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Effectively Managing Workforce Costs in Public-Sector Organizations

Robert J. Butler, CCP, SPHR
Reward Systems Inc.

Robert J. Greene, Ph.D., CCP, CBP, GRP, GPHR, CPHRC
Reward Systems Inc.

The pressure for employee cost controls in for-profit organizations has been constant for a generation and especially severe since 2008. Now the public sector faces very similar challenges as rapid declines in tax revenue are forcing major employee cost reductions.

There has been a great deal of publicity suggesting the pay levels and benefits provided to public-sector employees have spun out of control. In an early 2010 issue, "The Economist" reported that the average public-sector employee makes about 17 percent more in direct compensation than the private-sector employee if actual time worked is considered. And the same article stated that the "public-sector premium" was an additional 30 percent when benefits were compared. Whether or not one agrees with the specific figures quoted in the article, such reports have fueled intense public criticism of public-sector employee compensation. The majority of voters in Wisconsin recently failed to recall legislators who backed a bill to limit the ability of public-sector unions to control their benefits costs contractually, which is a reflection of the view that these programs may be too generous and likely are unsustainable.

It would be prudent for all public-sector organizations to re-evaluate the way they are staffed and the way their employees are rewarded. There have been changes to pay practices in some public-sector organizations over the past two decades. Approximately one-half of the federal workforce has been taken out of the General Schedule (GS) system and placed in "excepted service" plans of various types. Most of these new pay plans do not automatically raise individual pay rates each year the way the GS system did, and they typically have some element of pay for performance. The annual "Water Utility Compensation Survey" shows that about 30 percent of 1,000 reporting utilities have automatic time-based pay progression, like the Federal GS model, down from more than two-thirds a decade ago (American Water Works 2010). The federal organizations dropping out of the GS system had concluded that time-based pay progression did not provide motivation to perform, in addition to continuously escalating costs. State and local agencies are also finding that there are more viable and sustainable approaches.

ADDRESSING THE CHALLENGE

To date, the most common reaction to controlling costs is staffing level reductions, despite research that has presented compelling evidence that downsizing often does not produce the desired savings and very often has a destructive impact on morale and engagement (Cascio 2002). In addition, reducing staffing can endanger delivery of some public-sector services.

If staffing levels exceed those justified, there certainly should be staff reductions. But rather than mandating across-the-board staffing reductions, it is advisable to evaluate staffing levels in each unit within the organization and within each occupation. The best place to start is to decide which services are critical and which occupations justify different treatment. It is very difficult to evaluate just how much pay and benefits are justified for critical occupations that warrant special treatment, such as public safety officers. That would raise such questions as: 1) which jobs are difficult to perform for a 60 year old and 2) should those be the only positions that offer early retirement? It is time to re-assess public employee reward packages. Different cost-reduction methods have the potential to minimize the damage to workforce viability. There are no easy roads to reducing employee cost levels in the public sector. When all employee costs (base pay and benefits) are relatively fixed, drops in revenue are difficult to offset. The private sector is increasingly using variable compensation programs to make employee costs more responsive to revenue swings. It may be unrealistic to think the public sector will adopt significant variable compensation programs anytime soon. But when a total rewards perspective is taken, there are many more options that can be considered. By formulating a total rewards strategy, short-term tactics can be aligned with that strategy and provide a map for navigating rough roads.

APPROACHING REDUCTIONS IN FORCE (RIF)

When Reductions in Force (RIF) appear inevitable, public-sector organizations may consider several tools, techniques and policies adopted in the private sector over the past two decades to minimize or avert layoffs.

Last-In, First-Out or First-in, First-Out

These terms of inventory management describe the choice between retaining newer hires with technical skills or more senior employees with knowledge of practices essential to operations. When these talents reside in the same person, retention becomes a key issue. Of course, bargaining unit members have seniority rules in their contract that must be observed or negotiated away in times of RIF. In any case, a hard-and-fast rule on retention is often too rigid to be effectively applied in every case. Ad-hoc selection practices will risk each decision being challenged by disappointed employees. Further, targeting senior employees short of retirement, and over age 40, can trigger an age discrimination claim or even a class-action lawsuit. The safest choice for selection appears to be documented performance over time, providing such documentation exists.

Part-Timing

This approach, which allows employees who elect to work part time to adopt flexible schedules of 20-30 hours per week, can be popular with workers attending school or parents who want more time with children. Posting this option will create some demand, although numbers applying are often smaller than desired. One problem occurs when customers (internal or external) rely on this employee for decisions or information and that person is absent. A second complication may occur if a pattern occurs for these jobs predominantly occupied by women. Also, a policy decision is required to determine the circumstances that would allow an employee to return to full-time work.

Benefits Cost Reductions

Employee benefits costs are often an early target for cost reductions. One major advantage of reducing benefits costs is that it is typically conducted across the workforce and creates a sense of shared sacrifice. An early effort to address embedded costs and transfer some back to workers is a popular option in cost-reduction plans. Cutbacks that can save significant costs include: health-care co-pays; other insurance plan premiums; paid-time-off restrictions; and reduced vacation time. Few of these moves will be popular and a disappointed workforce will characterize all as painful. Lower morale can lead to labor unrest and lower productivity, although these takeaways tend to be viewed as less onerous than an actual pay cut.

For example, costs for employee health-care insurance would be lowered by increasing employee contributions. Private-sector organizations often expect employees to contribute at least 25 percent of the total costs of health-care insurance, while most public-sector employees pay a much smaller percent of the actual cost of providing this benefit. A total rewards strategy could be developed that would mandate a gradual increase in employee contributions to health care as an alternative to pay cuts. By increasing employee contributions to health-care insurance by the same amount that pay would be reduced, progress would have been made in adjusting the employee share of benefits costs with the same impact on taxable income as pay cuts. The total rewards strategy could also be revised to include a mandate that employees would absorb 50 percent to 70 percent of the annual increase in total health-care costs each year until the targeted contribution rate is reached.

The benefits cuts could be extended to retiree health plans. These plans are rapidly disappearing in the private sector. Given the public sector's tendency toward early retirement, this seems to be an area where savings could be realized and the plans better aligned with competitive practice. All those receiving retiree health coverage could be subjected to an immediate increase in their share of the cost, to perhaps 50 percent to 75 percent. And future retirees could be expected to pay 102 percent of the cost, similar to COBRA coverage. This would have the added effect of removing an incentive to retire early.

Realigning public-sector benefits to match competitive levels would also require major revisions to retirement plans. The disappearance of defined benefits pension plans in the private sector provides an opportunity for revising public-sector retirement plans.

Any such cuts, since they would involve active and retired public-sector workers whose compensation is funded by tax dollars, could become politically charged decisions.

Furloughs

Unpaid time-off plans have become a standard fixture in the public sector because of their simplicity and relative ease of administration. A modest number of furlough dates are spread throughout the year and create unpaid days off, often Fridays, to basically shut down nonessential services, offices and entire buildings to save on wages and energy. These are generally accepted by public-sector workers in lieu of layoffs, but they are often precursors of permanent RIF. They can create attrition if they become too frequent or if they proceed to more drastic cutbacks. Highly paid personnel react poorly to pay reductions based on involuntary days off, although the longer weekends have proved popular.

Voluntary Early Retirement

This is a common practice in private industry, encouraging senior staffers to elect a bridge to full retirement with some support in the form of lump-sum payments, salary continuance, benefits coverage or some combination of the above. Consequently, these are expensive programs that can result in adverse selection — key people opt out and are not easily replaced.

Besides the brain-drain potential, these programs are expensive, resulting in one-time charges for the wage and benefits coverage applied. The windows are often a month long, allowing people to volunteer to opt in. Granting exceptions to these is legally problematic as legal challenges to pension plans may be forthcoming.

Buyouts

These bonuses are paid in lump sum to volunteers who opt to leave by a certain date, usually 15-30 days later. They can be structured as 90 days of pay equivalent or similar amounts and are granted to volunteers on a first-come basis. These should be structured as one-time events and avoid wider windows of opportunity. Those who leave often have another job or a career change in mind upon departing. This may result in losing key players if an opportunity occurs that appears attractive. Replacement costs may consume most of the benefits if key employees volunteer.

Reduction with Large-Scale Reorganization

Permanent reductions accompanied by large-scale reorganization plans are the most expensive option to effect reductions. A permanent RIF requires massive coordination, indirect management costs, legal exposure, long-range benefits costs in unemployment insurance, wage and salary extensions, various layoff benefits extensions, and plenty of adverse publicity. Reorganizations create many new reporting relationships and often lead to additional attrition down the road. Nevertheless, some organizations have no choice but to slash the headcount and consolidate the management structure, creating maximum disruption for an extended period, usually a year or more.

Salary Freeze

This typical response to budgetary problems provides a quick solution to reduce further cash-flow outlays. However, it is often unsustainable as a long-term strategy since it provokes strong opposition and unwanted attrition, often by the most talented employees. The absence of flexibility prevents exceptions from being made that might prevent unwanted departures. Still, this approach is often popular due to its visible impact on cost and its immediacy. Such freeze actions are often retired after one year due to their dysfunctional impact.

Delayering

This reorganization method, which reduces tiers of management to cut overhead, is designed to produce more efficiency. But it can cause major disruptions in reporting relationships and work flows. It is often used when management spans are narrow, such as three reports to one manager, or when managers are numerous or hold honorific titles. This tactic is controversial when implemented and can create current and future attrition due to interrupted career plans. It also presents the problem of dealing with defrocked managers as individual contributors. The long-term cost can be significant and lead to increased unit output productivity.

Reskilling/Training

Most employees respond well to training opportunities and can view expanded roles as a chance for increased job security or higher pay. Enhanced technology and redirected functional responsibility often drive for new procedures and programs that reframe job content. Revised jobs require new documentation and training needs to be specific and focused on job requirements. This effort takes time and money and diligent follow-up to work well.

Hiring Freeze

These programs, which prevent new hires from replacing departures for a specific period of time, are sporadic and respond to short-term budget pressures rather than long-term considerations of organizational structure and mission. They also serve to put off tougher decisions on workforce modeling and future plans to conserve resources, limiting their effectiveness. Like a salary freeze, they tend to be viewed positively by political figures, but are limited in usefulness to short-term time lines. Most are enacted for one year or less. If kept in place too long, they can compromise functional missions such as public safety or access to public welfare programs.

Multiyear Reductions in Force

These alternatives to a single, large RIF are laid out over several years or are annual reductions based on budget forecasts. They can reduce the impact of a long-term decline in revenue by reducing staff, for example by 5 percent per year for four years versus 20 percent at one time. These plans are often kept confidential by management, but usually re-emerge near the end of the budget year. They often hurt morale and are viewed suspiciously by employees as deferred forms of torture because they create chronic uncertainty.

Reducing Managerial Pay

This quick fix for cash flow may have the single biggest impact on short-term budgetary concerns. A typical reduction may be 5 percent to 15 percent of base salary, but no reduction in noncash benefits. The management tier might prefer this method to an outright RIF, but the morale of managers will be damaged. The decision to implement this plan must come from the top of the organization and it must be a shared sacrifice. The attrition of key managers may occur more quickly if this plan is adopted.

Job-Sharing

This option, which allows two employees to hold a single job on a half-time basis, can help reduce a permanent RIF and keep experienced persons on payrolls where their skills can be utilized. It is often difficult to arrange through voluntary methods since two employees have to match the necessary qualifications. Some employers mandate this approach to reduce the confusion, but it is an unpopular option. This method also calls into question the costs of benefits coverage to part-time workers, which has to be spelled out carefully in policy.

Union Contract Modifications

These require negotiated consent when changes are made to work practices, pay or benefits under existing contracts. Of these, the most contentious are changes to pay or pensions, including mandating retirement age. Unions have bargained heavily for pension benefits and will fight hard to preserve terms such as pay determination and sick time accrual. These issues may promote labor actions, including strikes or sickouts, to stiffen opposition. Being prepared for determined resistance to such changes will assist the negotiator in preparing the way or seeking other concessions.

HANDLING A RIF

There must be advance planning and mechanisms put in place for any form of RIF to be successful. Factors to consider include:

1 | Timing key steps in the RIF. This requires sensitivity to employee impact, especially around the year-end holidays. This is an emotional time for most families and represents a time for celebration, not job anxiety. Timing a layoff at year-end is a guaranteed way to a negative public reaction. Job searching at Christmas is a tough message to share with families. If reality dictates abrupt action, delaying until mid-January will be remembered as more thoughtful timing of necessary action.

2 | Financial planning. There should be a detailed roll-up of costs associated with restructuring, retraining, separation benefits and contingency funds. Any summary must include a cost-benefit analysis of the plan and determine a break-even point in the future. Although this plan is essential for management direction, its details should remain confidential for two reasons: the assumptions are subject to revision and those projected costs may provide ammunition to critics who oppose any moves toward a RIF.

3 | Outplacement assistance. This feature, common to most successful RIFs, provides such services as resumé advice, conduits to external job placement and interview practice to laid off employees. They can access the center during working hours and use its computers and administrative links to seek new work elsewhere. Managing this process consists of careful handling of expectations and counseling of individuals who often experience long job searches. This service and aid reduce legal challenges, but do not prevent them.

4 | Counseling survivors of a RIF. This is often overlooked, but it is a very necessary service for the remaining workforce. These sessions help create a forum to process the concerns of survivor guilt and monitor organizational behavior that may suffer after a RIF. Counselors can share group, not individual, concerns with managers to mitigate the sense of loss or frustration that grows out of a RIF. These sessions can help rebuild group cohesion and redirect energy toward task accomplishment. Important to success is to use trained, outside consultants. A second constraint is to limit the timeline on counseling after the event concludes to a reasonable period, such as one month.

5 | Graduation Day. Management needs to announce the end of the process once the organization fully implements the RIF to redirect energies toward the future. This often occurs six months or more after the first RIF announcement and may be a cause for a somber celebration. One caveat: it is important to avoid a premature announcement of successful completion only to be followed by another RIF. Such reversals can cripple morale and cause cynical reactions to management efforts to redirect the organization.

CONCLUSION

Local, state and federal agencies are being forced to consider cutting back personnel and services and/or increasing taxes. Using a total rewards perspective to revise employee compensation can help meet those public-sector challenges. But new strategies must be realistic and allow public-sector agencies to fulfill their mission while ensuring they sustain the viability of their workforces.

AUTHORS

Robert J. Butler, CCP, SPHR, (rjbaf@aol.com) has had a 35-year career in human resources management, including working for General Electric Company, performing executive searches primarily for the technology industry and public sector, and consulting on general management.

Robert J. Greene, Ph.D., CCP, CBP, GRP, GPHR, CPHRC, (rewardsystems@sbcglobal.net) is the CEO of Reward Systems Inc. in Glenview, Ill. He has published more than 100 articles and book chapters and was awarded the first WorldatWork Keystone Award for attaining the highest level of excellence in the field. With more than 30 years of experience, he has designed and taught certification courses and seminars for numerous professional organizations around the world.His book “Rewarding Performance” was published in April 2010.

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