MPN INC.

Business Ownership White Paper

LAYOFFS

How to Cut Staff Without Cutting your Throat

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CMBA, CExP, CBI

Why a White Paper?

A white paper is an authoritative report to educate and assist people in making decisions. I issue white papers when the subject matter is important to business owners, but it is too technical or complex to address in the length of an article or blog posting.

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HOW TO CUT STAFF WITHOUT CUTTING YOUR THROAT

When times are tough, the headlines focus on job losses in large corporations. Reductions in force of thousands of employees have been commonplace in the news. What is far less noticed is the pain of small-business owners, for whom payroll is one of their few variable expenses.

Most small businesses provide services, and those services are provided by people. As an entrepreneur, your staff is in the critical contributing factor to the success of your company. Facing the need to reduce payroll expense is both difficult and painful. Unfortunately, when things get slow too many business owners make the necessary changes poorly or not at all.

Let's assume that, like most small business owners, you have addressed every other area of savings in your company before turning to the employees. You have gone through the expenses on your profit and loss statement line by line to identify those that were discretionary in better times. You have reduced your own compensation. In reality, for most of us, that is the first thing to go.

But your sales continue to decline. Unfortunately, your fixed expenses are just that, fixed. When the company was growing it was a joy to look at the expense items that remained the same regardless of how much revenue you were bringing in. When the revenue drops, those become looming items in the monthly P. and L.

So, eventually you have to turn your attention to the cost of your staff. They are the employees, and their families, who depend upon you personally to guide the company and safeguard their livelihoods. Most small business owners make staff cuts only as a last resort, because they feel that in doing so they've failed in a sacred trust.

There are also plenty of practical reasons that small companies avoid downsizing. Unlike large corporations, there is little redundancy in a small business' staff. We can't cut 2000 telemarketers in Boise because we still have 3000 in Phoenix to handle the reduced workload. We can't eliminate a layer of management, because there is another layer below them to handle the tasks, and one above to make the decisions.

Our employees fit together like a puzzle. Cross training is a luxury that we seldom get around to when we are busy. And then, when we really need it, it is usually too late. So each employee in a small business has a role, at least part of which only he or she knows how to do effectively. There is no fluff, no underutilized staff that stand out as easy opportunities for savings.

Faced with these emotional and practical difficulties of cutting staff, many small-business owners simply choose not to deal with it. As I often tell my clients, "owning your own business means you have the God-given right to procrastinate." Make no mistake about it, however, failing to make necessary cuts in a timely manner isn't a favor to people who'd otherwise be unemployed. It is a gross disservice to the rest of your employees who trust you to make the tough decisions necessary for the company's well-being.

Any Approach to Reducing Payroll has Special Dangers

You've reached the point where you can see no other option; you have to reduce labor expense. You can reduce employee hours, pay rates or head count. Which is the right way to go about it? How can you be fair, while to the extent possible doing what is best for your company?

Any of the three approaches has dangers associated with it. Besides the obvious morale issues of any reduction in force, different approaches impact different employees in a disproportionate manner. If you cut wages when there are idle employees, the more highly skilled workers are likely to look for a better situation elsewhere.

Reducing hours across the board can place a huge burden on key performers, whose skills aren't shared by others. If their responsibilities aren't redistributed elsewhere, or don't change with a slow-down, they will be unfairly forced to work without compensation. Purchasing is an example that often falls into this category. Although the company is ordering fewer of each item in inventory, the number of vendors or line items is seldom affected. The purchaser's job remains essentially the same, but he or she is merely paid less to do it.

This means that the right answer isn't always to reduce head count. Small companies risk losing key skills with every brain that walks out the door. There is a step by step process, however, that can help you to make the right cuts, the right way, and with the minimum of potential damage.

Think of the Dollars First

It sounds cold, but this is about the dollars. Too often we think of the people involved first. Who do we need the most? Who do we like the most? Who needs the job the most? Starting with the people usually leads to bad conclusions.

First, determine the *dollar amount* of the reduction you need. This is an important first step, and will govern your decisions through the process. Few business owners think of the dollars first, they would rather look at personnel, and make determinations based upon who their company can best (or least) afford to lose.

The problems with tackling it from a people viewpoint are many. The most frequent issue is when the owner decides who he can afford to let go, and then discovers it isn't enough to return to profitability. There is a strong temptation to make only those cuts, even though they are less that what's needed, and try to "tough out" the continuing losses until better times arrive. If the downturn lingers, or deepens, you have been consuming desperately needed resources, leaving none when it's most necessary.

How much should you target for reduction? Again, the temptation is to do less than what the numbers call for. A return to break-even, or close, isn't sufficient. You need to restore profitability to a level that permits your company to assemble reserves. You are in a dangerous time by definition, and reducing your margin for error is foolish.

There are a few rules to downsizing properly. They are critical to remember, and apply in all payroll reduction situations. The first is: *cut once*.

Cut as much as you can the first time. Inertia will keep most employees in place after a downsizing, because they want to believe that they have been spared. A second round of reductions is <u>ten times</u> more damaging to morale than the first.

Map your Critical Information

Once you have the target set, it is time to look at the pieces (employees) who make up the components of your labor expense. Make certain you fully value their costs. Include payroll taxes, benefits, commissions, automobile allowances, holiday gifts and any other item you can associate directly with the employee. List each employee with his or her fully loaded cost.

If you don't have a comprehensive functional organization chart, now is the time to create one. By "comprehensive" we mean a graphic representation of <u>every</u> person in the company. "Functional" describes the need to be realistic about the duties and responsibilities of each player. If your old fraternity buddy holds the title of Director of Customer Support for a job that supervises no one and has little impact on profitability other than his salary, it's time to face the music.

Once you have the chart drawn (in Microsoft Word you can use Insert/ Picture/ Organizational Chart) draw lines from each employee to the others not directly above in the chart who will be affected by their absence. This might include places where they are cross trained, lend assistance part-time, or are a critical step in a work flow. This will help you assess the broader implications of having that position unfilled.

When done, you should have a rough map of your organization by position, responsibility and skill. Regardless of the level, employees who have many lines radiating from their position and no other boxes in their position will have the greatest impact on the organization, and will require the most planning to replace. Those who have few interactions, or who have multiple players with the same profile, are the most likely to be redundant.

Deciding between People and Compensation

Once you have a target amount, it's time to determine how you are going to achieve it. There are two choices, reducing head count, or reducing compensation per employee.

Your decision will be an unhappy compromise between adding to some employees' workload, losing some level of experience and expertise, and reducing expenses. There is no easy choice.

One rule can be used to govern your decisions: If there is insufficient work to fully utilize employees, reduce headcount UNTIL the very next person to go would take irreplaceable skills with them. THEN shift to reducing compensation across the board.

If you have three techs that do the exact same thing, drop down to two. It may be painful to surrender the educational investment, but unless you can clearly predict when work is going to pick up again, a drain on your cash flow isn't somehow better because he used to be a profit center.

Try "reverse engineering" your organizational chart. Which positions were created to relieve another person who was overloaded? With the added workload gone, you may be able to recombine those jobs.

If you still need to make reductions and you've reached a point where you can't run the company without any one of the people who are left, then it is time to share the pain of reduced compensation. If some of the employees are paid hourly, check with the unemployment office about the availability of partial benefits. It won't be enough to matter to a highly compensated professional, but to a line worker it may be enough to save them.

If you reduce salaries or hours, plainly communicate the circumstances that will lead to their restoration. Employees tend to think the situation today is forever. They will accept hardship better if they think it has an end somewhere down the road.

Take time and care when setting the parameters for pay restoration. A busy week or a bit of backlog is not enough to do it. It's far worse for employees to think the hard times are "over" and be surprised when they aren't. If you have to temporarily accomplish more, let them know that working harder is a positive sign, but it doesn't meet the criteria for full restoration.

Communicating the News to the Departing Employees

Clearly, telling people the bad news is the hardest part of the process. Many business owners mentally jump ahead to envisioning the face to face meeting, and the pain prevents them from going any further.

There are actually two levels of communication. They are both vital, and both need to be done right. They are communications with the departing employees, and communications with those who are staying.

For the departing employees, your message is that you hate to see them go, you want them to succeed and be well, and you are doing everything possible to ease their transition. How you handle the departure is the single biggest factor in preventing frivolous claims of discrimination or wrongful termination.

Make certain you let the employees know that they are first in line if their jobs open back up. Many good employees will take another position with the intention of leaving if they can get their old job back.

Prepare a checklist for the departing employees. At the announcement interview, each should receive:

1. A personal letter of reference to a future employer, stating that the reason for termination was based on business conditions.
2. An itemized statement of any compensation due for time worked, or accrued paid time off.
3. A description of the steps you are taking to help them find employment. (Even the smallest business can afford to send an email to vendors or customers. It's not like the news won't get out.)
4. Any requirement or expectations for returning company equipment or information.
5. The contact information for the state unemployment office.
6. COBRA information, if applicable.
7. A description of additional severance or pay in lieu of notice compensation available upon signing of a general release of liability, which includes a time frame for signing and receiving the compensation.
8. A copy of the release they are being asked to sign.

You can decide whether the news is communicated better one-to-one or in a group. In either case, make it plain that the employee(s) are expected to leave the premises promptly, and to take all personal belongings. Do not allow the departing employees to congregate on company property. Do not permit "I'll come back for my stuff later."

The time frame for signing a release should be short; a few days at the most. Have someone call to follow up if you haven't heard in a day or two.

Many people ask "What is the best day to deliver the news?" No day is great, but I recommend the beginning of the week. Fridays leave the worker with a lot of time during which they can't actively job seek. They are more likely to spend the weekend with friends and family, many of whom will tell them that they were treated unfairly. They will be on the phone discussing it with co-workers who are still employed, raising issues of "survivor's guilt."

I prefer to do a downsizing on a Monday. The rest of the staff gets back to work immediately, and are focused on the implications for their own job. They're less likely to feel guilty when they are dealing with the impact of an increased work load (or finding that a well-liked co-worker left a mess to be cleaned up.)

Monday downsizing also allows a logical time frame for returning the release by Friday to receive the separation pay.

Communicating the News to the Employees who are Staying

The impact of a downsizing is equally great on those who stay. In some ways, it is more stressful to them. Besides the aforementioned "survivor's guilt" there is a greater uncertainty. Those who leave know what to do. Their path is clear. Those who stay are less sure of their future. What will be required of me? Is my job safe? Should I be looking for a safer position, or a more stable company?

Your job as the boss is to settle things back into a productive mode as quickly as possible. You may want to communicate in advance to those who are staying, although that is often difficult. If you are making the announcement to a group, the other employees can receive a simultaneous email telling them that their jobs will remain, and that you will talk to them shortly.

If at all possible, avoid the "death march" of meeting with employees in one by one while the rest wait to see if their name is called.

Here are the results of a study that measured attrition among "good" employees who left the companies voluntarily after a layoff:

Layoff Percentage	**Additional Turnover**
0	10.4%
.5%	13.0%
2%	14.1%
5%	14.9%
10%	15.5%

Overall, there are three components to every downsizing announcement. These are <u>not</u> optional. Whether you deliver them in writing or verbally (I recommend verbally with a written version distributed) make certain your communication includes all three.

"We have taken this action to preserve the health of the company."

> The point of downsizing is to save those who are left. Begin by telling the remaining employees that this action was for <u>you</u>, because we value your work and want to keep you here. Everyone wants to hear that they are a winner.

"We have a plan."

The actions are part of what you need to do to survive tough times. Employees want to believe that they have leadership that isn't merely reacting, but rather is moving forward to secure their future.

"Here is what you can do to help."

Employees want to have a role in preserving their future. They want to help, and they want to know that their actions matter. Whether it is work a bit harder, look for more sales opportunities, raise the level of customer service or look for ways to cut costs, tell them what they can do to participate.

Reducing payroll expense is never easy, but it doesn't have to be perceived as a disaster in your company. Business cycles wax and wane. Circumstances, markets and products change, and not every adjustment can be made seamlessly or painlessly.

If you have to reduce payroll, follow a step by step process. It will be easier, more effective, and hopefully it will set the stage for your business recovery.

AUTHOR'S BIO

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Business Ownership Expert

John F. Dini is widely recognized as one of the nation's leading experts on small business ownership. He is a consultant and coach to hundreds of business owners, CEOs and Presidents of companies. John is an outlier in coaching business owners, having achieved the rare feat of delivering over 10,000 hours of face-to-face, personal advice to entrepreneurs.

Mr. Dini is the author of *11 Things You Absolutely Need to Know About Selling Your Business*, now in its second edition. He is a serial entrepreneur currently operating his 9th company, and has conducted business in all 50 United States, Canada, South America, Europe and Asia.

John founded and operates the most successful peer group franchise in North America, overseeing 15 monthly meetings of business owners' groups under the auspices of The Alternative Board®. He holds a Bachelor of Science in Accounting from Rutgers University, a Master of Business Administration from Pepperdine University, is a Certified MBA, and holds six additional certifications in exit planning, business brokerage, behavioral analysis, medical practice management, facilitation and coaching.

Mr. Dini writes numerous articles on business topics for newspapers and magazines, in addition to his weekly column on business ownership on this website Awake at 2 o'clock in the morning? and his opinion blog at Awake at 3 o'clock. He speaks frequently to business groups and national associations, and is a 10-year member of Jim Blasingame's "Braintrust" appearing regularly on "The Small Business Advocate" nationally syndicated radio program as an expert in the issues of business ownership.

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