



Headcount optimization in large companies. Can you avoid mistakes?

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The 2014 economic downturn in Russia differs significantly from those of 1998 and 2008 – it has different root causes and expectations from the signs of the GDP curve reversal. But, as in any other crisis, the business (be it large or medium, public or private) responds accordingly in order to optimize costs, including personnel costs.

The most evident staff reductions took place in large companies. For example, in April 2015 the Supervisory Board of Rostec announced a plan to cut its administrative function by half. In absolute terms, these measures (if implemented) will result in the release of up to 40 thousand employees both in the headquarters and subsidiaries. To date, Rostec has already reported the completion of the first wave of reductions in the headquarters having reduced the headcount from 624 to 400.

No less ambitious steps are planned by the Central Bank of Russia. In December 2013 the Central Bank announced its plans to optimize headcount by up to 30% in 2014-2016. In 2014 the Central Bank has released about 3.5 thousand employees, having reduced its headcount by 5%. This process continued in 2015 (according to preliminary estimates, the share of released personnel in 2015 totaled 18%, primarily due to outsourcing of support functions). In H1 2015 Top 30 Russian banks planned to release 25 thousand employees representing about 4% of their total headcount. Exhibit 1 illustrates some examples of headcount reductions announced by major Russian companies. If all of them were implemented, at least 167 thousand people lost their jobs in 2015.

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Exhibit 1.
Overview of headcount optimization plans in top Russian companies in 2015

Examples of planned lay-offs in largest Russian companies			
Company	# of employees in 2014, thousand	Estimated reduction in 2015, thousand, percent	Comments
 PIB	835	58 -7%	As part of OPEX optimization plans through 2017
Top 30 Russian banks ¹	582	25 -4%	Primarily in retail business (loans)
 Rostec	443	40 -9%	Headcount reductions in administrative function
 ПОЧТА РОССИИ	353	15 -4%	As part of systematic long-term headcount reductions in 2014 - 2023
 Rostelecom	158	9.5 -6%	Primarily in mid-tier management
 AVTOVAZ	52	10 -19%	Dismissals of all employee categories
 РОСЭНЕРГОАТОМ	37	3.7 -10%	Primarily in mid-tier management
 VimpelCom	27	3.0 -11%	Dismissals of all employee categories
 ИНТЕР	12 ²	0.9 -7%	Reduction of personnel with duplicating functions
 UTair	7	2.3 -33%	Primarily in ground crew
Total companies in the survey	2 506	167 -7%	

1 Top 30 Russian banks by asset size
2 # of employees at "Inter RAO Elektrogeneraziya" and "Nizhnevartovskaya GRES"
Sources: RBC, reports of companies, MCG analysis

The banks with focus on retail business had been particularly negatively influenced by the crisis. Mass reductions had been completed in at least 9 large retail banks. As a result, more than 21 thousand people lost their job (Exhibit 2).

Exhibit 2.
Overview of headcount optimization plans in top Russian banks in 2015

Examples of planned lay-offs in some of the largest Russian retail banks			
Bank	# of employees in 2014, thousand	Estimated reduction in 2015, thousand, percent	Comments
 VTB24	42.2	3.3 -8%	Personnel and branch network optimization due to shift to distant client service channels
 HOME CREDIT	28.9	9.6 -33%	Optimization of retail branch personnel as part of cost reduction program
 otpbank	17.8	2.1 -12%	Cost reduction due to increased losses and bad debts
 ВОСТОЧНЫЙ	9.3	3.9 -42%	Optimization of underperforming regional branches
 RUSFINANCE BANK	5.3	0.4 -8%	Personnel optimization in accordance with Societe Generale banking group's effectiveness growth program
 Credit EuropeBank	4.8	1.5 -31%	Optimization of underperforming regional branches
 Запсибкомбанк	3.3	0.2 -6%	Personnel optimization in accordance with the bank's effectiveness growth program
 ДЕЛЬТАКРЕДИТ Ипотечный Банк	0.6	0.1 -17%	Personnel optimization in accordance with Societe Generale banking group's effectiveness growth program
Total companies in the survey	112.2	21.1 -19%	

Sources: RBC, Interfax, Reports of banks

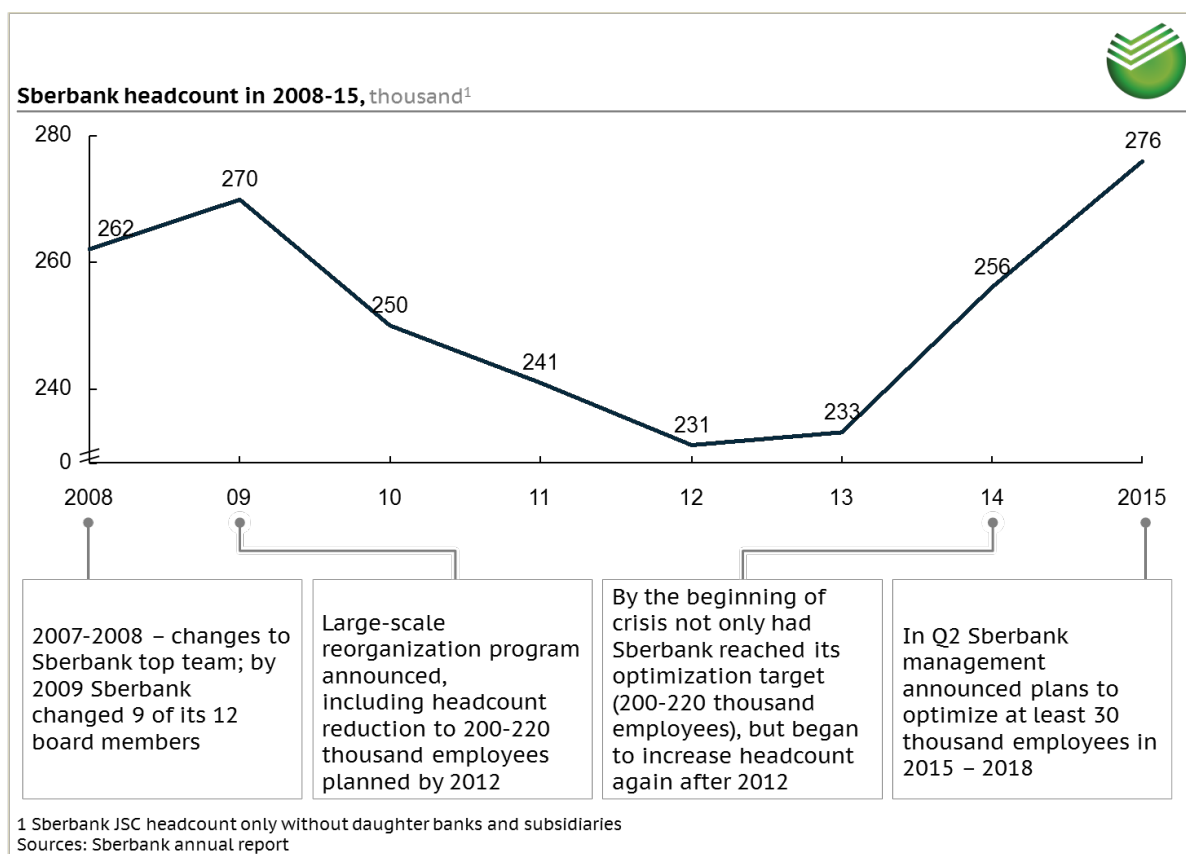
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However, planned reductions are not always completed as planned. And, moreover, the effect of headcount optimization is often likely to be short-lived.

For example, Sberbank's optimization plans announced in 2010 assumed the reduction from 270 to 200-220 thousand employees in 2014. The results of downsizing efforts made by Sberbank and consultant's Team were visible in 2010-2012 when the number of Sberbank employees dropped from 270 to 230 thousand. However, in 2012 the headcount curve reversed - by the end of 2015 not only the number of employees has achieved its target (200-220 thousand), but exceeded the 2010 level (276 thousand).

in Q2 2015 Sberbank announced its new optimization program having planned at least a 30 thousand reduction within the next three years (Exhibit 3).

Exhibit 3.
Headcount change at Sberbank



Let's try to understand how the regular headcount reduction process is organized in large corporations. What are the key drivers of performance and sustainability in such activities? Why do some companies manage to go through this complicated and unpleasant process within deadlines, achieve targets and sustainable performance in the future, while others are doomed to repeat futile attempts time and again?

Key headcount reduction phases

To ensure efficient project control and continuous progress tracking, the company fields a Project Team headed by the Project Sponsor – a senior executive who possesses all the experience, motivation and mandate to manage headcount reduction processes across all organizational units of the company. The Project Sponsor is responsible for final project deliverables and reports to CEO and shareholders.

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The optimization Team consists of dedicated employees involved in the project during the entire project duration, whose main task is to perform project activities. We can mention a number of examples when companies decided to go through the reduction process independently and created Project Teams relying fully on in-house resources (most often HR Department).

However, the most effective approach is to hire external consultants that 1) have a vast headcount optimization experience in other organizations, 2) are focused on the project objectives, and 3) take a completely neutral position with regard to all departments of the company.

In a short period of time (usually a headcount optimization project in a <5000 employees company takes 3-6 months to complete), the consultant's Team can impartially identify the most obvious pain points and propose an effective optimization program without significant changes to distribution of resources in the company

When an external consultants runs the project, employees of the company participate in the Project Team. Usually they are employees from HR Department, and managers of all the departments involved. However, the role of company's employees in the joint Team is limited to the provision of information support, setting up meetings, discussions, and participation in the final decision-making. The most part of intellectual and analytical work is performed by external consultants.

At all times and in all places headcount optimization is structured around 3 consecutive phases – goal setting, refining and syndication of the target headcount, followed by the implementation monitoring. Exhibit 4 shows the main phases and expected deliverables for each of the approaches.

Goal-setting is the first phase of the optimization process. It includes a comprehensive diagnostics of the current status and syndication of the expected deliverables. Will the reduction of payroll by X% allow to maintain your profit margin? What is the best timing to complete headcount optimization? How does the planned optimization fit not only with short-term (12-18 months), but with mid-term (3-5 years) production and sales plans? Are there alternative opportunities that allow to maintain stability without resorting to layoffs? What are pros and cons? How effective are these measures?

These questions can and should be answered by the end of the goal-setting phase. The key deliverable of this phase should be a high-level payroll reduction target (for example, a rationale for a 10% payroll cut within the next 6 months), agreed with top management and key project sponsors, and a set of measures that allow to reduce the payroll costs without direct layoffs. The top team must be strongly convinced that the optimization target is achievable on the one hand, and will allow the company to achieve its mid-term strategic goals, on the other. In this connection, it is also important to assess possible downsides and develop a respective mitigation plan.

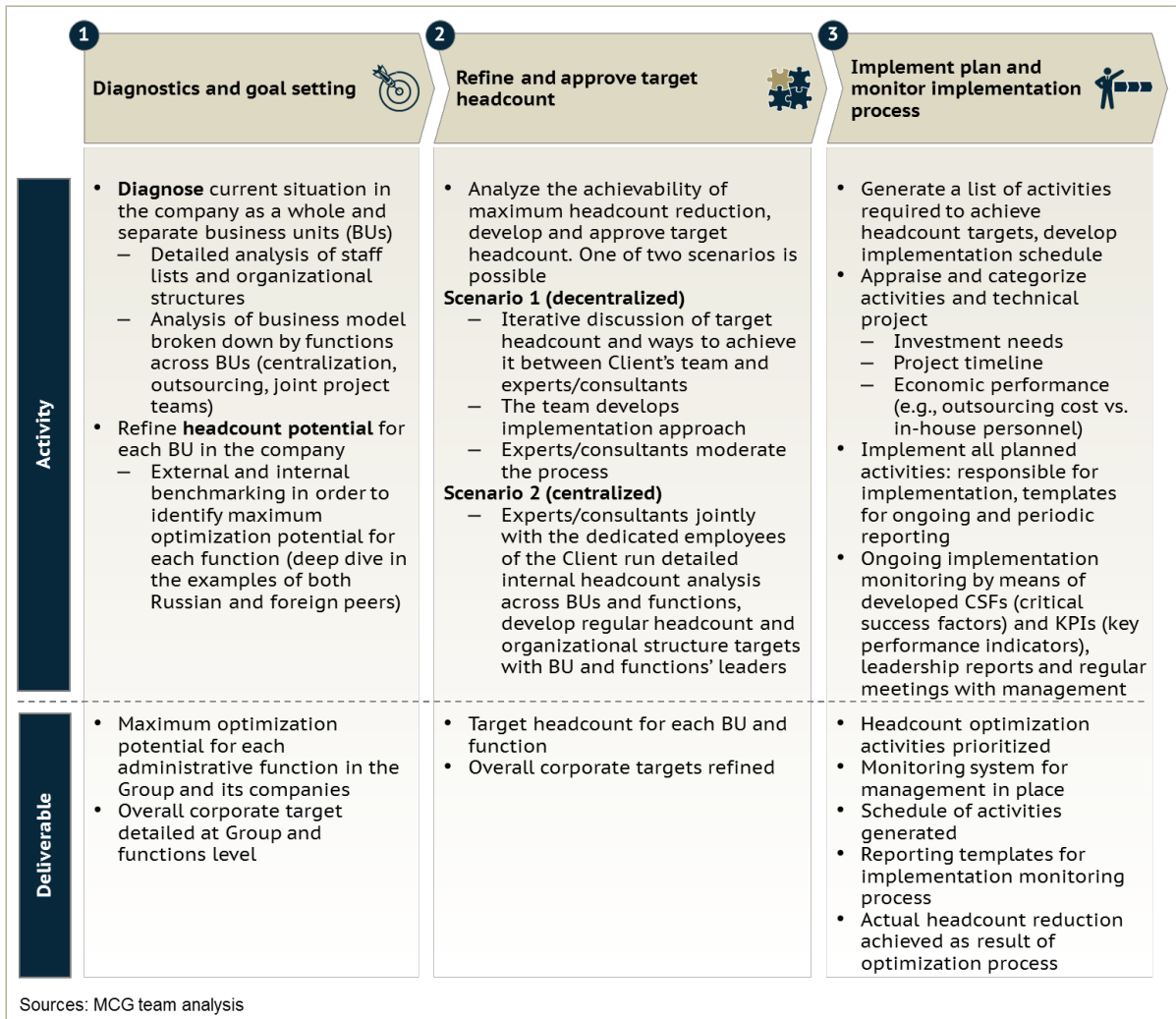
Further, once the overall target of the company is approved, a **detailed study and approval of the target headcount by business units is required.**

At the **Refining** phase the Team develops common principles and approaches to the identification of target headcount by business units. These principles and approaches underpin the headcount optimization methodology and remain unchanged throughout the entire project. Examples of such principles: “at least 2 and maximum 7 subordinates for each line manager” (maximum 15 for production crews), “at least 70% of employee's work time is used in core vs. auxiliary processes of the business unit”, “yield per employee is equal or higher than average in the peer group”.

The developed and approved methodology and optimization principles are communicated to all units of the company, thus creating a transparent optimization process and a sound case for decision-making.

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Exhibit 4.
Key phases of the headcount optimization project



Various methodologies and approaches can be used at the target headcount identification phase. Maximum and minimal Team involvement in the setup of the organizational structure are the two opposite approaches to the process. In the case of limited Team involvement, the management of business unit performs optimization in part or in full. The management prepares its headcount optimization proposals with or without the consultants' assistance.

However, the Team always remains responsible for the monitoring of compliance with the methodology and principles, analysis of the consolidated results by departments, preparation of final and interim reports and draft decisions for the top management. Exhibit 5 illustrates the main differences and optimization process principles with centralized and decentralized approaches. For example, the decentralized approach scenario assumes a deep involvement of top management.



In this scenario, the role of the Project Team is limited to coaching and consultation relying on the same standards and optimization principles, and monitoring and coordination of business units' independent activities. If expectations about the level of involvement of the units' management are low, the management should choose the opposite scenario with a centralized approach. In this case the role of the Project Team is broader and in fact requires a deep dive in the situation analysis and the development of optimal organizational solutions for each of the divisions of the company.

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Obviously, the expectations about the time required to complete the optimization target phase vary greatly depending on the approach selected. In the centralized approach scenario most of the work is done by the Team, and the expected time to complete will be maximized. In this case, large companies are advised to setup their work in several successive waves (the headcount is optimized in sequential waves rather than at once. For example, first we identify the optimization target for white collars, then for blue collars, and then for regional offices.) Throughout this Phase the Team regularly discusses the project status and reports it to the top management and project sponsor. This procedure helps to ensure the relevance of goals set and to prioritize operational decision-making during the project.

Exhibit 5.

Each of the two scenarios for target headcount refining and approval has its pros and cons

Benchmarking of target headcount refining and approval scenarios		
	Scenario 1. Decentralized	Scenario 2. Centralized
Scenario	 <p>Functional leaders of each BU in the organization independently propose headcount optimization activities based on top-level goals and reduction methodology</p>	 <p>The project team generates detailed headcount optimization ideas to be agreed with BU and functions' leaders</p>
Requirements	<ul style="list-style-type: none"> All functional leaders are involved in the process (at least 30% of working time) High loyalty of personnel Significant involvement of top team to ensure high motivation High competency of functional leaders in the area of headcount optimization 	<ul style="list-style-type: none"> The project team employs best talents from each function in the BU and organization (10-15 people with 50-100% involvement) Insignificant involvement of corporate top management: during project launch and syndication only
Strengths	<ul style="list-style-type: none"> High involvement of personnel ensures high loyalty in the implementation process No dedicated phase for syndication of the optimization process 	<ul style="list-style-type: none"> Single independent approach to generation and study of hypotheses Average involvement of key functional leaders of the Group and corporation
Weaknesses	<ul style="list-style-type: none"> Potential schedule overruns and incomparable results in the companies of the Group High implementation complexity due to low competency in headcount optimization Potential effect of arbitrary judgment and personal relationships leading to loss of competent personnel 	<ul style="list-style-type: none"> Availability of syndication phase Potential occurrence of additional questions at implementation phase and schedule overruns due to necessity for subsequent study in all BUs

Sources: MCG team analysis

The key deliverable at this phase is the organizational structure for each unit agreed upon by the top team and prepared in accordance with the pre-defined principles, that help achieve the payroll optimization targets set at the goal-setting phase. Also, at this Phase, the Team prepares and approves implementation plans and budgets for additional measures to reduce the payroll, developed at Phase 1.

If time allocated for Phase 2 is significant, it is quite possible that some of the additional measures will be implemented during this Phase. Thus, the organization will see the actual tangible benefits prior to project completion.

Phase 3 is the final project phase when optimization measures are implemented. Phase 3 involves the development of optimization plans and implementation of progress monitoring system. At this project phase the Team prepares realistic optimization plans, supports business units in emerging issues, and

prepares regular reports on the project status for top management and project sponsor. At this phase the company may decide to refuse from the external consultant's services fully or in part, as many of the activities required at this phase are direct responsibilities of HR and other departments, while the project effect is already evident. The role of an external consultant may be confined to regular (usually weekly) sessions when the consultant provides methodological support and participates in the discussion of the implementation status.

Key success factors

- 1) Focus and personal buy-in of top management
- 2) Selection of the optimization approach that truly fits the organization
- 3) Regular monitoring and prompt response

Based on our experience, we see several key factors that allow us to predict the effectiveness of the company's efforts to optimize headcount with high accuracy from the onset.

First, it's **top team's focus and strong buy-in**. Key success factors include close attention to the project, focus on deliverables, allocation of responsible with resources, mandate and motivation to implement the project. When it comes to real experience, we encountered the situations where top management expected to see immediate effect, however, without incurring the costs associated with staff reductions (e.g., lump sum severance pay, negative coverage in the media, restructuring and business processes optimization costs). Moreover, the responsible HR Director was not vested with the mandate to collect the information on the optimization status in the subsidiaries.

As result, the layoffs took place in some of the least operationally important units only (controlling, HR and information networks) and has not resulted in the expected payroll cuts. Moreover, a few weeks after the project completion the management was forced to recognize the need to return some employees to their jobs (primarily, system administrators). This caused doubts among other business units and debates about the cancellation of the project decisions.

As a result, not only has the company lost time and money, but also reduced the motivation of its employees, disappointed with inconsistent and ill-conceived actions of management.

Another critical success factor is **the selection and use of the appropriate optimization methodology and approach**. As mentioned earlier, the workload necessary for the successful development and planning of optimization activities is allocated among the selected experts of the Team and heads of departments of the company. Most likely, the heads of departments do not wish to part with their employees immediately and voluntarily. Moreover, they often do not envisage the optimization project as their highest priority. Moreover, if the department has no optimization experience, or, alternatively, has passed through multiple optimization procedures, the role of departments in the setup of optimization projects should be minimized. Otherwise, shifting the responsibility on the department will not lead to the ultimate goal.

As an example we may mention a headcount optimization project in a Group of Companies. In this project we faced a situation where the Group management wished to reduce the project duration, as well as to minimize the Team size while maximizing the role of its units. After developing basic principles and optimization methodology the Team focused on its consulting and project supervision functions. The heads of departments had independently developed their new organizational structures. However, since most of the Group units were almost full-fledged operating companies, their experienced leaders have tried to avoid the dismissal of their employees, having transferred them to

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alternative employment contracts or separate companies that provided services on the outsourcing basis. As a result, although the payroll reduction was achieved, the actual costs of business units has not changed. On the contrary, sometimes they increased due to the redistribution of the units' costs. Thus, the main goal of the optimization project (to increase Group's profitability) was not attained.

On the other hand, we may mention an optimization case with a large multinational company with many representative offices across the world. In this project we recommended that the management uses the approach minimizing the role of the Team. Geographic dispersion of the offices, homogeneity of their functionality (sales and marketing), and unquestioned authority of the Head Office, which was the project sponsor, made us convinced that the regional branches will successfully perform the tasks, and the Team will effectively monitor the project status.

The third success factor of the headcount optimization project is **regular progress tracking and proactive response to changes in the project status**. At the beginning of the project the Team approves a schedule of meetings with executives and project sponsors. For each meeting (at the first two phases the meetings are held 2-3 times a month), the Team prepares a brief report identifying the project status (progressing according to plan/needs acceleration), the results, and issues requiring top management's attention. This format allows project managers to focus on the most important decisions only and gives them a complete picture of the project status.

At Phase 3, when implementation of initiatives takes place, the reporting formats slightly change. Most often we are talking about 1-2 page reports with periodic assessment results by units, and a list of issues requiring top management's attention. These reports can be e-mailed once per week and do not require personal meetings.

In order to ensure that project decisions are sustainable and effective in the long-term, we recommend that management preserve the reporting formats after the active project phases are completed. Of course, their regularity may be reduced, but KPIs (for example, profitability and performance of BUs) should be recorded and measured, and deviations communicated to managers.

Perhaps all companies undergo headcount optimization process sooner rather than later. It is in their interests to maximize its effectiveness and minimize downsides. The involvement of external specialists allows (a) to relieve tensions and personnel's dissatisfaction with management, (b) to setup a functional unit, capable of focusing on goals only, and (c) to avoid methodological errors thus reducing the project timeline and increasing the likelihood of sustainable results.

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About Moscow Consulting Group

Moscow Consulting Group was established by management consultants from McKinsey & Company to provide high quality consulting services for companies of different sizes in Russia and CIS. MCG offers its clients unique flexible business model by combining in-house consultants with carefully selected independent consultants with experience in top tier global firms. MCG works with more than 500 consultants and 1000 experts across different industries. MCG focuses on strategic and operational management consulting projects. For more information about Moscow Consulting Group please visit mcgroup.ru or contact us at info@mcgroup.ru.