# Total Cost of Workforce: The new Magic Word for CFOs

Neeraj Tandon explains how a TCOW framework can inform better decision-making

Traditionally, organisations tend to measure compensation costs quite effectively. In general, the average compensation costs across functions and levels are measured, and then used to make decisions, including during the annual performance review cycle.

Yet, keeping in mind that workforce and workforce-related costs add up to about 70 per cent of the total operating expenses of large organisations, CFOs are starting to review data that goes above and beyond mere compensation costs. Further, as the available salary budgets shrink, companies need to be smarter about how they use money to retain talent. It is important to prioritise the best performers, and to review how employees are rewarded through other incentives, such as more attractive benefits. Often, factors such as the spend on contractors, or indirect costs associated with the workforce – factors that might help CFOs take more informed business decisions – are hidden from view.

To make better decisions, CFOs need to be able to answer the following, critical questions:

- What is the investment required, given the expected strategic goals?
- What would be the impact of an employee reduction programme on operating expenses?
- When designing the reduction programme, how will critical roles be defined?
- What is an optimal span of control?
- With reference to the volumes and level of staffing expected to deliver the project, what margins can be expected when pitching for new projects?
- How will the cost vary as the workforce composition changes during the delivery of the project?

To answer these questions, the CFO and CHRO need to work closely, building a Total Costs of Workforce (TCOW) framework. Compensation cost is only one of the components of TCOW, and in this article, I will highlight the other facets that go into it.

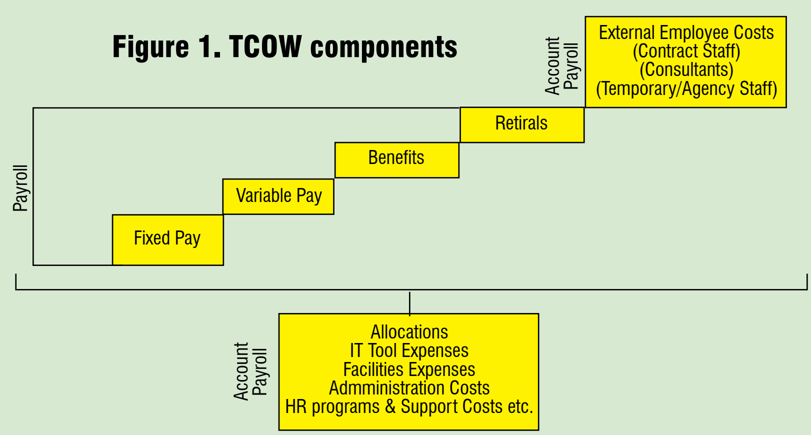
> Workforce and related costs make up the bulk of operating expenses for most companies, and at the same time, shrinking salary budgets mean that firms need to be smarter about how they use money to retain talent

## UNDERSTANDING THE VARIOUS COMPONENTS OF TCOW

### What is the investment required to pursue strategic goals?

Often, an organisation's strategic goals hinge on its people. Information on TCOW helps the CFO to determine the incremental investments required to fund the organisation's next level of growth. For example, initiatives such as growing the customer base, or increasing investments in R&D

**Figure 1. TCOW components**



/ innovation, require new talent. Enhancing one's customer service levels demands new hiring and/ or training initiatives, whereas operational efficiency improvements may call for a restructuring, which impacts workforce costs.

Part of this information is captured in the annual budgeting exercise. However, the data that feeds into a TCOW framework is much more detailed, and provides the clarity needed to take decisions related to critical roles. This helps organisations better prioritise their investments.

## Costs associated with a contingent workforce

The world of work is changing fast. Increasingly, businesses are leveraging alternative work arrangements to meet their changing needs. The employee-employer relationship is no longer the only strategy used by recruiters to get the right talent. With the growing use of contingent workforces to execute work, it's important to capture the workforce cost in its totality. When CFOs have a view of the spending on their contingent workforce, they are able to forecast trends and make plans to utilise it in both their current and their future business scenarios. If they find that too much money is being put into contingent labour over a period of time, they may even choose to evaluate whether new investments should be made in long-term hires.

## Business transformation and restructuring

Any transformation, reorganisation, or restructuring can trigger major changes within the organisation in terms of eliminating or creating certain positions. The tangible benefits of these decisions are uncertain at the start of any project. Indeed, today's economic headlines are dominated by examples of large companies that may have wrongly evaluated the cost and impact of a restructuring exercise. A strong understanding of TCOW helps CFOs measure the net impact of cost reductions achieved through workforce rationalisation – i.e., the elimination of job roles, or investments in new skills or talent.

> TCOW helps organisations evaluate investments, better plan an employee reduction or restructuring programme, and get insights on the overall cost of the workforce, including contingent workers

Employee reduction programmes traditionally work on a top-down basis. Often, these decisions impact the most valuable segments of the workforce, including high performers, critical-skill employees, and tenured employees. A more mature employee reduction programme can be formulated if the CFO or CHRO analyse the TCOW in conjunction with factors such as performance, the blockage of cost on poor performance, and span of control.

## Implementing TCOW

So far, Finance departments have tended to capture such information in specific 'cubes', though without mapping it to workforce data. The real power of this metric is realised only when cost information is combined with workforce data in the HRIS tool. While it is possible to do this exercise manually by combining data from multiple systems, it is tedious, and moreover, it often does not align with workforce information. In contrast, by moving TCOW information to business intelligence tools, it is possible to generate tremendous amounts of workforce-cost intelligence.

Clearly, TCOW is a superior metric for taking staffing-related decisions. However, in order to better implement it, one should first study the key performance indicators – whether customer satisfaction, sales, or revenue growth – and demonstrate how a clear understanding of total workforce costs helps in taking informed decisions. At the end of the day, TCOW works best when HR and Finance institutionalise the metric, creating a deeper and more holistic measure of workforce costs. ■

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