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FedEE guide to HR during business cycles

At the low point in the business cycle, most companies seek to cut employee costs. But what are the best approaches? And how can common mistakes be avoided?

It is firstly important to take note of the bigger picture:

- Business cycles at a national (and international) level tend to operate in regular patterns. Economic growth wavers around central trend line with a significant peak in the cycle every 5-7 years. There have been few periods in human history when the economy has actually shrunk - the most notable being the Great Depression of 1929-30 and the slump of 2007-12. When economists talk about recession, they usually mean that GDP has fallen over a period of at least two consecutive quarters. FedEE also uses a definition whereby industrial or manufacturing production has fallen in at least five of six consecutive months in a row, with the final figure not indicating an upturn. But GDP changes can be deceptive and a contraction in an economy can arise simply because of a fall in tax receipts or due to the poor performance of a single sector - even though other sectors continue to grow.

- Since WW2 the average length of an expansion in a business cycle has normally been three to four times longer than a sustained downturn. Expansions have tended to last between 3 and 5 years, whilst downturns have been as short as 12-15 months. The 2007-12 downturn was very much the exception and largely arose because employers in general were reluctant to make large scale redundancies and cut pay rates. This led to a fall in productivity and the absence of internally generated funding for capital investment.

- The pattern of expansion and contraction in an individual firm may differ significantly from the business cycle as a whole. A great deal will depend upon the nature of the firm's business and whether it tends to do well or badly as the general economic climate changes. Manufacturers of capital equipment are, for instance, amongst the first to suffer at the outset of a general downturn, but maintenance companies may continue to flourish well into a recession as their customers seek to extend the lives of their existing capital equipment.

- Individual companies may also be subject to seasonal fluctuations that complicate (and sometimes mask) the underlying cyclical trends. It may, for instance, be very difficult to detect a genuine downturn in the tourist industry if it occurs immediately after the summer holiday period.

- Because expansion periods have tended to be much longer than contraction periods, each has tended to induce quite different sets of behaviour amongst employers. The length of an upturn may lull managers into a condition of over-optimism about the future and companies frequently over-recruit during the latter stages of a period of expansion. At the beginning of a major downturn, however, it takes time for managers to adjust their horizons to a new state of austerity and recruitment often continues to take place even after the economic fundamentals have

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changed. The longer this misreading of circumstances occurs the sharper will be the need to reverse behaviour when it comes.

- In the same way that a long period of business expansion generates over-optimism, the sharp nature of an economic downturn tends to generate an over-pessimistic reaction. Sudden declines in turnover and profitability may appear to have greater significance than normal events in a business cycle. Stock market speculation frequently compounds this problem as 'bear traders' persuade private investors to panic and share prices are depressed below their realistic levels. Thus, up until the 2007-12 downturn companies generally offloaded more staff during downturns than they would it they took into account the nature of cyclical trends. This has led to high quality staff being terminated simply because of a 'last in, first out' redundancy policy. The whole process in the UK was further exacerbated by bottom-line pressures to reassure shareholders that the business remains sound and that adequate dividends will still be paid. On the European Continent, however, many governments gave financial subsidies to allow paid short-term lay-offs and companies were encouraged to explore new markets for their products when staff could be released from operational roles to assist with marketing. Companies also took steps in the last recession to address longer-term changes in their business - like Royal Dutch Shell and Exxon Mobil - who both focused on cleaner-burning fuels.

- The increased costs of unnecessary recruitment and redundancy have had a significant impact upon company profitability and future growth prospects. The process has also taken up management resources that could otherwise be directed at more important operational issues.

The logic of downsizing

Every company needs to take periodic stock of its manpower and skills mix. Downturns act as a convenient imperative to optimise productivity and go back to basics. However, downsizing is a skill that HR managers have to relearn every five to nine years and which they will usually have acquired through trial and error rather than formal training. It is not a subject that many managers contemplate with relish and therefore little shared knowledge has developed either within or between companies on the best way to carry it out.

Guidelines for completing a successful downsizing exercise:

- It is rarely effective simply to issue cost-cut targets and deadlines to departmental managers. Most will need help in carrying out the selection of jobs to be cut and many will prefer to apply a simple formula (such as last in, first out) or will look to achieve short-term goals at the cost of the longer term interests of the organisation. In many countries (such as Germany) it is a legal obligation to select candidates for redundancy using objective criteria. These criteria may include personal factors such as family size and employability. Employers must also be careful not to discriminate on the basis of age, gender, marital status, disability, sexual orientation, race, ethnic origin, nationality or religion when applying selection criteria. In fact, disabled employees and

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those nearing retirement often enjoy a higher level of de facto job protection than other employees.

- Some cost savings may be achieved by cutting back on the use of temporary or agency workers, but this may not be practicable where cover is being provided for permanent staff on maternity or sick leave.

- If incentives are offered to managers for maximising cost savings, they should not be payable until at least twelve months after the cuts have be made and should also take into account any subsequent readjustment (re-recruitment) that occurs. This helps to prevent managers from taking too draconian an approach to downsizing and also encourages them to remain with the business to see their changes take effect.

- To the extent that the law allows, the starting point for any downsizing exercise should be a review of the existing organisation chart. A rationalisation project will be a good opportunity to flatten out the organisational hierarchy and remove narrow spans of control where, for example, just two or three people report into a managerial position.

- The next recession will be a good opportunity to review the potential for automation in areas not previously touched by expert systems. In many cases labour savings can pay for a lasting level of personnel reduction. It is also a time when HR should be spending time on matters that they have little time to attend to when activity is high - this is particularly legal compliance and the updating of HR policies.

Other prime targets are:

- Posts created by a desire for organisational symmetry or neatness ("They have one, so I want one too"). These include deputy posts, or status levels that always command an exclusive secretary/PA.

- Functions that could be readily outsourced, or carried out through a management buyout of the activity in question.

- Posts left over when a function has been outsourced. Why does the organisation need a residual department in this area?

- Tasks that are carried out on a full-time basis that might be more cost-effectively fulfilled through the creation of a part-time post. The full-time jobholder may not be able to be declared redundant, but they may be successfully redeployed.

- Tasks that were assigned a permanent staff member, but which could be conceived as a series of discrete projects and thus be carried out by someone on a fixed-term contract.

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- Posts retained after the take-over or merger of another business, but which are now free from the constraints of 'transfer of undertakings' employment security rules.

- Areas where current functional boundaries are reducing effectiveness. For instance, the existence of technical support positions in sales departments when the tasks carried out could be more credibly and effectively performed by a shop floor engineer or production supervisor.

- Most large companies develop an over-reliance on external lawyers and allow costs to build during an up-turn. Increasing the use of legal services provided by FedEE is one way to cut such costs.

- In international enterprises, downsizing may also provide an opportunity to remove operations from countries where employment constraints have become too onerous. One example is France and Spain, where changes in employment legislation are making operations more bureaucratic and inflexible. Provided that any necessary works council consultation procedures are carried out to the letter of the law and PR repercussions are handled in a professional way, the rationalisation of international operations could prove to be a worthwhile longer-term investment and a useful focus for downsizing activities. For example: where the rationalisation concerns only sales staff, the problems of geography might be readily overcome by conducting sales visits on a short-term deployment basis from a sales office in an adjoining country.

Who should carry out the redundancy dismissals?

In many companies the roles of the HR function and/or corporate lawyers are restricted to advising line managers on the conduct of redundancy dismissals and handling the detailed administration of dismissals that have already been decided. This can give rise to problems as individual managers lapse into favouritism, ignore important contractual clauses (such as non-competes) or seek to skirt round statutory obligations. They may not be able to judge when it is essential to involve internal counsel and their failure to do so will almost certainly result in a string of unnecessary litigation at a difficult and sensitive time for the business.

The wisest approach is to make the downsizing process an area of joint accountability in which the HR adviser and/or corporate lawyer plays a central role. In addition to following appropriate legal procedures, it will also be important to ensure that:

- Termination interviews are conducted in a legally compliant, humane and responsible way.

- Information, consultation and codetermination procedures are carried out according to both national laws and practice and any applicable collective agreement (s).

- All affected individuals are aware of their statutory rights and any enhancements to statutory obligations that are provided through the company's redundancy policy.

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- Policies are followed in a consistent way so that costly precedents and discriminatory decisions are avoided.

- Support is provided to assist redundant staff in coping with the transition and securing fresh employment.

- The timing of individual redundancy announcements does not undermine current projects.

- The redundancy programme has the minimum adverse impact upon the employee relations climate and does not damage overall morale in the company.

Postscript

With the arrival of every new task comes the question: Is it more cost-effective to achieve a desired goal through capital investment or through human labour?

It has been shown by many academic analyses that capital is around four times more successful in generating value added than a purely human solution. Thus, as companies become more capital-intensive, it will be tempting for line managers to see the contribution of human labour as less valuable and more expendable. However, the position for HR is quite the reverse. The people who remain in a business are likely to be more important and progressively directed towards tasks which can only be effectively carried out through human interaction, whilst the skill levels of remaining staff will also rise over time.

Greater capital intensity reduces the scope for a business to solve problems arising from variations in the business cycle through short-term recruitment or redundancy programmes. Labour costs are already a relatively small proportion of total corporate costs in most utility and many manufacturing businesses. The automation of service functions will soon extend this growing inflexibility to all employers in the developed world. For this reason it is critical that companies learn to live with business cycles and take a longer-term strategic view about corporate costs - with a greater focus on retaining talent, managing suppliers and optimising capital assets.