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## Managing your cost base

### The viable alternatives to redundancy

**As organisations continue to rationalise their cost base the question of redundancies remains high on the corporate agenda. In this paper we examine the implications of redundancy programmes, the viable alternatives and the potential legal and HR ramifications of each.**

#### The 'quid pro quo' of redundancy

In a survey conducted by Speechly Bircham and Kings College London of over 300 senior HR professionals, the overwhelming consensus among the HR managers was in favour of considering the alternatives to a redundancy programme. Too often, however, this view is not shared by senior management who either fail fully to appreciate the associated cost to the business of redundancy programmes or to appreciate the potential benefits of the alternatives.

The contracting economy has forced an immediate response from some businesses to trim excess capacity and align themselves with the expected demand for their goods or services in the medium term but it remains part of HR's challenge to educate senior management to various options in this regard.

#### Reasons for avoiding redundancy

- Maintaining employee engagement
- Talent retention
- Saving on future recruitment costs and avoiding shortages as the economy recovers
- Saving on redundancy costs including the loss of productivity during consultation periods, the time that management must devote to managing redundancies and redundancy payments.
- Avoiding negative PR. In fact, avoiding redundancies may lead to good PR -- KPMG and parts of the car industry being examples of this.

#### Alternatives to redundancy and legal considerations

Alternatives to redundancy can be categorised into three main types:

1. Alternatives which do not directly affect employees (eg recruitment freezes, reduction in the use of agency staff).
2. Alternatives which affect employees but only on an individual and usually voluntary basis (eg sabbaticals, reduction in working hours, redeployment).

3. Alternatives which have a collective impact on employees (eg pay freezes, pay reductions, outsourcing certain functions).

### **Alternatives which do not impact on employees**

A recruitment freeze is often implemented as a precursor to any further steps to reduce costs, although in isolation, it may not be enough to weather the storm. Employers are often reluctant to invest in the recruitment of new staff during a downturn since it is a relatively straightforward way of reducing costs. It reduces the likelihood of being saddled with superfluous employees who will accrue certain statutory rights once a period of time has lapsed (one year's service for unfair dismissal rights and two years' service for the right to a statutory redundancy payment).

A freeze is not without difficulties. Employers should be mindful of the long-term impact of a freeze as it can lead to staff shortages in the upturn. Graduate recruitment is often the first area to be targeted even though this is essential for ensuring a constant stream of new talent entering a company. In recognition of this, the government has recently proposed ways to incentivise employers to maintain graduate recruitment. A recruitment ban also prevents an employer from taking up the talent pool of immediately available and highly skilled executives often seen during a downturn.

Perhaps recognising this, several law firms have recently offered their future trainee solicitors the opportunity to defer the start of their training contracts in exchange for a lump sum. Some firms are paying the sum without conditions, others are asking their future trainees to make a case for the funding, for example, to take up some charitable or educational pursuit.

The other key way to cut costs whilst protecting core staff is to reduce the use of agency or temporary workers. That said, a hiring ban often increases the need for casual or agency staff so as to plug any gaps in staff shortages. Before terminating any agency or temporary staff, employers should check the terms of any supply agreement as it will need to comply with any notice provisions. Employers should also take care when terminating temporary or agency staff since they may have inadvertently acquired employment status (and the additional employment rights that go with such status). An employer who terminates, as a matter of policy, all of its temporary or agency staff may also face discrimination claims since workers, including agency workers, are protected under the discrimination laws.

Employers can also consider other practical changes to reduce costs, such as implementing a training budget freeze, cutting travel budgets and re-negotiating terms with third party suppliers (such as insurance companies, equipment suppliers and recruitment agencies). Some practical changes to reduce costs also have a positive impact on the environment (for example, double-sided printing, encouraging computer shut-down and turning off lights) and this can constitute a good selling point when encouraging employees to accept the changes.

Key points:

- A hiring ban can lead to future skills shortages and have a negative impact on the firm's profile, especially where graduate recruitment is targeted.

- Employers should check the employment status of so-called temporary or agency staff before dismissing them. The successive use of two or more fixed-term contracts over four years or more results in permanent status. Agency workers can inadvertently become employees if they are fully integrated into the business and are, to all extents and purposes, treated like core staff (for example, having to work fixed hours on fixed days, request holidays in the usual way, be covered by the company's disciplinary procedure, be treated in the same way in respect of sickness absences etc.) although employment tribunals are unlikely to imply a contract of employment with the end user if the agency worker has an employment relationship with the agency.
- A policy of dismissing all temporary staff could lead to discrimination claims on the ground of fixed-term status under the Fixed-term Employees (Prevention of Less Favourable Treatment) Regulations 2002. Such a policy could also be said to constitute indirect sex or race discrimination where a higher proportion of the temporary staff are female or of a certain nationality or ethnic minority.

### **Voluntary measures which affect employees individually**

Various options can be offered to employees on a voluntary basis in order to reduce costs. This involves a change to the employee's terms and conditions of employment, usually for a limited period, at the end of which his/her employment contract will revert back to its original terms and conditions. There are two main types: the first involving changes to working hours or duties (for example, unpaid leave or paid sabbaticals, reduced working hours or redeployment); the second involving changes to compensation and benefits (for example, salary sacrifice, deferred payment of salary or a reduction in contractual benefits).

The professional services firm referred to in the case study below is a prime example of a firm who has successfully implemented such measures.

Key points:

- Since these are voluntary changes, they require some goodwill on the part of the employee. Often employers will be required to incentivise employees to volunteer. For example, employers might offer interest on salary deferred or an option to earn back the salary plus a bonus should the company reach its financial targets. As can be seen again from the case study below, employees may be unwilling to take unpaid leave or a reduced working week without pay on the day off but are more willing to accept partial pay during their time off.
- These options may be less attractive to lower-paid staff who cannot afford to accept time off even on partial pay.
- Employers should refrain from putting pressure on employees to volunteer for the changes (for example, by saying "accept the changes or be made redundant") because this could lead to a breach of the implied term of trust and confidence and subsequent constructive dismissal claims.
- It will usually be safer for employers to offer the changes to everyone so as to not be seen to be targeting certain groups (and therefore minimising risk of indirect discrimination claims which that could lead to).

- There is a risk with sabbaticals that employees may not return to work, particularly if they pursue a “life dream” whilst taking the sabbatical! One way to avoid this is to defer payment for the sabbatical until say, six months, following their return to work. Another concern is that employees may take steps to compete with their employer whilst on sabbatical. Specific non-compete provisions could be included within a sabbatical agreement to prevent employees from competing with their employer.
- Some employees may prefer to be made redundant than accept a sabbatical or reduced hours as their insurance will cover them in a redundancy situation.
- In addition to a reduction in staff costs, flexible working initiatives can improve office efficiency (for example, a reduction in the need for office space).
- Employers may have to update their documentation to provide for specific flexible working and sabbatical policies and should be mindful of the long-term effect on flexible working requests.
- Internal redeployment is particularly attractive as it retains talent and the knowledge of the business whilst increasing the skill-set of the workforce. It can also plug the shortages which result from a hiring freeze.

### **Compulsory measures which affect employees collectively**

As a last resort, employers may be faced with no choice but to make changes to employees’ terms and conditions of employment on a collective and compulsory basis. For example, they could cease overtime payments, freeze salaries, implement pay-cuts, reduce other contractual benefits such as bonuses and pension contributions or, in rare cases, implement a complete office shut-down (usually an option that is only appropriate for certain manufacturing industries).

Given that this approach requires varying the terms and conditions of employees’ contracts of employment, an employer can either obtain the consent of its employees to the change (or obtain the consent of the trade union if it is recognised for collective bargaining purposes) or, if consent is not forthcoming, dismiss employees and re-engage them on new terms and conditions.

These measures are complex and require a careful approach. Collective consultation issues may arise depending on the numbers of employees involved. This approach is unlikely to be attractive to an employer unless its competitors have done or are contemplating similar moves as the more skilled staff may choose to move employer and recover the shortfall that way.

Another option to reduce costs which affects employees collectively is to outsource a function or activity. In this situation, the employees who represent an organised group of resources dedicated to the activity being outsourced may well transfer to the outsourcing company under TUPE on the same terms and conditions and with continuity of employment in tact. As with any TUPE transfer, a full consultation exercise should be carried out with representatives of the affected employees (which includes those employees who will not transfer but who are affected by it in some way, for example, those employees whose reporting lines will change). An outsourcing may be a good short-term measure to reduce employee costs since at the end of the contract, those employees who are dedicated to the services being transferred will transfer back

to the company. When an outsourcing arrangement ends, therefore, the employer will most likely be faced with an influx of employees, whether it wants them or not.

Bonus scheme changes can be useful in reducing costs. Costs can be reduced by paying some of the bonus in shares or share options, applying a cap on the overall amount, deferring payment or part-payment of the bonus, making bonuses more long-term (for example, based on performance over five years rather than annually) and placing more emphasis on company performance rather than individual performance. The current public pressure in respect of bonus schemes in the financial services sector reflects this changed approach. The FSA has recently published an FSA code of practice on this subject (see [www.fsa.gov.uk](http://www.fsa.gov.uk)).

Key points:

- Any material change to an employee's terms and conditions of employment without their consent could constitute a breach of contract entitling the employee to resign and claim constructive dismissal.
- Where consent is not obtained and the employer wishes to dismiss and re-engage, it should ensure that the full contractual notice period is given to employees before imposing the new terms (or else risk wrongful dismissal/breach of contract claims). There is always a risk of unfair dismissal claims where employees are dismissed and re-engaged, subject to the one-year qualifying period of service.
- A collective redundancy procedure must be followed where 20 or more dismissals (even if followed by re-engagement) are under consideration in any 90-day period at the same establishment.
- Until the statutory dispute resolution procedures are repealed on 6 April 2009, where fewer than 20 employees are being dismissed and re-engaged an employer should follow the statutory dismissal procedure or risk any dismissal being automatically unfair. Following 6 April 2009, employers are advised to follow the new ACAS Code when dismissing employees since any failure may result in an uplift in compensation of up to 25%. Fortunately for employers, a failure to follow the ACAS Code will not result in a dismissal being automatically unfair.
- Where terms and conditions are being varied and new policies are being implemented, these should be clearly drafted. Any variations to terms and conditions should be in writing and signed by an employee
- The law on bonus schemes is complex and care should be taken to determine if a scheme is contractual or discretionary. Schemes which appear discretionary (from the wording of the scheme) can become contractual over time. Even where schemes are genuinely discretionary, employers can be sued if they exercise their discretion perversely or capriciously or in a discriminatory manner. It would be very difficult for an employer to argue that a guaranteed bonus is not fully payable, unless it is expressly stated that the bonus is conditional upon certain financial targets of the company being reached.

The current climate is encouraging employers to "think outside the box" as to ways to reduce their costs. Employers that previously were reluctant to accept flexible working requests are now

encouraging their entire workforce to go part time. “Lay offs” which were once the preserve of heavy industry in the 1970s are becoming the fashion for 21<sup>st</sup> century professional service firms, but using the more attractive term “sabbatical”. The likelihood must be that these employers will see the benefits that flexible working can bring to their organisations and that the fears they had were misplaced. Even if employers remain unconvinced, they will find it hard to put this genie back in the bottle. An employer that embraces flexible working in the downturn will find it hard to convince a tribunal in any upturn that client demands mean that a blanket refusal to consider flexible working can be justified. Either way, we may be witnessing a sea change in working habits.

## Contact

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## Events programme

Speechly Bircham and Kings College London are running a series of learning events from February to July 2009, based on the key trends and issues that emerged from our joint survey ‘Riding the recession’.

To find out more about the events programme and to download the survey report “Riding the recession? The State of HR in the economic downturn”, please visit [http://www.speechlys.com/Employment\\_training\\_programme](http://www.speechlys.com/Employment_training_programme)

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## Case Study of a professional services firm

The firm offered a package to all of its employees in order to try to avoid redundancies. The package was offered to the entire workforce, from trainees to senior management and including those in busier departments as well as quiet departments. The package comprised two offers:

- A reduced working days scheme for 11 months or 18 months. This essentially puts the employee on a waiting list during this time and they can be assigned to work reduced days on one week's notice. Employees who are chosen to work reduced days, will work one day less than their normal weekly hours and they will receive 50% of their normal pay on the day that they do not work.
- Four to 12 week sabbaticals. Again, employees who sign up to this are placed on a waiting list and can be chosen to take a sabbatical at four weeks' notice. The sabbatical is paid at 30% of the employees' usual salary. The employee cannot necessarily take the sabbatical in one entire block.

The firm consulted collectively and individually with its employees about this package. In order to manage its employees' expectations, the firm has made it clear that the package does not guarantee that there will be no redundancies in the future. However, the firm is clearly striving to use alternatives to redundancies where possible.

What the scheme seeks to do is temporarily vary the terms and conditions of employment to allow for a period of economic downturn, something that used to be common place in manufacturing sectors but is a new concept to professional service firms. Further, the scheme embraces in the reduced working week the whole idea of flexible working, with the flexibility being that of the employer rather than the employee.

In our workshop on alternatives to redundancy, some concerns were expressed mentioned about the firm's approach. Some other companies who have tried similar approaches have faced suspicion by employees. In particular, some sabbatical schemes require employees to return to work on one week's notice which makes it difficult for such employees to travel. Some employees would rather be made redundant than take a sabbatical, as their insurance will cover them in a redundancy situation. It was also noted that a reduced working days scheme is more appropriate for better paid employees, as the reduced pay will still leave them comfortably off which would not be the case for those with more modest incomes.

A further problem of sabbaticals is that employees may not return to work, particularly if they pursue a 'life dream' whilst taking sabbatical and decide that they would prefer this as a career! It was suggested that employees can be incentivised to return to work by paying them a return to work bonus of some kind or deferring some of the pay they were to receive during the sabbatical.