An Executive's Guide to Cutting HR Costs

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Introduction

It's no surprise that most people like to do what they're best at, and small businesses are no different. Most small business executives want to focus on their core business—usually the founder's area of expertise.

Still, the economics of profit and loss demand that entrepreneurs must deal with what they may view as the "HR troll"—the all-important but dreaded management of human capital and the programs that are as important to the healthy life of the company as food and water are to the human body. You can ignore what's good for you for only so long. And then it catches up with you.

Entrepreneurial execs know that they need to follow the rules, but they may not realize what decisions may lead to the two vital components that keep HR costs lower:

1. Increasing productivity
2. Minimizing human capital expenses

The following paper will focus on minimizing human capital expenses in four areas:

1. Hiring the right person for the right seat on the right bus
2. Improving performance with motivational yet balanced total compensation
3. Complying with the law
4. Offering competitive benefits, communicated effectively

Barbara Spector of SmartMoves! (www.smartmovesconsulting.com) advises small businesses to "hire the right person for the right seat on the right bus," borrowing a quote from Good to Great by Jim Collins. She urges, "Think of the small amount of investment involved here compared to what it costs if you hire the wrong person."

"Hire the right person for the right seat on the right bus" (a.k.a recruitment and retention)

Scott Hauge, president of Cal-Insurance and founder of the Small Business Commission in California, reinforces Spector's admonition: "Hiring a bad employee is really expensive. Set up a hiring procedure to know which questions you can [and should] ask ... You can't pay someone enough to [pick up the slack of] a bad employee ... it sends a message to good employees that they're going to have to do the work that the bad employee can't or won't do."

Most hiring managers will tell you that they want to hire the right person. But how do you translate dozens or even hundreds of resumes into the employee your company can't live without?

"Most companies hire on skill, fire on fit," Spector observes. "And that's a mistake. To find top talent, first you have to define superior performance. Then you've got to take that definition and apply it to performance-based behaviorial interviewing and other strategic recruiting techniques to attract the best candidates."

With recruitment, Spector says, success or failure depends on four additional measurements of prospective employees—those soft skills that cannot be accurately discerned in an interview:

1. **Personality.** How will they approach their work? Do they have the necessary drive? Do they have the right attitude to achieve the desired job results?
2. **Cognitive ability.** Will they be able to cope with the mental demands of the job? How do they solve problems? How will they communicate?
3. **Occupational interest.** What type of activities will motivate and prompt candidates to succeed? In what type of culture or environment will they thrive?
4. **Job Match.** How do candidates' overall make-up (items 1-3) compare to your best performers in the same job?

According to Spector, combining a performance-based interview approach with this four-part assessment method will vastly increase your success rate in hiring the right employee, especially when compared with traditional methods:

Hiring Methods	Success Rate
Traditional 1-on-1 interviewing	14%
Behavior-based interviewing	50%
Validated job match using assessments of the measurements above (personality, cognitive ability, occupational interest)	75% or higher

What happens if, despite your best efforts, you end up with no-talent talent? Determine the issue, says Spector, who has devised the following table modified slightly by TriNet for this white paper.

Skill & Fit Assessment Action Plan	
IF EMPLOYEE HAS A	THEN DO B
A. High Skill, Low Job Fit	**B.** Reassign and retrain
A. High Skill, High Job Fit	**B.**Retain and protect these individuals....They are your top performers
A. Low Skill, High Job Fit	**B.** Train
A. Low Skill, Low Job Fit	**B.** Get rid of

"Lastly," says Spector, "once you have the right person in the right seat, survey that talent regularly to assess job satisfaction. This significantly impacts retention and keeps your organization tuned in to what your employees are needing from and appreciating about your company."

While most small businesses wouldn't be inclined to conduct surveys in this way, employees may surprise you with the simplicity of their feedback. And it's okay to set an expectation that the company can't or won't comply with every suggestion for change.

Flexibility can translate to loyalty for working parents and anyone trying to manage busy lives while giving 100% at work.

Incent performance with motivational yet balanced total compensation.

MBA graduates may learn that both negative and positive reinforcement will motivate people to perform. But as the saying goes, you get more with sugar than you do with spice. The "sugar" you offer can take many forms, such as these:

- **Implement pay-for-performance programs.** Providing incentive pay may seem counterintuitive to a treatise on keeping costs in check, but in the long run, it could be your best weapon against out-of-control expenses. With clearly communicated and reasonable goals, who wouldn't work harder or more effectively for a little more cash in their pocket? Nothing motivates a team to work together the way you want than incentive pay.
- **Eliminate the guesswork on competitive compensation**—use compensation surveys. Compensation surveys help you to benchmark your company's salaries against similar companies' salaries to ensure that you are paying your staff at market rates. Radford Surveys, a division of Aon Consulting, has one of the best reputations in the compensation survey world and can offer compensation surveys that reflect small employers' smaller budgets. In addition, other benefits consulting firms such as Hewitt and Mercer offer similar surveys. (Mellon has one in development.)
- **Offer flexible work schedules.** In a recent survey, when employees were asked if they'd rather have more pay or more time off, they chose more time off. Some employers—large and small—offer every other Friday off as an incentive to remain with the company and to work harder on the days that employees are in the office. Flexibility can translate to loyalty for working parents and anyone trying to manage busy lives while giving 100% at work.
- **Reward employees through low**-cost alternatives, such as:
  - Parties (e.g., birthday parties, "success celebrations")
  - Other special events (e.g., luncheons, movie outings, golf outings)
  - Spot rewards for exceptional performance (e.g., spot bonuses, gift certificates, dinner-for-two, sports tickets)
  - Informal time off (e.g., Friday afternoon off)
  - Company-branded items (e.g., t-shirts, hats, coffee mugs)
- **Ask your employees for ways to cut costs.** Generally speaking, employees know their jobs better than anyone else. What they're complaining about around the water cooler could translate into lower HR costs for you.

Compliance may sound simple enough, but employment laws—mainly state and federal—are copious and complex.

COBRA, ERISA, HIPAA ... say what? Compliance.

One of the smartest and most cost-effective strategies that you can adopt as a small employer is to comply with the law, the mother of all HR trolls. Compliance may sound simple enough, but employment laws—mainly state and federal—are copious and complex. They dictate nearly every aspect of the management of human capital from how you hire and fire, to how you pay, to how you provide benefits.

Compliance boils down to this: Don't give the IRS or any other government agency a reason to become interested in your company. To help you accomplish this, here's some advice from the experts on avoiding the potential pitfalls:

- **Independent contractors.** When asked what is the single largest legal pitfall, Hauge warns small businesses "to be very careful with independent contractors. So many people try to get around hiring employees by using independent contractors. They do a 1099, but in the eyes of the state and the IRS, the workers are employees." If the worker becomes injured and files a claim for workers' compensation, the IRS can slap the employer with the cost of the care plus hefty penalties.
- **Health insurance.** Providing a generous health insurance plan can be one of your greatest recruitment and retention tools. Know the laws that govern how you provide it.
  For simply written and palatable information on health insurance for small businesses, visit California Health Care Foundation's comprehensive, impartial website at www.healthcoverageguide.org/referenceguide.aspx. Click "Rights and Rules for Small Employers," and then "Laws Related to Health Insurance." The site provides valuable and detailed information on federal and state laws, such as COBRA and HIPAA, by employee size.

- **Overtime and job classification rules for exempt employees.** Even Hauge, a small business veteran, admits "The overtime rules are so confusing." You'll find that defining an employee as exempt can vary depending on what percentage of the employee's time is spent on exempt job functions. For example, if an employee spends more than 50% of a 40-hour work week digging ditches, the employee cannot be considered exempt by California standards. By federal standards, more than 40% of a worker's time must be allocated to exempt tasks. And classifying how much time counts as overtime varies according to federal and state law as well. If an employee in one week works 10 hours on a Monday, six hours on a Tuesday, and eight hours on a Friday, by federal law, the employee is not entitled to overtime, because the employee only worked 24 hours that week. By California law, the employee is entitled to two hours of overtime for the time worked on Monday.
- **Harassment or discrimination laws.** Lack of training can get employers into hot water. A new California law, AB 1825, requires employers to provide two hours of sexual harassment training to managers every two years. Administrative damages can reach $150,000 if handled internally through the Fair Employment and Housing Commission, or if filed in state court, can be unlimited. In federal court, damages for emotional distress are limited to $300,000.
- **Disability and leave laws.** These laws can become very tricky to implement. If you make a mistake, you'll face not only the fines of several government agencies, but also the ire and distrust of your employees, which will linger for eternity. Numerous leave statutes, particularly in California, require experienced coordination and communication. In addition, the statutes interact with traditional time-off programs, such as pregnancy disability, vacation, and sick leave, long-term disability, and long-term care. Small employers need to know when they can or should provide the leave and/or dock employees for time away from work for medical purposes—it differs for hourly and salaried employees. Disability and leave laws include:
    - The California Family Rights Act
    - Short-term Disability Insurance benefits
    - State Family & Medical Leave Act
    - Federal Family & Medical Leave Act
    - Paid Family Leave also known as the California Family Temporary Disability Leave Act (www.edd.ca.gov)
    - Workers' compensation benefits

- Ensure that you have a written injury and illness prevention plan. Hauge estimates that 75% of businesses under 10 employees don't have one. That can lead to trouble if an employee becomes injured on the job. For example, let's say that you hire an employee and on the first day at 8:15, the employee is injured. If you file a report, the claim is entered into your experience and you could be hit with a 30% to 50% surcharge in workers' compensation fees. If the worker was previously injured and the claim is suspect, then the business owner may have the right to replace the employee. But be very careful: insurance brokers such as Cal-Insurance at cal-insure.com have experts who can give you guidelines. In addition, you may need legal advice and should seek out a lawyer.

Small employers may also need to adhere to the following laws, depending on their company size and jurisdiction:

- California Domestic Partner Rights and Responsibilities Act
- Working Families Tax Relief Act of 2004 (WFTRA)
- California Occupational Safety and Health Act (Cal-OSHA)
- Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA)
- Fair Employment and Housing Act (FEHA)
- San Francisco Administrative Code 12A, the gender identity protection– a local law with no comparable federal or state brethren.

Employment law also varies depending on company size:

- For 100 employees and above, all laws apply.
- For 50 employees or more, most laws apply.
- For 25 employees or more, some laws apply.

When you get below that number of employees, the applicability of federal and state laws fluctuates wildly. For more information on the laws that govern all small business employers, visit the HR Resources section of www.trinet.com.

The standard list of benefit categories may look the same for small and large employers, but the plans, features, and services offered can be as different as black and white.

Offer competitive benefits, communicated effectively.

Like most executives, you want to know that you aren't paying more than you have to, but your employees feel motivated to perform. Offering the right benefits package can help you achieve this goal.

Benefits differ between small and large employers

The standard list of benefit categories may look the same for small and large employers, but the plans, features, and services offered can be as different as black and white. The standard list would include insurance coverage for medical, dental, and vision care as well as short- and long-term disability, life, accidental death & dismemberment (AD&D), and more and more frequently, long-term care. In addition, most employers offer some sort of retirement plan, defined benefit (traditional pension plans) or defined contribution plans, such as a 401(k). Very small companies may consider individual retirement accounts (IRAs) designed specifically for them, such as SEP IRAs, but most tend to stick with a 401(k) plan.

For small employers, the level of benefits is generally much lower than that provided by large employers, the level of risk to the employer is much higher, and the cost per employee can be higher as well. Benefits, such as health insurance, and the cost of providing those benefits can vary widely depending on:

- Age
- Amount of compensation
- Claims history and amount of high-dollar claims, such as treatment for cancer
- Level of education
- Number of employees and eligible family members

You'll want to choose your vendors wisely. If you're looking for health insurance, for example, choose a solid administrator. That means someone who can pay claims promptly, provide intelligent customer service, offer great discounts, and handle various financial and funding arrangements that will grow with your company.

Your vendor should provide some degree of technology as well. For many small businesses, keeping up with the rapid changes in technology just isn't feasible. These days, employees expect robust benefit technology. Not only must the technology provide information, but it must also handle transactions, track claims, and in the case of healthcare, provide specialized applications such as health risk assessments.

So, what benefits do you offer?

Health. It's recommended that companies offer a generous benefit plan from Day 1, providing a rich plan that encourages employees to stay on and help grow the company over the long term. For example, offer a plan that pays at least 90% of the cost of a PPO and include dental and vision plans.

Here are some tips on cutting costs:

- **Pass on some costs to employees.** In some cases this strategy makes sense, especially if employees are paying 0% to 10% of the cost of their health insurance. However, the strategy is likely to backfire if your employees aren't happy about it. In addition, your insurers will restrict your efforts to pass on the cost because they may deem the cost to employees to be prohibitive. For example, if you want to pay only 60% of the premium, insurers may require you to provide 80%. Without this provision, insurers believe that only the sick people will sign up.
- Implement higher deductibles, assuming your employees can meet them.
- **Encourage employees to spend their healthcare dollars wisely.** Because administrative costs of health insurance plans run on average about 30%, educate your employees wherever and whenever you can that you want them to get the care they need, but you also want them to make smart choices about spending their healthcare dollars.

  For example, you can ask employees to question their doctors and other healthcare providers to ensure the best possible treatment is prescribed. These questions could include, "Should I get a second opinion?" and "What are my alternatives?" Again, you want to encourage employees to seek treatment, particularly preventive check-ups, but they should also know that some medications (such as antibiotics) are overprescribed.
- **Push for more disease management programs**, which can justify their return on investment—however, HIPAA confidentiality rules may limit the amount of disease management within a small company.
- **Implement wellness programs** to encourage employees to stop smoking, lose weight, and maintain healthy blood pressure. Check with an expert in the field or an employment lawyer before you do, however, because employees or those who weren't hired could view some programs as discriminatory.

- **Above all, communicate, communicate, communicate!** This may come as a shock, but even the people who write benefits materials don't read their own materials. Why? Because traditional benefits booklets tend to have all the appeal of a chewed boot. Invest in a communication program that includes well written, succinct, compelling, and palatable descriptions of your programs as well as four- or two-color professional printing.

  In addition, hold regular employee meetings to roll out new plans or just help employees understand the value of their benefits and how to use them, including how to keep costs low for themselves and the company. Open enrollment is a perfect time to ask employees to assess whether their plan choices meet their lifestyle needs, particularly for employees who have gotten married or had children in the last year.

Dental & Vision. Some experts advocate not offering these plans at all, because the cost/benefit ratio isn't always worth what you pay in insurance costs. Says Hauge, "Dental is expensive – a lot of it could be trading dollars." Still, you have to assess your workforce – if your employees are accustomed to having these benefits at other companies, they may perceive your efforts to keep costs low as stingy rather than as a smart business move. Again, if you have intelligent, hard-working, and loyal employees whom you would like to retain, offer dental and vision coverage.

Cafeteria plans. "Cafeteria plans make good sense," Hauge says, "And employees really like them." If you implement a cafeteria plan, such as a Healthcare Spending Account or a Dependent Day Care Spending Account, include comprehensive communications as part of your effort because you're going to need them. All of these plans provide pre-tax savings, but may differ slightly in the types of claims that are eligible for deduction or payment. In addition, employees must use all of the cafeteria plan funds by the end of each calendar year.

401(k) plans. Offering a 401(k) plan is a no-brainer for a company on the rise. It can help employees save money – on taxes and for retirement. According to Wikert, however, some firms are re-examining whether they want to continue to offer a 401(k) based on fiduciary liability issues. Employers offering plans must have sufficiently diversified investments, and they must watch how they match employees' contributions, if at all.

Life and Accidental Death & Dismemberment insurance plans. Life and AD&D insurance can be relatively cheap, but as a small business, you should watch how you define the base pay that these plans may depend on. Wikert notes that most companies may include measured commissions, but they do not include bonuses. The goal is to sustain, not overinflate the benefit.

Long-term disability and long-term care plans. Most small employers don't typically offer these plans, but if your competition does, you may want to comply. Long-term disability tends to be expensive says Wikert, but employees may have more trouble getting that coverage on their own because of medical evidence restrictions.

Workers' comp. Well, you have to offer this coverage, so it's not your typical employee benefit. Still, you need to watch your costs.

The benefits of HSAs

Some experts speculate that the most cost-effective option for highly compensated, highly educated employees of small firms is the Health Savings Account (HSA) plans. These plans appeal to some employers because they:

- Cost significantly less than most health plans because they don't provide what's known as first-dollar coverage—payment for the first dollar of claims incurred by the employee or a family member.
- Allow the employer to offer competitive health insurance that it might not otherwise be able to afford to offer.
- Put the purchasing decision for healthcare services in the employees' hands, making employees the users and payers of their care. It's an incentive for employees to compare costs, services, and providers to determine which is the most cost-effective. The concept behind HSAs is that they discourage employees' belief that an office visit costs $10, instead of $110, and that this realization will lead to lower cost choices in healthcare.

And, employees who can afford them like them because HSAs feature:

- **Lower monthly premium costs**
- **Tax-free savings accounts to pay for healthcare**—generally speaking, the accounts are exempt from federal, state, and employment taxes, although states such as California have not committed to that exemption yet.
- **Account earnings grow tax-free and are portable**—employees can take them to any employer.
- **No "use it or lose it" provision**, so employees can start saving money into the account when they are most likely younger and healthier, then continue to save into their later years.

The disadvantages of HSAs

1. Hauge and other experts agree that HSAs are not the answer to employers' cost-cutting quests, however. "HSAs do not receive a very positive reaction from small business owners, because it can create a problem for employees who can't come up with the money." That said, even highly compensated employees may not want to fork over their hard-earned money for health-care expenses—especially those employees coming from larger companies where the benefits may have been more generous.

2. In addition, the portability of the account allows employees to take it with them to another employer. That reduces the incentive to stay with your company because of a favorable benefit plan.

3. **HSAs are fairly new.** Insurers offering the plans haven't necessarily learned how to streamline their administration efficiently. HSAs also allow employees to use the money in their account for whatever they choose, though a 10% penalty applies if the money is used for non-medical purposes.

4. While one of the benefits to HSAs from the employer's standpoint is that the plan forces employees to see the real cost of their healthcare, it's not a pleasant reminder. For example, employees may shop around if their doctor tells them the cost of an office visit is $150, not the $10 that they would normally pay through a copay system. The unfortunate result? An employee may scramble to find another, less expensive doctor whom the employee may or may not feel comfortable sharing the intimate details of a medical condition.

5. Generally, all of the experts agree that an HSA isn't going to appeal to highly skilled employees used to working at large companies where workers receive first-dollar coverage.

The Bottom Line

HR is a tremendously important resource in the business equation, but finding ways to cut its cost isn't easy. The twin goals of increasing productivity and minimizing expenses are the way to get there; put your focus on recruitment/retention, compensation, compliance, and benefits. Doing so will help build a culture that's not likely to be distracted by inefficiencies in day-to-day operations, and therefore retains the ability to become a truly customer-focused organization. And that's the way to build a winning business.

About TriNet

TriNet helps small business entrepreneurs realize their ambitions by being their essential HR partner. As their Trusted Advisor, we help them contain HR costs, minimize employer-related risk, and relieve the administrative burden of HR, thus helping them focus on their number one priority—their business.

For more information, visit **www.trinet.com**.