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Proven Guidance for C-Suite Action



3 Considerations for Managing People Costs Every Executive Should Know

by Jessica Kranish and Oana Lupu

It's a difficult time to make decisions about hiring, firing or freezing job openings — or weighing up compensation and benefits. Employees are feeling the strain of the prolonged crisis. Each organization must juggle its own set of unique financial pressures and strategic priorities. People costs are the biggest line item for most companies, representing about two-thirds of the total budget.

In 2021, some executives will be in the enviable position of reintroducing benefits that were withdrawn in 2020. Others may be required to make additional, tough cost-cutting decisions.

Business leaders should work with finance and HR to evaluate how such decisions will affect employees and the company. When assessing people costs, functional leaders should consider the following three factors:

- The more personal the cut, the greater the negative impact
- Reducing people costs has long-term implications for growth, not just immediate ones
- Protecting preferred benefits and communicating transparently can help mitigate other cuts

These elements have the most impact on well-being, motivation, retention and ultimately the success of your organization.

The More Personal the Cut, the Greater the Negative Impact

Cuts that affect employees' day-to-day lives — such as closing production sites or replacing full-time staff with contingent labor — do the most damage to employee engagement, experience and productivity, a 2019 survey of nearly 10,000 managers and employees found.^{1,2}

Cost-reduction initiatives that aren't as personal, such as outsourcing activities that add little value and don't generate revenue or reducing spending on external consultants, have less of an impact (see Figure 1). This data was consistent across different employee groups, regions and industries.

Changes to employee experience and engagement are important because they also affect performance. For instance, a 10% increase in engagement can boost employees' effort by six percent. This, in turn, can improve performance by two percent, while reducing their probability of leaving the company by 9%.³

If your company has cut people costs already and is now considering reintroducing some of them, don't automatically return to the same spending levels you had before the pandemic. For instance, this may be a good time to attract new talent without having to spend as much. The salary bump employees expected to receive when switching to a new job fell to 10.8% in the second quarter of 2020, whereas previously it had been 14% to 15%.⁴

To retain some of the efficiencies established in response to the crisis, executives should base their decisions about reopening their wallet on:

- The sustainability of current reductions, not on revenue returning to normal
- Maximizing strategic differentiation, not matching prepandemic profit margins
- Supporting the postpandemic catalysts of business growth, not the traditional ones⁵

Functional leaders should provide the CFO with a qualitative assessment of the projected effects of keeping specific people cuts in place on their respective key performance indicators.

This will equip the CFO and heads of HR to gauge the impact maintaining any reductions will have on employee satisfaction and retention.

Reducing People Costs Has Long-Term Growth Implications, Not Just Immediate Ones

To understand the implications of any proposed changes, look beyond the short term to consider longer-term associated costs that may be less apparent. Keep this in mind when evaluating potential savings. What seems like a good way to meet revenue targets this quarter may harm your ability to meet them in the future. For example, the true cost of layoffs and severance packages might include recruiting employees for roles when the economy rebounds, training and the time needed to get them up to speed, and the opportunity cost of not having staff ready as soon as the rebound happens.

These costs can add up: The median cost per hire for external candidates is \$4,623, according to a Gartner survey of 51 recruitment leaders in North America and Europe, conducted in the first quarter of 2020.⁶ Heads of HR should help identify and calculate these expenses.

If your company is considering layoffs, incorporate this holistic view of costs into your discussions. CFOs can help structure the conversation by using our segmentation matrix (see Figure 2). This tool helps provide context on the impact of layoffs on the organization. For example, "cost to rehire" is listed under alignment with future business strategy. HR could also add in the cost of training new employees.

Figure 1. Employee Impact of Cutting People Costs

Less Detrimental  More Detrimental

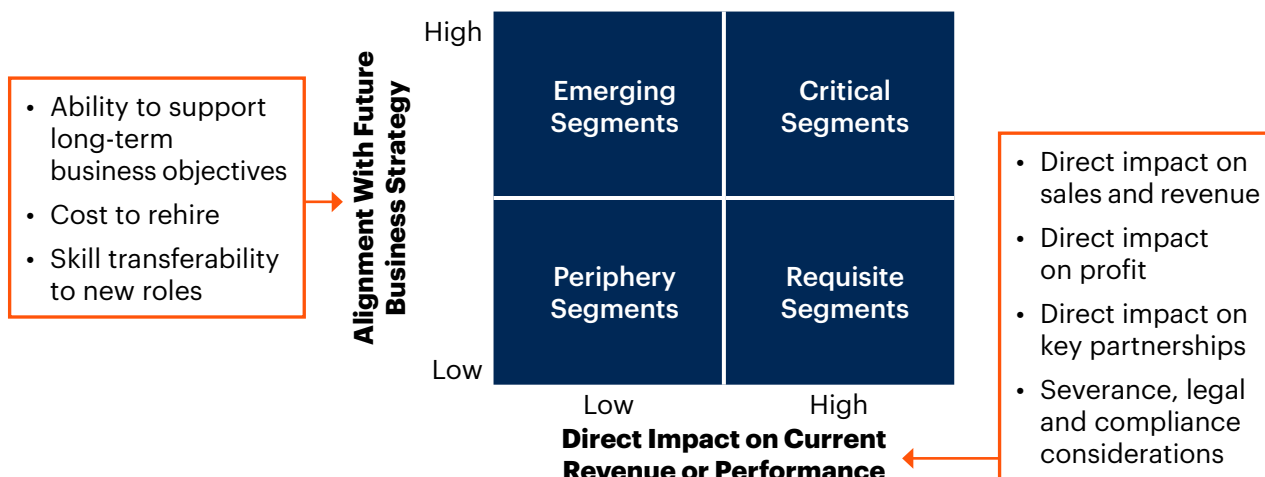
Cost-Cutting Initiative	Average Engagement	Average Experience	Percentage Meeting Performance Goals
Outsourced Noncore Activities	5.06	4.90	83.30%
Reduced Spending on External Labor/Consultant Support	5.13	4.91	81.60%
Acted on Poor Performers/Underutilized Staff	5.04	4.89	80.90%
Froze Hiring	5.04	4.76	81.40%
Reduced Working Hours	5.01	4.82	79.80%
Froze Promotions	4.96	4.75	79.10%
Replaced Full-Time Headcount With Part-Time	4.91	4.69	80.40%
Reduced Headcount Overall	4.94	4.65	79.70%
Froze Bonuses/Compensation Increases	4.96	4.64	78.70%
Reduced Headquarters Headcount	4.90	4.71	78.20%
Reduced Employee Perks/Social Occasions	4.93	4.64	77.70%
Closed Production Sites	4.81	4.70	77.40%
Replaced Full-Time Headcount With Contingent Labor	4.83	4.64	77.40%

n = 9,994 managers and employees

Source: 2019 Global Labor Market Survey

Note: Employee engagement and experience are measured on a seven-point scale.

Figure 2. Reduction-in-Force Segmentation Matrix



Source: Gartner

When reintroducing benefits or making further cuts, executives should consider the impact on the employment value proposition (EVP). This is the set of attributes the labor market and current employees perceive as the value they gain by working for a specific organization.

Prospective hires will consider these factors when deciding whether to apply for a job or accept an offer. They may require more compensation or look elsewhere if the EVP doesn't meet their expectations. Protecting the benefits and incentives that matter most to employees helps attract and retain future talent.

If your company paused retirement contributions or froze promotions, then candidates may be swayed by a competitor still offering them. In a poll in the spring of 2020, only 7% of 138 CFOs picked reinstating 401(k) matches as their top choice to start spending, as revenue returns, whereas nearly half (49%) said new hiring would be their top spending area.⁷

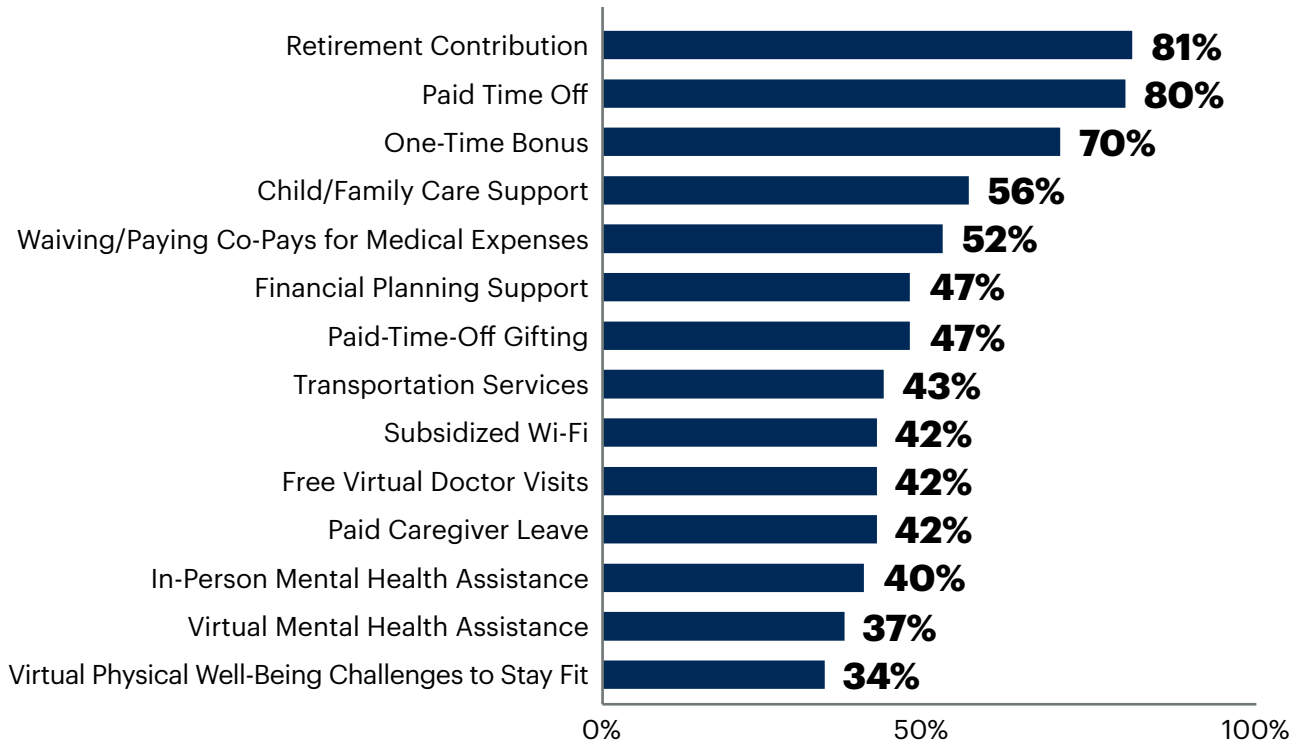
In the long term, prospective employees who learn about past benefit cuts may be reluctant to join the organization, fearing this might recur. It's therefore essential for executives to think through these long-term implications and work with HR to consider the trade-offs.

Protecting Preferred Benefits and Communicating Transparently Can Help Mitigate Other Cuts

Any change in the portfolio of benefits will affect employee stress, productivity and engagement during the pandemic. Consider how the portfolio of benefits can mitigate the impact on morale concerning reductions in other types of people costs.

In the spring of 2020, when the pandemic first spread in the Western Hemisphere, U.S. employees most valued retirement contributions (such as a 401(k) match), paid time off, a one-time bonus and child or family care support (see Figure 3).

Figure 3. Most Valued Benefits



n = 588 employees

Q: "Which of the following benefits does your organization offer at this moment? (Select all that apply.)"

Q: "Please select up to three benefits that you value the most (of offered benefits)."

Source: 2020 Gartner Culture of Quality During Disruption Employee Survey

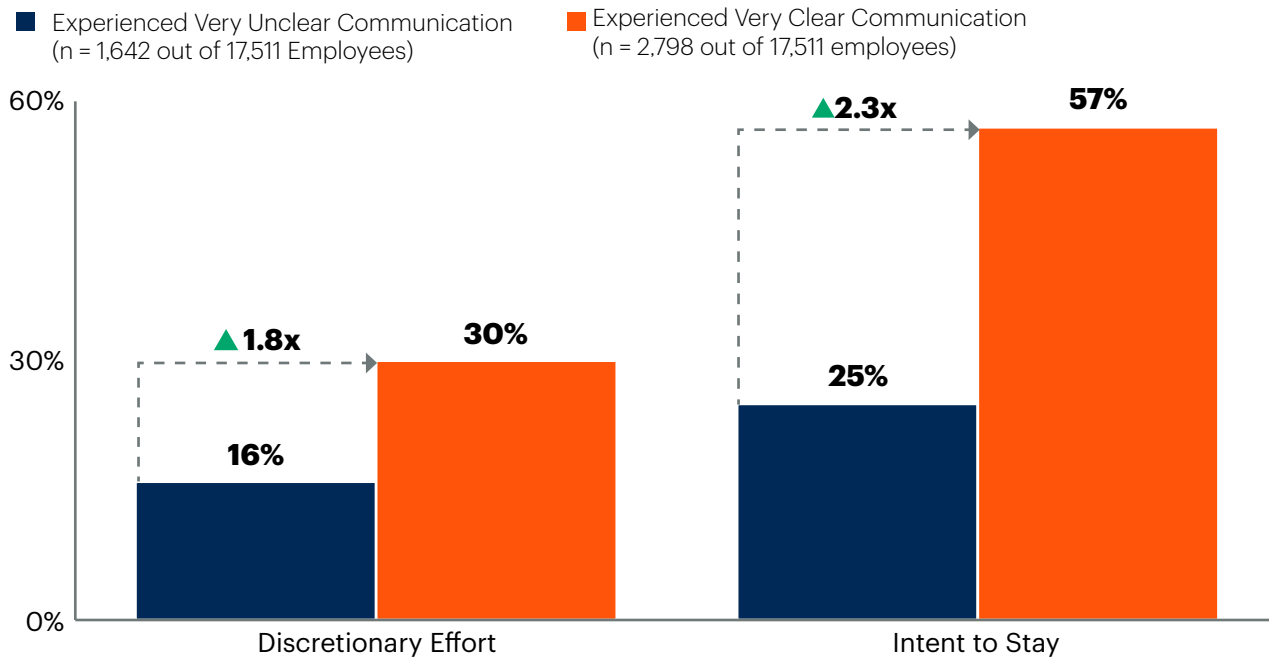
Use this data to help assess the overall impact of changes to people costs. If you're making cuts that will have a significant, negative impact on the employee experience, like freezing compensation increases, you could mitigate these effects by protecting valued benefits, like retirement contributions and paid time off.

Any changes to benefits will also affect productivity. During the initial phase of the pandemic, employee engagement increased from 1Q20 to 2Q20, although it varied significantly by industry.⁸ Several public health surveys suggest the crisis has increased stress levels and mental health problems

(see Employees Need Mental Health and Well-Being Support Now More Than Ever). But we don't yet have sufficient data to assess how these factors will affect productivity in the long term.

Finally, no matter what changes your company makes to its people costs, transparent communications about cuts boost both retention and discretionary effort (see Figure 4). CFOs and heads of HR should work together to craft messaging about the financial rationale for making strategic cuts. The communications can also provide insight on how different scenarios would affect the company's financial health and future vitality.

Figure 4. Impact of Clear Communications About Cost Cutting on Employee Discretionary Efforts and Intent to Stay



Source: 2019 Gartner 4Q Global Labor Market Survey

¹ Engagement is the extent to which employees feel passionate about their jobs, are committed to the organization and put discretionary effort into their work. Employee experience refers to perceptions and feelings based on interactions in the work environment. Productivity means the ability to meet objectives.

² 2019 Gartner Global Labor Market Survey

³ 2011 Gartner Engagement Capital Study

⁴ 2Q15-2Q20 Gartner Departure View Exit Surveys

⁵ How to Sustain Efficiency Gains in Functional Costs Post-COVID-19

⁶ 2020 Gartner Recruiting Executive KPI Benchmarking Survey

⁷ Gartner COVID-19 Finance Quick Poll (29 April through 3 May 2020)

⁸ 1Q20-2Q20 Gartner Global Labor Market Survey

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