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The hidden costs of reorganizations and downsizing

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Overview

Far too often the CFO and Controller have been far too silent when a reorganization is muted. If anyone is to talk sense to the board and senior management team, it has to be the CFO. This 'expert article'will hopefully make the reader aware as to why they need to be very vocal and take steps to prevent these costly mistakes.

A major reorganization is as complex as putting in a new runway at Heathrow Airport while keeping the airport operational. The steps, the consultation, the dynamics, and so forth are as difficult. Then, how is it that we are unable to understand the ramifications and costs of a reorganization fully? Why do organizations appear to have an addiction to reorganizations? This guide, while it may not give a cure for the addiction, may help management be more aware of the symptoms so that advice can be sought.

A 2014 McKinsey survey of 1,800 executives identified the top three common pitfalls for reorganizations (in order of frequency).

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1. Employees actively resist the changes, and while the organisational chart changes, the way people work stays the same.
2. Insufficient resources—people, time, money—are devoted to the effort.
3. Employees are distracted from their day-to-day activities, individual productivity declines, and good employees take the redundancy and run.

Ramifications and Associated Costs

Contrary to common advice, do not act quickly to remove staff as you probably don't know enough at the moment. The companies that emerged from the 2007-08 crisis in the strongest shape relied less on layoffs to cut costs and leaned more on operational improvements. That's because layoffs aren't just harmful to workers; they're costly for companies with a whole raft of costs, including:

- **redundancy payments** (these only amount to 10-15% of total costs)
- **the halt in operations as everyone is scrambling to reapply** for their jobs and managers are involved in interviewing (these costs can be as much as 60-70% of total costs)
- **loss of key staff in the third and fourth tier** management ranks due to disillusionment and the redundancy offer as they know they are good enough to go straight into employment elsewhere
- **ex-employees are** now coming back as expensive contractors.
- **consultants' fees** targetting culture change and communication.
- the **cost of the internal interviewing process** in upsizing
- if the reorganisation involves a name change, you have the additional **costs of designing a new logo, letterhead, signage and stationery**.
- the **recruiting agencies and advertising** costs
- the **unproductive time as new staff** settle in
- the **training costs of new staff**

In addition to the above costs, you can add

- **The unwinding of the property leases** that may become surplus can take up to 24 to 36 months until the organization is released from its prior commitment.
- **Dysfunctional management teams.** A reorganization can leave you with the also-rans and the vultures (those nasty individuals busily burying hatchets in all those around).

About 24 months after the reorganization was announced, productivity is back to normal; thus, for the duration, you effectively have been going backward. In the 24 to 36-month period, advantages may kick in, provided that the reorganization has been successful. It is useful to remember that only one out of seven takeovers or mergers actually works. While reorganizations may have a greater success rate than this, it may well be less than 50 percent.

An Addiction to Reorganizations

CEOs seem to think restructuring operations is good for efficiency, improving service, and, of course, their future aspirations. In some sectors, it is an addiction. Government agencies are forever splitting up and then amalgamating. The only purpose I see is to distribute some of the public purse to the private

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sector advisors, consultants, and contractors (some of whom were previous employees).

As Francis Urquhart, a fictional character in the BBC's 'House of Cards',[i] might say,

> *"Some of you may think that restructuring a department frees the newly formed teams to deliver. Others may think that the confusion and miscommunication that often goes with a reorganization undermines people's confidence in what they do and in their team, giving rise to a period of stagnation. You may think that, but I cannot possibly comment."*

Typical Reasons for a Reorganization

Let us analyze four typical reasons for a reorganization. None of these reasons, in my opinion, really warrants a reorganization of two separate companies.

Reorganizing to Remove Certain Staff

In Government and not-for-profit agencies, it is not uncommon for a reorganization to occur in order to remove one or two senior managers. It is quite remarkable how much will be done to conceal this real intention. This is not only weak management, it is also stupid.

As Jack Welch[ii] points out, you need to apply candour and allow these senior managers to move on in many cases to the benefit of both parties.

Reorganizing to Improve Efficiency

Merging two units/teams or splitting teams up and re-forming into new teams certainly does create a climate change. The question is whether it leads to efficiency. In order to become more efficient, there needs to be a behavioral and procedural change. Staff members need to change work habits so that logical efficiencies can be introduced.

One energy sector company has made much progress with continuous improvement programs. Senior managers are heavily involved in change management, and now this is part of the culture. The company has workshops to identify areas where change needs to occur, and people at the meetings agree to take on the process of change. They have had a number of successful projects.

One finance company has had a number of successes with business reengineering. It has made significant inroads by using preferred suppliers and eliminating paperwork or passing over the paperwork to suppliers. Continuous improvement is now part of company culture. There is an ongoing requirement for staff members to keep up in their field, bonuses are paid if you pass a tertiary exam, and so forth.

The interesting point about these two stories is that they arose from business reengineering as opposed to business reorganization. Any efficiencies reorganizations achieved are simply those that are associated with reengineering the processes. Thus, one can surmise it would have been better to have performed a reengineering exercise in the first place.

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One mistake that the uninitiated often make is assuming that large savings are available when merging corporate service functions. In many cases, the costs of changing systems far outweigh the savings from eliminating any duplication of labor costs.

Reorganizing to Improve Service

As stated earlier, a reorganization or merger is like putting in a new runway at Heathrow Airport. Surely, you might think simply laying down foundations, concrete, and a bit of infrastructure is not that hard. You try telling that to the management at Heathrow Airport.

Likewise, a reorganization is a lot more complex than your planning will have indicated. Day-to-day routines are disrupted with meetings to discuss the new organization, staff members applying for new positions, staff members searching the papers and recruitment agencies for alternative jobs — need I go on? Service does not improve, not in the first two years anyway.

For service to improve, you need a behavioral change. Staff members need to buy into becoming more customer-oriented, measuring their performance in a balanced way. You have only to see the quotes on the wall in any Tony's Tyre Service (a tire company in New Zealand) customer waiting room to understand that staff members live and breathe service.

> *"Every job is a self-portrait of who did it. Autograph your work with quality. Quality only happens when you care enough to do your best."*

A positive behavioral change does not often occur with a reorganization; in fact, quite the reverse occurs in the first two years. So if you are looking for better service, maybe a service program is what is needed rather than a reorganization.

Reorganizing to Show There Is a New CEO

Many CEOs like to stamp their authority by throwing out systems they do not understand and reorganizing the business to fit a model they are more familiar with. They like to show that there is a new broom in the organization. This is typical of a CEO with an ego problem. Many reorganizations occur within the first 6 to 12 months of a new CEO arriving, and often, these CEOs are making decisions without full knowledge of the business. The cost to the enterprise is huge. In fact, as part of the recruitment process, one should evaluate the reorganizations the CEO has done.

There Are Alternatives to a Major Reorganization

Many reorganizations are unnecessary. Here are alternatives to a major reorganization that are worth considering.

Remove the Targeted Staff

Instead of putting everybody through much pain, be direct and open and face the issues. Remove the one or two senior managers causing the problems. Jack Welch in his book "Winning" offers very sound advice on Candour.