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Learning from the downturn

An employer perspective

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Introduction

There has been much debate on what has been seen as the surprising resilience of the UK labour market in the most recent recession, and this paper looks at some of the aggregate trends and possible explanations for them, including the role of public policy.

It is clear that despite the depth of the economic downturn, the fall in the employment rate has not been as severe as in previous recessions. One reason for this could be the greater intensity of active labour market measures, working to keep many more people closer to the labour market; other reasons include more benign industrial relations climate and the low inflationary environment, which have combined to make it easier for employers to make use of alternative strategies to mass redundancies and to 'hoard labour', in recognition of the value of the employee asset (Meager, 2010).

In this paper (based on work in progress for the IES corporate membership programme, the HR Network) we move from the aggregate level to the micro level, to explore some of these issues by looking in detail at the kinds of initiatives that HR functions took to reduce redundancy and protect skills during the economic downturn. The aims of the research were: to see whether organisations were responding to economic problems differently than in the past; and if so, to consider why they were adopting these strategies; to assess how well the strategies had worked; and to consider whether such initiatives might have longer term beneficial impacts, not just on the bottom line but on factors such as employee engagement and workforce flexibility.

The research was based on a review of existing research and literature on employers' use of cost-saving measures during the recession, complemented by in-depth case-studies (conducted towards the end of 2009) of four organisations (KPMG, Jaguar Land Rover, Norton Rose and the BBC) highlighted in the literature as having implemented innovative cost-saving programmes in an attempt to keep headcount reductions to a minimum.

The economic context

Employment has fallen during this recession but by a much smaller proportion than in the last two recessions (of the early 1980s and the early 1990s), despite the fact that the fall in output of six per cent over the past two years represents a much larger decline than was experienced during the two previous recessions. During the early 1990s recession, in order to contain labour costs businesses quickly reduced the number of people they employed. However, the manner in which businesses have responded to the falls in output during this recession appears different. Early commentary on the current recession pointed to the growth in part-time and short-time working, arguing that although total headcount had fallen less than in previous recessions, this had been because the burden of adjustment had fallen on working hours rather than total employment. In fact, the evidence from the Labour Force Survey (Bank of England, 2010) does not confirm this; rather the trend in average hours worked appears to have behaved similarly to the early 1990s recession. It seems that we must look elsewhere to explain the robustness of employment in the current recession.

Possible reasons include real wages being more flexible than in the previous recessions and a low inflation environment, alongside either a less powerful union movement or one more prepared to accept the necessity of change. These factors may have increased management discretion to take cost-saving actions that affect terms and conditions of employment but ultimately retain labour:

> *'Businesses may have shown increased willingness to accept lower productivity for a period during this recession. And employees might have accepted weaker real wages in return for maintaining employment'*
>
> Bank of England, 2010, p. 45

The organisational context

Against this broader background, we need to understand the organisational drivers that might lead companies to be more innovative and experimental in their approaches to change in this recession than previously, despite the fact that financial savings through redundancies would quickly meet the organisations' short-term goals. Indeed, a number of our case study organisations admitted that compulsory redundancies were initially considered as the prime solution.

Our research confirms, however, that other contributing factors are in play.

Firstly, the cost-saving approaches employees have taken that have retained labour may also be a nod towards an acknowledgment of the need to be fully prepared for recovery, which is harder if you are at reduced capacity with knowledgeable and skilled employees gone. In previous downturns key skills, such as IT, have also been lost due to poor workforce planning and simply reducing headcount without thought to the future.

Secondly, there has been a desire to avoid crude downsizing methods that can have adverse effects on the employees left behind – the so called 'survivor syndrome'. Developing employee engagement has been a more explicit aim of organisations in recent years because of the belief that this will drive higher organisational performance. Maintaining engagement during a downturn is especially important in meeting organisational goals. This suggests giving particular care to the process of achieving cost reduction, involving employees as much as possible in the decision making, and then executing any difficult decisions in a demonstrably fair and even-handed way.

Thirdly, how an organisation handles cost savings also resonates in the labour market. Organisations have invested much in their brand image and do not want it sullied by the way in which they are perceived to have handled the recession. Similarly, having an attractive 'employee value proposition' (EVP) (the content of the employment offer) is important both internally to the organisation's own employees, and as an external marketing device. Employers may be seeking to limit damage to the EVP, or even be seen to enhance it in the way that change is handled.

Finally, there are the enormous hidden costs of redundancies, as observed in companies in the 1990s who were laying off staff in one part of the organisation, only to be hiring others in another part. Moreover, there has been the imperative to retain and protect their investment in talent, both to survive the recession and succeed thereafter. Previous downturns had also demonstrated that it takes considerable time to recruit adequately once the market improves and managers are all too familiar with the 'war for talent' in the good times.

Five key findings

Our review of the evidence, reinforced by our detailed case-study findings, leads us to the following provisional conclusions:

1. There is clear evidence of **pay-focused approaches** being widely adopted as alternatives to redundancy, with pay freezes being the most prevalent.
2. Despite the aggregate evidence suggesting no greater tendency to reduce hours worked in the current recession, it would appear that greater innovation in hours adjustments through a variety of **flexible working practices** has been a major theme for employers looking to cut costs by flexing or temporarily reducing time inputs.
3. There is evidence of employers making intensified efforts to maintain **employee engagement** levels during the recession.
4. There is evidence of employers having taken a more strategic approach to cost-saving initiatives, focusing on what are seen as the **'key enablers'** for a business, often on an enterprise-wide basis, thus protecting the organisation's ability to capitalise on new demand when growth returns.
5. Employers have attempted to foster a **'shared destiny' approach** in applying cost-saving strategies across all levels of the organisation and establishing collaborative working relationships and a one-firm response to changing business circumstances.

In the sections below, we present some of the evidence underlying these conclusions, but it should be noted that these themes are inter-connected rather than discrete and that evaluation of their effectiveness is not yet complete. Moreover, it should also be stressed that strategies we describe were often more emergent than clearly determined at the outset. There was evidence of experimentation, of trying things out. Indeed, it seems that as the recession deepened companies have become more creative in their search for the optimum solution (Towers Perrin, 2009).

1. Pay-focused approaches

In response to falling activity levels, employers have adopted a number of cost-saving strategies as alternatives to reducing headcount. Research conducted by the CIPD and KPMG (February 2009) showed the top ten alternatives to redundancy in operation during the downturn were:

1. recruitment freezes
2. pay freezes or cuts
3. pay deferral schemes
4. removal of overtime
5. short-term or flexible working
6. reduced use of agency workers
7. cuts in bonuses or pension payments
8. sabbaticals (paid or unpaid)
9. secondments to other companies
10. redeployment in other parts of the business.

As the above list shows, much of the focus of cost-cutting has been on reducing pay costs per head as well as the size of labour input. Concentrating on pay related cost-cutting, a survey of 1,600 UK workers conducted in Summer 2009 showed over half (54 per cent) of workers had experienced a cut in pay, a reduction in hours or a loss of benefits since the recession began (Keep Britain Working, 2009). A Towers Perrin survey published in 2009 also found that the most common cost-cutting approach was salary freezes.

However, the extent to which salary 'freezes' in the private sector over the duration of the recession have really been absolute pay freezes has to be questioned. The latest CIPD Quarterly Employee Outlook reports that over a third (35 per cent) of staff state their organisation has frozen pay; however, various surveys and IES's own research into employer responses to the recession and reward effectiveness have highlighted that, in a significant minority of cases, pay freezes have been applied with what the HR Director of Canon Europe (at IES's 2009 Annual HR

Conference) described as being '*with a pinch of salt*'. Incremental and developmental pay increases, 'hot skill' payments for professional staff, pay increases and bonuses for high performers, all seem to have continued to operate in 2009 despite no general pay award, meaning that at least some staff received earnings increases. However, the use of other cost-saving strategies, such as those mentioned above, has reduced levels of total earnings for employees at some companies.

2. Implementing flexible working practices

Throughout the recession we have seen greater use of temporal flexibility (ie varying working hours to achieve a more effective deployment of labour to meet business requirements) in order to avoid headcount reductions. Employers have implemented flexible working patterns, such as flexible working weeks, short-time working and reduced hours, to flex or temporarily reduce paid hours. According to joint CIPD and KPMG research in February 2009 some 19 per cent of companies were making greater use of flexible working during the recession and the CBI found, some four months later, that over two-thirds (69 per cent) of organisations had increased or were planning/considering increasing flexible working.

The Towers Perrin survey also found that temporal flexibility was a major theme for organisations to seek ways to make cost reductions without losing talent and for placing them in a favourable position when demand for services or products returns. This form of flexibility was also a valued feature within the case studies IES conducted for this research.

The business benefits of flexible working patterns have long been known, but have not always convinced management, being seen more as a benefit to employees. Employers who implement flexible working successfully, so that labour supply more closely matches the business need as well as the individual's request, have reported bottom line benefits in terms of reduced levels and costs associated with sickness absence, more returners from maternity leave, greater productivity and engagement, and an ability to retain the employees they want to retain without necessarily having to increase financial incentives or rewards (IES, 2010).

Two of the case studies IES used for this research – KPMG and Norton Rose – told us of the increased appetite for flexible working amongst employees, and gave us insight into how more permanent approaches to flexible working might be implemented after the recession.

KPMG launched 'Flexible Futures' in January 2009 in order to achieve flexibility in its workforce costs and retain its investment in talent. The scheme involved two voluntary flexible working options:

- one day off a week unpaid
- between one and three months off at one-third pay.

It provided a guarantee that there would only be a maximum 20 per cent salary reduction for employees. Staff could opt to take one or both options. The second option was the most popular as employees could fit the time release in blocks to fit around school summer holidays or childcare. Some 83 per cent of the workforce signed up to the scheme across 10,000 employees.

Norton Rose asked also employees to change their terms and conditions of employment for the financial year running from 1 May 2009 to 30 April 2010. This gave the firm the opportunity to increase the flexibility of their workforce during the downturn, reduce redundancies and make cost savings through a reduction in the pay bill.

Staff could take a sabbatical of four, six or eight weeks at 30 per cent of pay or work a four-day week at 85 per cent of salary. Salary deductions are spread over six months to reduce the impact of the loss in salary. The company was aiming for 75 per cent of staff to sign up to the programme, but overall 96 per cent of staff agreed.

Neither firm has introduced their scheme as a permanent arrangement but the large number of positive responses and agreements to take part may have a longer-term impact on the organisations. At KPMG there has also been an increase in normal flexible working options being signed up to and annualised days and 'glide time' (8am to 4pm or 10am to 6pm) have increased. It also predicts that more employees may sign up to its regular flexible working patterns once the agreed period of change in terms and conditions comes to an end.

This suggests that there is a demand for more flexible working and that flexibility can become more acceptable for men, as well as women, if sustainable employment practices and business benefits are at the heart of schemes, rather than a focus on childcare and work-life balance, although these are, of course, much valued by-products.

3. Maintaining employee engagement during the downturn

Previous IES research has produced a definition of employee engagement is as follows:

> *'Employee engagement is a positive attitude held by the employee towards the organisation and its values. An engaged employee is aware of business context and works with colleagues to improve performance within the job for the benefit of the organisation. The organisation must work to develop and nurture engagement, which requires a two-way relationship between employer and employee.'*
>
> Robinson 2009

Alongside the flexibility theme, our case-study and literature evidence suggests that employers have made efforts to maintain employee engagement during the downturn, in the belief that it is engaged employees who will keep companies afloat during the hard times, and help them recover and thrive when business activity levels rise. Employers have also recognised that the way in which they manage the workforce during the downturn impacts not only on the well-being and productivity of the surviving employees, but also on the external presentation of the company brand and reputation. Therefore, many employers have been focusing on more intangible factors, such as timely communication and promoting honesty and trust within the organisation.

A recent report by the International Labour Organisation comments that:

> *'Companies with long-term Human Resource Development strategies are more likely to view their employees not only as costs, but also as assets.'*
>
> Ulrich et al., 2009

And our research has suggested that, during this downturn, maintaining the engagement of the employee asset has not been neglected, with a focus on the mutuality of an engaged relationship and efforts taken to build trust in the integrity of management.

Valuing honesty, integrity and trust

IES research (Robinson 2009) has found that, during the recession, character traits such as integrity, honesty, humility, modesty and reliability have been attracting attention and admiration. This had started before the recession, but the downturn has simply accentuated the trend. IES's recent research on engagement identified the behaviours adopted by managers who are perceived by their organisations and, in particular, their teams as being 'engaging'. These include, among others:

- integrity, honesty and openness is demonstrated, for example, when communicating bad news
- providing clear explanations and direction, and skilled at communicating organisational culture and aims to the team
- interest in people, knows what interests and motivates them as individuals, and understands their strengths and weaknesses
- involves the team in decision-making and work organisation, and delegates effectively
- visibility and accessibility.

However, the research showed teams were also very appreciative of managers who were performance-driven, and who were able to be hard-edged and firm if the situation required it. It would appear that:

> *'A key lesson for leaders is that engaging with employees takes time, effort and hard work, and is about genuinely establishing a two-way, collaborative relationship.'*
>
> Robinson, 2009

At one of the IES case study organisations in the current study, trust was perceived as having vital importance in ensuring the success of the scheme implemented to reduce workforce costs. It was argued that such high levels of sign-up to the cost-saving scheme would not have been possible if staff did not have trust in their managers.

Maintaining the engagement of the 'survivors'

Any poor management of the workforce and the cost-saving measures implemented during a downturn have the potential to also damage the reputation of a company and therefore its competitiveness. Earlier IES research has shown that when headcount is reduced the 'survivors' may experience a decrease in morale, increased absenteeism, reduced job motivation, reduced organisational commitment and employee engagement, risk avoidance, reduced speed of decision making, and a drop in productivity (Wolfe, 2004).

The attitude of the survivors is also largely determined by the management of the change process and the demonstration of procedural justice, as this contributes to people's judgement of the fairness of the changes. It is how an employee feels they are treated rather than the outcome itself that counts most in their minds and affects their acceptance of any changes (Reilly, 2001).

The way in which changes are communicated to employees can profoundly effect the commitment and well-being of the 'survivors' and can determine their perceptions of the current situation and the future consequences (Wolfe, 2004).

Maintaining effective communication was a key element in the implementation of the cost-saving strategies employed by the IES case-study organisations. Similarly a study by Deloitte (2008) described cost improvement as 'both a science and an art', arguing that, on the one hand, it is critical to pursue tangible cost savings, yet on the other hand, less tangible factors such as stakeholder buy-in and timely communication are often just as important to achieving the desired outcome (Deloitte, 2008). IES research on reward effectiveness highlights just how critical communications really are, with 65 per cent of participants planning and investing in improvements in employee communications or understanding (Brown et al., 2010).

The external impact of actions on the company brand

The external exposure received for any change programmes can have consequences for a company brand and reputation and can impact on its ability to attract future talent. One of the IES case studies for this study received significant media coverage in the national and human resources press for the cost-saving measures they introduced during the recession (emphasising retaining talent and protecting employee loyalty) with, it is believed, a positive future impact on its attractiveness to graduate recruits. The implementation of the cost-saving scheme in the case study organisation also generated a significant amount of goodwill among employees. In July 2009, after the implementation of its scheme, it was reported in a trade publication's survey that some 85 per cent of employees believed the way the case study company had managed redundancies had enhanced the reputation of the company and brand.

4. Focus on the key 'enablers' of the business

Another key message emerging from the IES case studies was that any cost-saving strategy, beyond compulsory redundancy, has to address the key enablers of business performance, in order to make it effective in avoiding headcount reductions. This point has a number of dimensions. It is about focusing on the long term as well as the short; not adopting a blanket set of measures, but ones targeted on the cost pressures faced in different areas of the organisation; seeing issues from an organisation-wide perspective and not simply allowing narrow, sectional interests to prevail.

Actions have to be anticipatory, and considering and consulting with a range of stakeholders about future pressures will directly influence decisions made in the short-term. For example, the key business enabler in the manufacturing division of one case study organisation was considered to be achieving labour mobility across different manufacturing sites, while in the finance department it was achieving savings in the pension scheme.

A Deloitte survey (2008) found that during a recession companies must find cost savings that cut across organisational silos, and suggests that an '*enterprise-wide analysis of actionable spend (ie costs that are within the company's control over the next 12 months) can help uncover new opportunities*'. This company-wide examination is considered valuable as:

> *'Most managers and executives only have visibility to a narrow set of costs related to their day-to-day responsibilities. Seeing everything rolled up together can help a company put its existing cost-reduction initiatives into perspective, and help decision-makers understand the broader opportunity. It can also provide guidance and input on where the company should focus its efforts.'* Deloitte, 2008

This 'enterprise view' does not equate to making deep cuts across the board. Deloitte's report highlights the danger of cutting investments in business areas that are critical to the long-term strategy of the business, such as R&D and marketing. Cost-saving in these areas can reduce the company's ability to capitalise on new demand when growth returns. This was foremost in the mind of an IES case-study organisation that offered voluntary redundancies. To act as a safeguard on the staff volunteering for the programme, the Board of Directors had to sign-off each application for voluntary redundancy or retirement and any new hires over the last two years who were volunteering required the HR Director's sign-off to check they were not losing skills that they had recruited specifically to fill a skills gap. Also, among the company's white collar staff, the working week was increased by three hours from 37 hours to 40 hours with no additional pay. This was so that staff could spend longer on product innovation and creative solutions that would help the company when the markets improved.

5. Fostering a 'shared destiny' approach

In some organisations employee engagement is seen very much from an organisational perspective and may lack the mutuality that we argued should be part of how it is managed. An important theme, therefore, emerging from the IES case studies was a deliberate attempt to create a sense of a 'shared destiny' in facing business problems. For example, cost-saving measures were often launched amongst the most senior staff before launching to staff on lower grades. Salary freezes were applied to both employees and executives, causing Towers Perrin to reflect on '*companies' increased sensitivity to setting a good example at the top of the house and living the "shared destiny" theme'.* This naturally makes a lot of sense in that their research with employees showed that staff tend to be more engaged when they feel leaders are 'with them' in meeting challenges (Towers Perrin, 2009). It is also consistent with the points we made earlier about good communication and processes being perceived as fairly designed and executed.

The concept of a shared destiny is also well illustrated by the Chief Executive of Marks & Spencer, who said last year: '*There won't be any (executive) bonus, I certainly won't be getting anything over and above what my staff enjoy*'. The recent Towers Perrin survey found that fewer than half of employees in organisations that had frozen or cut pay agreed with the action, leading to the conclusion that:

> *'Poor communications have eroded the bonds of trust between employer and their employees.'*
>
> Towers Perrin, 2009

One way of emphasising shared destiny is by involving employees in making the tough decisions over how to make savings. Just under half of respondents to the

Towers Perrin survey actively brought their workforce into the problem-solving process during the downturn, in keeping with the trend for increasing employee involvement in businesses processes that can drive engagement and also build a two-way collaborative working relationship.

Jaguar Land Rover, for example, following a collapse in product demand, consulted its employees over potential savings; presenting them with a menu of options worth over twice the level of reduction required. This way employees could choose which concessions to make. However, it remains to be seen whether, if eventually further cuts still have to be made, these approaches are seen as simply delaying an inevitable headcount reduction.

Indeed, even when actions are taken by employers in good faith, it can be easy to lose the trust of employees when implementing cost reduction strategies, which directly impact the workforce, if measures do not stretch far enough. One of the IES case study organisations, after protracted negotiations with the unions, implemented a number of cost saving measures (including a pay freeze, reduced working week, termination of bonus, and reductions in training budgets) but found it had to find further savings as the recession deepened. This was described by the HR Director as going back to the employees '*Oliver Twist-like to ask for more*' and he feared this would be a potential cause for resentment among employees who had already made concessions in good faith.

Conclusions

After consideration of the five main lessons emerging from this research, we are presented with a number of questions.

Organisations may have been genuine in seeking to avoid compulsory redundancy by employing creative solutions to cost saving, but this has taken place during a period great market uncertainty and the extent of the downturn may result in companies having to seek further savings. After initially implementing these creative solutions, will organisations revert back to the tried and tested approaches if the market demands it, receiving little credit for their attempts to avoid redundancies at an earlier stage? And to employees, will change feel like 'salami slicing' – just what organisations might have hoped to avoid?

What will happen when the economy improves? Will we, as many commentators forecast, soon face a difficult employee relations climate as unions and employees try to win back some of the financial concessions made over the past months? If the economy does not pick up quickly, how long will employees tolerate wage restraint?

With regard to the use of temporal flexibility, will we all go back to 'normal' with the majority of men working full time and flexible working slipping back to being the preserve of the working mother? Will organisations recognise that flexibility can have productivity and other business benefits even in the good times? Should we acknowledge that flexible working of this sort is much easier to apply in professional service firms, such that its adoption will be limited to organisations of this type?

While organisational leaders may have realised the benefits of engaging with employees, have recent experiences made them rethink employee engagement on a more mutual basis? Retaining employee trust in a volatile market is challenging and requires leaders to establish genuine collaborative relationships with employees and find the means to involve them in decision making. In times of recovery will the benefits of engaging and communicating with employees and fostering participative leadership be realised, and will these investments continue to be made?

Next steps

The full research findings including the four detailed case-studies will be finalised and disseminated to IES corporate members during the coming months. The research has also been used to inform IES HR consulting projects, such as a current project with the IDeA, looking at organisational redesign. IES is also hosting an HR Network member event in May 2010 on 'Resourcing for the upturn'. This event, which will feature the research, invites members to explore and learn how organisations have responded to challenges to remain competitive during the recession while ensuring they can acquire and deploy the right resources at the right time when the upturn begins.

Discussion points

- Do the research findings in this paper match your own experiences of how employers are reacting to the current economic climate?
- How effective do you think these alternative measures are proving and do they signify a longer-term and more widespread shift in the management of people at work?

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