

Furloughs vs. Layoffs

Reducing work hours can be a great alternative to layoffs, but will it save you as much money? Find out what types of companies benefit the most from this recession solution.

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When [Primary Freight Services \(http://www.inc.com/inc5000/2008/company-profile.html?id=200844500\)](http://www.inc.com/inc5000/2008/company-profile.html?id=200844500), a global shipping and logistics provider and No. 4,450 on the Inc. 5000, lost their biggest account in August, CEO John Brown started worrying. The deteriorating economy had finally hit home and it became abundantly clear that he was facing an industry-wide contraction. His company's sales slumped by 21 percent from 2008, and he faced a budget shortfall of 36 percent. When Brown consulted his clients and peers, he found that they too were experiencing significant gaps in revenue.

That's when he started looking at his options. "I knew changes needed to be made, but I didn't

know how," Brown recalls. He wanted to avoid layoffs, if possible, to protect his employees' jobs and to keep from getting caught without his experienced staff when sales picked back up.

In February, Primary Freight turned to a solution that's been gaining favor with employers as the downturn drags on: furloughs, a range of actions including reduced work hours or unpaid vacation time. With the jobless rate at 8.9 percent, the outlook for laid-off workers is grim, and many employers are hesitating to add to the unemployment rolls.

While layoffs are traditionally common in American business, some forms of furlough have existed here for awhile. Temporary shutdowns are common in manufacturing, points out Richard Rogerson, a professor of economics at Arizona State University. "Historically, the manufacturing industry globally has always made extensive use of temporarily layoffs, which we saw in December and January, when a lot of auto assembly plants shut down for a month," he says.

The practice of reducing work hours is much more common in Europe, Rogerson says, where employees can collect unemployment insurance for the days they miss. Only 18 states in the United States, including California, Florida, and Massachusetts, offer benefits to furloughed employees, and employers have to work out the details in a written agreement with the state beforehand.

Brown decided that a 10-week furlough for all 68 employees would be best for Primary Freight Services, executed as a four-day workweek. The endeavor has cut overhead by 13 percent, while retaining the expertise of the 17 employees he would have otherwise let go to save the same amount. After two and a half months, Brown will reassess the situation and either add back a day every two weeks, return to a full schedule, or do layoffs.

While the decision saved less money than doing permanent layoffs may have, Brown saw it as putting the company in a good position for when sales recover by retaining trained, talented workers. "We're in a service industry, so our staff is the key to our success, and we wanted to preserve all we could," he says. "We felt this was the way to accomplish that."

Retain Your Top Talent

Companies who slash their payrolls during downtimes are taking a big risk. "It means they're hamstrung when the economy turns around," explains Steve McElfresh, founder of human resources firm HR Futures. He gives the example of an overnight delivery service, which decided against layoffs when they found putting a new driver on a route lost between 10 and 15 percent of their customers. Raw recruits couldn't provide the same personalized service as old hands.

"There's a tremendous amount of personal knowledge there, and the consequences of turnover can be very expensive," McElfresh says.

Furloughs also signal to employees that the boss values them and wants to preserve jobs. Only one Primary Freight employee resigned because of the furlough, and the other 68 accepted the changes. "The whole company really came together as one, through adversity, and everyone could understand what we were doing," Brown says.

From the employee perspective, Ernie Donner, Primary Freight's financial controller, agrees. "Obviously, the first reaction is to the reduced income," he says. "But once you get a little past that, the reactions have been that it's really a blessing, because it allows people do things

that would have been done during the weekend that subtracted from family time." He uses his Thursdays off to run errands and care for his elderly mother and aunt, while other employees are taking second jobs or just taking the day off.

But furloughs aren't easy to implement. They require clear, open communication about the company's situation and about how the program will work. Primary Freight introduced their furlough to employees with 15 frequently asked questions, followed by a town hall meeting and letters sent to employees' families. That's in addition to quarterly town hall meetings that chart their progress toward company goals versus the budget. Brown and his sister Cathy, who serves as the company's vice president, even prefaced the announcement by telling employees they were no longer taking out salaries for themselves.

"We communicated the whole process from start to finish, the reasons, the anticipated timeframe, everything," Brown explains.

Companies also need to be aware of the legal issues involved with furloughs, particularly compliance with the Fair Labor Standards Act, says Doug Weiner, senior trial counsel at Epstein, Becker, and Green. FLSA, which mandates a minimum wage and time-and-a-half for overtime among other things, exempts salaried workers from overtime pay. Where this runs into trouble with furloughs, is that the law requires that salaried workers receive their full salary for every week they perform any work, even if it's just tending to e-mail. That means employers can't risk telling all employees to stay home on Fridays and then deducting money from their paychecks.

"Once an employee decides to question whether they should have been paid a salary those weeks, it gives rise to the possibility of a class action claim against the employer, which would almost instantaneously wipe out all the gains realized from the furlough," Weiner says.

Instead, he recommends employers institute a pay cut, then tell workers to take the time off.

Furlough Isn't For Every Business

But some employers are skeptical that furloughs would have any benefit for their company. Dave Kiewra, founder of IT firm Innovative Systems, prefers the straightforward, one-shot approach of layoffs. Even though the company had a pipeline full of projects, slow payers were stretching out working capital. Kiewra took a look at the books and, when he found their revenue simply wasn't going to cover salary expenses, laid off two of his 20 employees.

Kiewra doubts the claim that shortened workweeks or unpaid vacations are better for morale. "I think the employees are all wondering at that point if it'll lead to layoffs, and they're making less money," he says. "It's a state of limbo, and that's not good for anybody."

He hasn't seen any signs that employees are worried about further cuts at Innovative Systems, which he attributes to their full workload. "I am sure there are some doubts, subconscious or not, but don't they exist for most folks in the current state of our economy?"

Unlike layoffs, which are usually single events, furloughs have a continued impact on the company. Truman Bewley, a professor of economics at Yale, says the longer the furlough drags on, the more the reduced income jeopardizes the morale of the company.

"Layoffs are devastating for those laid off, but they're gone," he says.

Another concern is the even-handedness of a furlough, which hits the highest performers just

as hard as the least-productive. "Every company has its top and lower performers, Kiewra says. "With a furlough, everyone gets hit equally. In a layoff, you just get rid of the people who aren't key."

"Across-the-board cuts leave open the possibility that your best workers will look around and see if someone else offers them a better deal," says Professor Rogerson. "Employers choosing furloughs have to balance the risk of valuable employees leaving with their need to have everyone on hand for the recovery."

But Primary Freight's Donner, contends that employees are also well aware of the high rate of layoffs, which makes the furlough look comparatively appealing. They're also getting calls from people with great experience from jobs in their industry who have been let go since the recession began--proof that employers risk the chance of losing their top talent to competitors.

Nevertheless, furloughs simply won't save as much money as layoffs. Kiewra doubts they can save enough to be worthwhile. "I just don't know how effective furloughs are at preserving jobs and cutting operating costs," he says, pointing out they don't reduce the fixed costs of having an employee, such as health insurance. For companies who need cash immediately, furloughs might not be the right answer. Those that can benefit the most should be able to balance saving less money with retaining their top talent.

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