues: organization charts.

Organization charts have aggregated headcount and clearly identified the formal supervisory structure for decades, but today's digital technology means they can also be utilized to aggregate workforce costs and other metrics as well. With a new window into detailed workforce costs finer than the traditional department/cost center structure, HR and finance could analyze and pro-actively identify solutions to the cost issues organizations face.

Figure 1a: **Figure 1b:**

Note: Organization Chart technology provided by OrgPlus from Human Concepts

Why organization charts? How can embedding workforce cost information in organization charts really highlight workforce issues and costs? How does the organization chart differ from managing at a cost center/department level aside from the obvious visual differences?

The best way to discuss using organization charts to manage workforce costs may be to just show examples visually of how the process can work (s*ee Figure 1a and 1b below).*

In *figure 1a and 1b*, total cost of workforce is shown, broken down by manager. The detail shows total employees managed as well as total and average cost of workforce. Using customizable color code formats, one can easily spot outliers and drill into the organization to identify root causes. In the example above, CEO Jane Smith could quickly see that the Chief Technical Officer, Mike Thornburg's, group is causing her organization to be above target in workforce costs.

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Due to their visual nature, organization charts have several advantages in managing workforce costs and metrics, such as:

1. Intuitive at-a-Glance ability to visually assess the workforce, managers and employees both in aggregate and individually on key workforce dimensions.

2. Org-charts are better than cost center/department structures for managing, classifying and enabling decisions about workforce cost for the following reasons:

   a. The ability to understand cost issues at the individual manager level, which is particularly valuable when multiple managers occupy the same cost center.

   b. The ability to analyze the workforce and managers using performance level, compensation element (e.g., salary, bonus, and benefits), tenure and job role among other analysis options.

   c. The ability to calculate additional metrics and measures that roll up the organization structure and use color coded conditional formatting to spot issues.

3. Organization chart cost data can be tied to both managers and individuals, enabling near real-time "what-if cost scenario modeling" for reorganizations, layoffs, acquisitions, or divestitures.
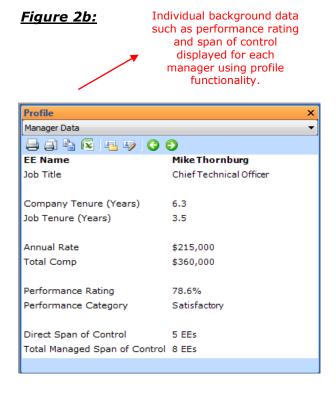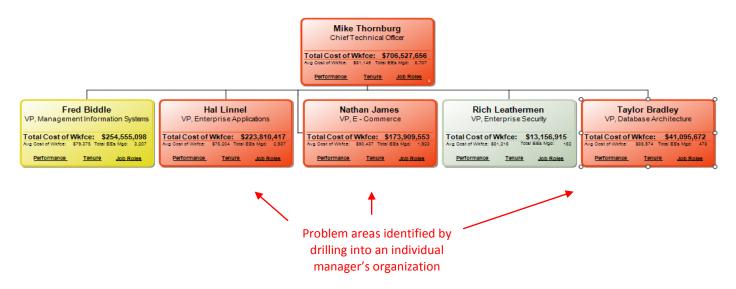
Figure 2a:

Figure 2b:

Individual background data such as performance rating and span of control displayed for each manager using profile functionality.

Detailed cuts for each manager's employees displayed with hotspot functionality.

Figure 2a and *2b* show highlighted hotspots and profile popup information that can be shown for each manager's organization down to individual employee level. A profile can summarize key workforce data on virtually any workforce dimension, as in *figure 2a* showing number of employees managed and total cost of workforce by performance rating level. Also, *figure 2b* shows individual demographic at-a-glance information, plus span of control and cost information.

In *figure 2c* CEO Jane Smith drills into Mike Thornburg's group and can clearly see that Mike has several problem staff areas in terms of workforce cost vs. targets. Now Jane can implement a "surgical" hiring freeze and have Mike work with his managers to conduct a root cause analysis and address total cost of workforce. From this analysis, they could choose to increase spans of control, forgo replacing future turnover, limit salary increases or bonuses, among other surgically implemented interventions.

Figure 2c:

Problem areas identified by drilling into an individual manager's organization

Note: Organization Chart technology provided by OrgPlus from Human Concepts
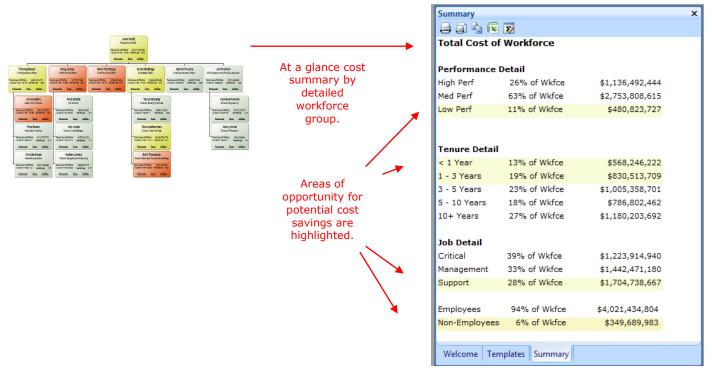
Jane can utilize summary level analysis and what-if modeling to drag and drop potential organizational changes. Metrics will automatically recalculate to show the revised total cost of workforce. This capability to monitor and fine tune total cost of workforce across various dimensions or key demographic criteria is a further step toward workforce optimization.

Another use of contextual workforce information is for the CFO or head of HR to have a summary as shown in *figure 3b (following page),* highlighting both percentage and total cost of workforce across multiple dimensions. This can in turn highlight savings opportunities across performance, tenure and non-critical job roles. *(see figure 3a and 3b on the following page)*

Figure 3b shows a total cost of workforce summary for "Jane Smith" the CEO of the example large scale technology business shown in the charts. This summary shows important ways to cut or breakdown workforce cost information so that

Figure 3a:

Figure 3b:

At a glance cost summary by detailed workforce group.

Areas of opportunity for potential cost savings are highlighted.

finance or HR professionals can easily spot how much of the total workforce costs are potentially sub-optimized. The examples noted above in red show total cost of workforce summaries for low performers, workforce tenure less than both one and three years, support job roles (defined as non-critical and non-managerial) and contingent or non-employees as a percentage and total cost of workforce.

Of course there are other considerations that must be taken into account around managing and making workforce decisions. Important considerations to include when considering the addition of key workforce information and costs into company organization charts include:

1. Clear accountabilities, governance and oversight in loading managing and analyzing workforce cost and other information via digital organization charts.

2. Leveraging role-based security to automatically update the org chart ensuring that information flows appropriately and that no sensitive employee information goes to unauthorized parties.

3. Frequency of information updates. Should information be updated in near real-time with changes to the workforce or reporting structure or on a less frequent basis (weekly or monthly) such as for cost and financial information, or both depending upon the information type.

4. Data sources to consolidate and upload to the organization chart. Multiple data sources can be consolidated to feed information into the organization chart such as

the upload of simple data elements or metrics upon which additional calculations can be made.

Ultimately, the possibilities are limited only by data availability and input metrics. Additionally, the most advanced capabilities allow users to calculate additional metrics and combined indices in the tool itself, creating powerful, issue-based measures that recalculate and update as the data is refreshed.

Case Study - Span of Control at XYZ Corporation:

XZY Corporation, a large fully integrated technology manufacturer and seller paid a top tier consulting firm several million dollars to analyze and recommend a series of changes across the organization. They increased the overall manager span of control from an average of 4 to 1 in terms of employees supervised per manager to an average of 5 to 1, netting the company nearly $150 million dollars annually in savings by eliminating 1,000 manager positions across the company at various tiers in the organization at an average total workforce cost per manager of $150,000 each. However, what is noteworthy is that if XYZ had in place a digital organization chart using similar metrics as shown above, they could have achieved the same cost savings on their own, thus saving an additional several million dollars while building credibility internally and embedding cost control DNA further into the organization.

Summary and Conclusions:

With the integration of basic cost data and metrics into today's digital, online organization chart technologies such as HumanConcept's OrgPlus software, it is possible to visualize, and therefore effectively manage, total workforce costs, ultimately resulting in better workforce strategy decisions.

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Instead of applying workforce strategy like peanut butter across the organization, embedding workforce cost information and metrics into organization charts creates a workforce analytic capability and focus that allows users to more effectively identify and execute specific workforce cuts, re-organizations, and acquisitions and divestitures. This capability enables both thorough and thoughtful risk management and identification of unrealized opportunities for cost savings.

Without the appropriate level of analysis and tools, there can be a continuing wake of destructive activity as organizations move from one extreme in over hiring to the other of recurring layoffs and reductions, much like a binge and purge bulimic cycle, destroying company health over time.

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[1] Cited from a 2006 SHRM survey of over 700 companies including a significant number of Fortune 500™ companies and corroborated by a study at the Brookings institute.

[2] Total Cost of Workforce (TCOW) is defined as the total costs of all salaries, wages direct and indirect cash or equity compensation for all employees. TCOW includes all costs for contingent temporary or contract workers whenever the organization primarily directs the work of such labor. For example, offshore employees who work in a separate legal entity that is 50% or greater controlled by the organization should be included in the total cost of workforce. TCOW includes all company provided or paid employee benefits, perks and rewards. Such costs also include all company retirement related costs for both current and former employees. TCOW includes all enterprise training costs provided to employees and or contingent labor. All recruiting costs not already included incurred as workforce acquisition costs. All employee relations, severance and legal settlements paid to current and former employees or contingent labor.

[2] Critical job roles/families for purposes of this article are defined as those roles excluding management, separately noted as a critical role, which the organization can show is critical to both current and future company growth and without whom the company would be either unable to grow or to retain its' current level of performance and profitability. Critical job roles are not defined on an individual basis but rather on an aggregate group basis. For example, a given organization may deem that its' direct sales force is a critical job family and that its' information technology developers are also a critical job role/family, since the first group directly drives revenue and influences pricing while the second group provides the tools, technology and potentially even product for the sales force to sell. While accounting professionals may be very important to a company and certainly a CFO is a key individual role, unless the accounting organization directly drives revenue as in a CPA firm or directly drives or influences, product, pricing or profitability, they are not a critical job role as an aggregate group.