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Layoffs: Deciding who stays and who goes

Many companies make costly mistakes trying to cut costs

Presented by



Peter Tingling, CEO of Octothorpe Software Corporation, Financial Post



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The litany of corporate downsizing announcements reflects the first response for many managers to negative conditions - batten down the hatches and cut staff in large numbers.

This is not necessarily a bad thing. An organization's costs must align with its revenue. Still, in too many cases empirical evidence from white-collar or knowledge-worker downsizing shows that it does not lead to better performance. Incoherent layoff strategies

result in brightsizing, where poor decision processes and perverse incentives encourage the brightest and best to leave. Short-term costs are reduced, but like the medieval practice of bloodletting, the patient is frequently left in a further weakened state.

Easy-to-announce and fair-sounding horizontal cuts are the worst. Rather than tackle the difficult decisions to identify and reduce or eliminate weak or uncompetitive areas, ineffective managers announce that the pain will be shared equally (other than by senior management, of course). The net result of this simplistic across-the-board strategy is to cut the flowers and to water the weeds.

A far better approach is one of vertical or targeted cuts that reflect the new organizational strategy and preserve or reinforce areas of strength or focus with the highest-performing contributors. This may not sit well with egalitarian views, but is particularly true in knowledge-intensive industries. Former Microsoft CEO Bill Gates, for example, has said that a good computer programmer was more than 10 times as valuable as an average one and Microsoft was already known for hiring extremely talented employees.

Deciding who is vital

The first step is to recognize many biases and flaws impact the process. Consider this real but simplified example from a company that implemented a 40% reduction in a 300-person business unit:

A small group of the most senior managers were assembled. Over two days they collectively reviewed all employee files and categorized employees into "retained, released, or needed further consideration." The organization encountered two large problems.

First, the use of the annual performance appraisal information biased the outcomes in favour of employees who had demonstrated the characteristics that had created the prior success. While these are appropriate metrics if the future is expected to look like the past, better decision processes would have involved determining the knowledge, skills, and attitudes that were required to compete and win in the ambiguous and perhaps unfamiliar new economic reality, and then to determine which employees had those attributes.

Eliminating bias

Second, the decisions were made sequentially - from A to Z. Thus, as managers worked through the first group of names in the alphabet, they realized too many employees had been proportionally categorized as "retain" and "reconsider." The result was that the process became progressively draconian and those employees with names starting with letters in the latter half of the alphabet were not only given far less consideration, but were much more likely to be released. Better processes would have involved independent decision makers using recursive evaluation techniques and applying end-stage decision aggregation.

This example is far from unique. A recent U.S. study found that well-designed and procedural layoff identification processes saved, on average, US\$1.28-million in litigation costs alone for every 100 employees released. Our conversations with senior executives and outplacement specialists often acknowledge significant problems. Most common are expensive and avoidable Type I mistakes, where employees are paid to leave despite being key to the ongoing operation. Aside from the impact on morale and the decrease in the credibility of management's ability to make good decisions, the cost of these errors includes the expense of bringing back a now-recalcitrant employee who has already received a large severance payment and is in a strong position to negotiate a second.

Too often, the processes used to make downsizing decisions amount to fine-grain work being conducted with coarse tools - a jeweller attempting to repair a watch with a chisel. Decision making is the essence of management and new technologies are generally available that are not only easy to use, but address and obviate many of the problems and biases inherent in deciding who stays and who goes in times of trouble. It's time more firms used these tools.

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-Peter Tingling holds a PhD in Organizational and Technological Decision Making and has an appointment in the Faculty of Business Administration at Simon Fraser University. He is the founder and CEO of Octothorpe Software Corporation, a decision sciences company.

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