

## **How to Make the Decision to Hire**

The first step in making a decision to add a person to your company is to try your best to avoid it.

Normally, hiring is felt to be a solution to a perceived capacity shortage. There's more work to do than the existing employees are able to accomplish, within the required time frames, in order to operate a growing, profitable business. Or there's a function that needs to be done that doesn't exist yet.

If the reasons for that capacity shortage is because existing employees are either not capable or not willing to do the work necessary, then hiring people will guarantee inefficiency and higher labor costs than would otherwise exist if the underlying reasons for the capacity shortage were addressed. Therefore, honestly and objectively answering the questions of capability and motivation is a necessary prerequisite. Also, it may be that the expectations for performance are unreasonable, or perhaps not truly necessary. The leader must look in the mirror and challenge their own expectations.

If the capacity shortfall is not about inappropriate expectations, capability or motivation, and the work still needs to get done, then adding people may be appropriate.

If so, it's critical to remember that adding people does not immediately reduce workloads of the team or the leaders. Hiring a new person increases time demands on others and especially on leaders, who must help the new person acclimate to the company, its methods and the tasks to be completed. The time frame for this added workload can be weeks (for relatively simple roles that can be trained in a short period of time) to literally years (for complex roles that require both high level skills and specific experiences in order to be effective). Even people with a good deal of competency and experience will not be immediately productive. There is a significant time investment by several people when a single person is invited to join. If that time investment is not made, the odds of the new person becoming as effective as possible go way down, no matter their skills and experience.

Assuming proper evaluation of the need to hire, and no way has been found to avoid it, the result of that effort will be a clear set of expectations for the role and

what contributions are necessary. Now you are better prepared to evaluate candidates, and the cost-benefit of hiring.

The cost side of the equation comes from a thorough understanding of the labor market for the associated competencies. To measure the labor market effectively, you will need a variety of data sources. Commercially available surveys take time and money to participate in, but they can offer an objective, vetted source of labor value. In comparing internal roles to commercial compensation surveys, it is critical to make as close a match as possible to the reported data. Benchmark job descriptions are a major type of comparison in such surveys. Point-factor methods focusing on competencies, and not on titles or functions, is another way, which has a better chance of matching market value when internal roles do not fit standard benchmark descriptions, and when internal roles might span across countries where titling and functional accountabilities can be widely different.

Another source of labor market data is the recruiting information that comes from having real-time interactions with potential candidates. It can be said that you find the edge of the labor market value of a role when the candidate you know can do the job declines your offer because of compensation considerations (and not any other factor).

A third source of labor market information is the set of economic parameters that correlate with labor market and compensation trends. These include primarily unemployment rates specific to the role being recruited, economic trending that can be measured by GDP, and to a lesser degree, inflation rates. Labor costs are more closely tied to supply-demand dynamics, which is tied more closely to economic trends within industries and functional roles. Inflation rates alone do not generally translate to higher compensation, outside the environment of collective bargaining where inflation is used to establish annual “cost of living” adjustments.

If you have established a reasonable estimate of the value of a role, including all elements of compensation costs (base, fringe, payroll taxes, likely incentives, time off benefits, etc.) then you can estimate what revenue and profit levels would have to be achieved to warrant the expenses incurred. It does not often make sense to bring on a largely fixed cost (as labor should be viewed, even though it

continues “at will” in most U.S. states) that comes with annual escalation, if the resultant contributions of the new employee don’t directly result in incremental revenue and/or profit that more than covers those costs, now and into the future.

Often, hiring is done with an assumption that if the role is filled, the revenue and profit will come. In some cases, that is a reasonable assumption. If sales are dependent upon sales people generating leads, providing quotes and gaining commitment for orders, then without those sales people growth will not occur. But in this logic, there is a potentially flawed assumption, which is that the *only* thing hindering sales is having people to do the selling. Having a number of good sales people, working hard and daily, does not translate to sales if there is insufficient market appetite for the products or services being offered. A compelling offering with demonstrated demand is more important than growing sales staff.

The other roles that directly translate to those desired products or services are more valuable to a company because without them, there is not much to offer the market. Product design and development, research and manufacturing roles have a direct impact on creating and sustaining a market which desires the offerings. Filling these roles also requires assumptions, which is that the people serving in these functions are able to create intellectual property—products and services—which customers want.

Some support roles are often hired defensively, when required functions must exist by virtue of regulatory requirements. When filled, these roles prevent disruption to the company’s ability to create value for customers, but they do not directly add to the value of the products or services, as viewed by customers.

Other support roles are hired because the company cannot operate effectively without them, such as human resources, quality assurance, accounting, facilities, etc. These roles become the “engine” of the company, performing functions that customers don’t care about directly, but which are essential for the entire organization to perform well.

Each type of role comes with a different cost-benefit analysis. The role may directly generate value related to products and services. Or it may ensure the organization stays in business, i.e., compliance and risk management. Or it may create higher growth with lower overhead costs because of efficiencies and

effectivity contributions to the operation of the business. Each type of role can be analyzed according to its purpose, but all roles must be viewed as investments that should provide a return.

To assess the return required for a given role, it can be translated into the necessary revenue and profit required to 1) breakeven annually on the labor costs, and 2) contribute a return above those costs. It might be a wise move to hire a role that may only break even over time, but which prevents risks that could generate future costs and impede the organization's ability to create future profits. But if the equation isn't calculated, then those assumptions made to justify the hire will have a hazy view of the financial impacts over time.

Accompanying this overview is a simple spreadsheet model that can be used to determine the annual effect of adding labor costs, with the associated required revenue and profit to break even and then to generate additional profit. Once estimated, it can be updated as reality reveals whether or not the assumptions forming the basis for the hire were accurate.

In general, there are two approaches to hiring strategy. One is to hire ahead of the revenue and profit that would provide the return on the compensation (and time) investment. The other is to wait until the existing staff has generated sufficient "head room" of revenue and profit to allow the increase in labor costs while maintaining strong profits even after the added costs are in the business.

The first method's risk is that the revenue and profit doesn't come, at the same time the cost structure increases, thus reducing profits and the ability to sustain the business. The second method is no less a risk than the first, but its risk is to quality of work life for the company's employees who may be working unduly long hours in place of adding human capacity. This can be sustained for a time, but not for too long, else turnover from exhaustion is possible.

If the decision is to hire ahead of revenue and profit, and it doesn't come, then letting people go because the business can't afford them sends a message of insecurity to the remaining employees, and of course wastes all the time and money spent in sourcing, evaluating, hiring, training and leading the people who are let go. Layoffs are the most detrimental to a strong and engaged company culture, followed closely by poor leadership. In fact, the two are related.

My rule of thumb in hiring is that the company should be able to sustain a 20-30% drop in revenue, without having to lay people off. This would cover nearly all of the worst-case economic scenarios that can be driven by external factors (such as the Great Recession and the pandemic recession), and nearly all of the internal mistakes that could cause a significant drop in revenue and profits. This is a main reason why I've found the best compensation strategy is to pay fixed compensation costs at the median of the labor market, while offering incentive opportunities well above market when profit hurdles are met. Most people will understand the trade-off and the security that strategy brings to their future.

In summary, the sequence of making the hiring decision is:

1. **Try to avoid hiring.** Find better methods, prioritize functions, re-engineer tasks, eliminate wasted tasks, etc.
2. If you can't avoid hiring, you must then be able to **articulate exactly what the role(s) contribute(s), what is expected, what competencies are required** and how success is to be measured. These will inform candidate evaluation methods.
3. **Acquire objective, data-driven estimates of the labor market** for the competencies required, as you can. Aim for fixed compensation at the median, plus or minus a bit. Provide short and long-term financial incentives for performance that creates the profits necessary to pay out those incentives (self-funded).
4. **Translate the fixed compensation costs anticipated into revenue and profit levels required** to break even on those costs, and then to provide a return. Create objectives for all relevant roles, including the new one(s), and methods to achieve them, which will result in the return required.
5. **Communicate all of the above to everyone involved**, especially the leaders accountable for the results and the person(s) hired.