

# Total cost of workforce – The new magic word for CFOs

Traditionally, organisations have measured compensation costs quite effectively. Average compensation costs across functions and levels are measured and used to make performance review decisions during the annual performance review cycle.

However, given that direct workforce or workforce-related costs constitute approximately 70% of the operating expenses for large organisations, CFOs look at information over and above compensation costs which can give them information on the types of workforce. Moreover, as the available salary budget shrinks, companies need to be smarter about how they use them to retain talent. It is important to prioritise the best performers and review how employees are rewarded with other incentives, such as more attractive benefits. Often, factors such as spending on contractors or indirect costs associated with workforce are hidden from the view of CFOs which helps them to take informed business decisions.

To make these decisions, a CFO would need answer to the following critical questions:

- What is the investment given the expected strategic goals?
- What would be the impact of an employee reduction programme on the operating expenses?
- When designing the reduction programme, how would 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 composition of the workforce changes in the delivery of the project?

To answer these questions, the CFO and the CHRO would need to work closely and build the Total Cost of Workforce (TCOW). Compensation cost is only one of the components. In this article, I will highlight the other facets of TCOW.

## Understanding the various components of TCOW

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

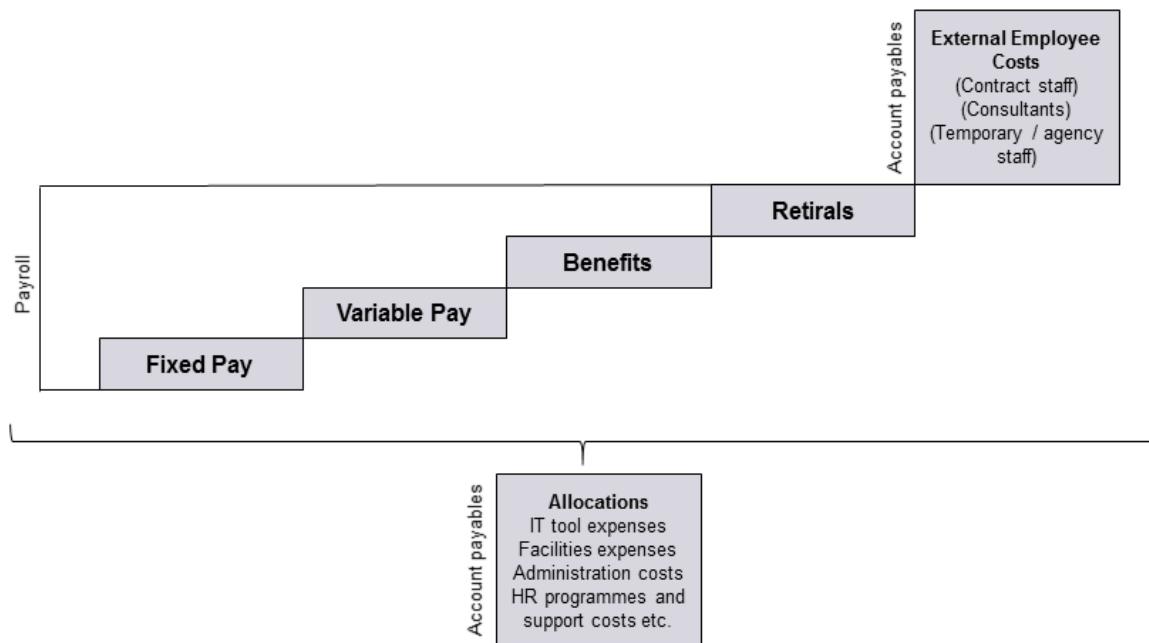
The strategic goals of the organisation often hinges on people. The information on TCOW helps the CFO in determining the incremental investments required to fund the next level of growth in the organisation. For example, initiatives such as growing an organisation's customer base and increasing investments in R&D / innovation requires new talent. Enhancing customer service could require new hires and / or training initiatives, whereas improving operational efficiencies may call for restructuring that impacts workforce costs.

Part of this information is also captured in the annual budgeting exercise. However, as opposed to the annual budgeting exercise, the information captured as a part of the TCOW is much more detailed and provides clarity to take decisions related to critical roles. This helps organisations prioritise investments.

### Cost associated with contingent workforce

The world of work is changing fast – Organisations are increasingly leveraging alternative work arrangements to meet changing business needs. The employee-employer relationship is no longer the only sourcing strategy used by recruiters to get the right talent. With increasing use of contingent workforce to execute work, it's important to capture the workforce cost in totality. When CFOs have a

**Figure 1: Total cost of workforce components**



view of the spending on their contingent workforce, they are able to forecast trends and make plans for utilising the workforce in the current as well as future business scenarios. If too much money is being put into contingent labour over a long period of time, companies can evaluate if an investment should be made for long-term hires.

#### **Dealing with transformation / restructuring and employee reduction programmes**

Any transformation, reorganisation, or restructuring can create a major change for any organisation in terms of elimination and creation of certain positions. The tangible benefits of these decisions aren't certain in the beginning of the project. Today's economic headlines are full of examples of large companies who may not have correctly evaluated the cost and impact of a restructuring exercise.

Knowledge of the TCOW helps the CFOs in understanding the net impact of cost reduction achieved through rationalisation of workforce (elimination of job roles vs. talent investments in new skills). Employee reduction programmes are traditionally top-down. Often, these programme decisions impact the most valuable segments of the

workforce such as high performers, critical-skill employees, and tenured employees. A more mature employee reduction programme can be formulated if the CFO or the CHRO can easily look at the TCOW and further analyse it with factors such as performance, cost blocked with low performers and span of control.

#### **Implementing TCOW for the organisation**

Finance department has been traditionally capturing this information in finance cubes. However, this information is not typically mapped to workforce data. The real power of this metric is realised when the cost information is combined with the workforce data in the HRIS tool. While it is possible to do this exercise by manually combining data from multiple systems, it is a tedious task and often does not align to the workforce information. Organisations can start generating a tremendous amount of workforce cost intelligence the moment they move cost of workforce information to business intelligence tools.

While we understand that TCOW is a better measure to use for staffing related decisions, for better adoption of this metric and to create an understanding of this measure, it is important to first

look at the key performance indicators for the key stakeholders within the organisation (whether it's customer satisfaction, sales or revenue growth) and demonstrate how a clear understanding of total workforce costs will help in taking informed decisions. TCOW will work well when HR and Finance departments collaborate to institutionalise this metric. The introduction of this metric will lead to a better and holistic calculation of the cost of workforce.

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