Downsizing as a Strategic Intervention

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ABSTRACT

The effects of downsizing as a strategic intervention typically stem from organizations seeking to reduce the number of employees through layoffs, attrition, redeployment, early retirement and reorganization or de-layering. These reductions are generally a response to one or more of the following conditions: a response to mergers and acquisitions; revenue loss or loss of market share through technological and industrial change; the execution of new organizational structures; and social pressures attributed to the philosophy that smaller is better. The focus of this article will apply Cummings and Worley's (2001) five application stages using downsizing as a strategic intervention, which examines organizational goals and objectives, overall assessment of the organization, relevant choices and decisions, the implementation stage, workforce reduction, survivor syndrome and organizational renewal and growth strategies. The authors will also examine the effects of downsizing on financial performance, reputation for corporate social performance and managerial commitment to strategic change.

INTRODUCTION

Downsizing is a business strategy designed to improve the financial standing of a firm by reducing and changing the structure of the workforce in order to improve operational results (Appelbaum, 2001). Downsizing has become a widely held intervention for organizations looking to demonstrate flexibility, reduce bureaucratic structure, increase efficiency regarding decision-making, improve communication and cultivate entrepreneurship (Appelbaum, 2001; Bruton, Keels & Skook, 1996; Mroczkowski & Hanaoka, 1997).

According to Cummings and Worley (2001), downsizing is accomplished by decreasing the number of employees through layoffs, attrition, redeployment, or early retirement or by reducing the number of organizational units or managerial levels through divestiture, outsourcing, reorganization, or de-layering. Downsizing is generally a response to one or more of the following four conditions: (1) mergers and acquisitions; (2) loss of revenues and market share through technological and industrial change; (3) the implementation of a new organizational structure; and (4) the belief and social pressures that smaller is better (Cummings & Worley, 2001).

This article will examine the findings of empirical research studies and other sources to determine the impact of downsizing as a strategic intervention on financial performance, reputation for corporate social performance and managerial commitment to strategic change. Each of these issues directly and inclusively influence Cummings and Worley's (2001) five application stages using downsizing as a strategic intervention as illustrated in Figure 1.

THE STRATEGIC INTERVENTION MODEL

Downsizing is most effective when planning takes place well before, during and following the proscribed intervention. "A downsizing plan should be included in the strategic management plan of all organizations, regardless of whether they plan to downsize or not. By including such a plan, the organization will be better prepared to begin the staff-reduction process should it be forced to do so in response to environmental changes" (Davis, 2003).

Downsizing is reportedly a common response to an emergent, global environment. Incorporating downsizing in the strategic management plan can increase organizational efficiency by maintaining a focus on core competencies that promote competitive advantage and increasing (or at least maintaining) current levels of market share. Responding to an organizational crisis absent a well-defined strategic plan might result in across-the-board cuts that "penalize the most efficient units of the organization, thus decreasing its competitive advantage" (Davis, 2003). Unquestionably, the dramatic implications of the downsizing process need to be carefully assessed. The implementation should take all reasonable steps to minimize the potential negative impact on core competencies, productivity and workforce behavior.

Successful downsizing as a strategic intervention has five application stages (see Figure 1) (Cummings & Worley, 2001). The first stage is to clarify the organization's strategy, which entails communicating the organization's stratagem, and to achieve its goals and objectives. Organizational leaders are called upon to maintain focus and provide consistent support throughout the process. The organizational leaders can provide opportunities for members to voice their concerns, ask questions and obtain counseling if necessary (Cummings & Worley, 2001).

Figure 1: Five Application Stages Using Downsizing as a Strategic Intervention

1. Clarification of the Organizational Strategies: Goals and Objectives
2. Assessment Stage: Relevant Choices and Key Decisions
3. Implementation Stage: Reduction in Workforce
4. Survivor Syndrome: Behavioral Implications of Remaining Workforce
5. Organizational Renewal and Growth: New or Modified Strategies

The second stage refers to the assessment stage wherein relevant choices and key decisions are made as to which downsizing method will be utilized. There are primarily three methods: workforce reduction, organization redesign and system change (Cummings & Worley, 2001). Figure 2, as described by Cummings & Worley, defines the three tactics utilized in downsizing.

Figure 2: Three Downsizing Tactics

Downsizing Tactic	Characteristics	Examples
Workforce reduction	Aimed at headcount reduction Short-term implementation Fosters transition and transformation	Attrition Transfer and outplacement Retirement incentives Buyout packages Layoffs
Organization redesign	Aimed at organization change Moderate-term implantation Fosters transition and transformation	Eliminates functions Merge units Eliminates layers Eliminates products Redesigns tasks
Systemic redesign	Aimed at culture change Long-term implementation Fosters transformation	Change responsibility Involves all constituents Foster continuous improvement/innovation Simplification Downsizing: a way of life

Cummings, T. & Worley, J. (2001). Organization Development and Change (7th ed.). Cincinnati, OH: Southwestern College Publishing, Inc.; p 297.

The third stage involves implementing methods for reducing the size of the organization. There are several practices that characterize successful implementation, such as downsizing is best controlled from the top down due to the difficult decisions that must be made while maintaining perspective and avoiding people's natural instinct to protect their enterprise or function; identify areas of inefficiency and high cost; maintain focus on the organization's strategy by consistently reminding individuals that restructuring activities are part of a plan to improve the organization's performance; and communication, which is key to the success of the organization's goal (Cummings & Worley, 2001).

The fourth stage addresses *survivor syndrome*. During this stage, employees are generally asked to take on additional responsibilities and to learn new jobs, often with little or no increase in compensation. Survivor syndrome involves a narrow set of self-absorbed and risk-averse behaviors that can threaten the organization's survival. Rather than striving for organizational success, survivors often are preoccupied with whether additional layoffs will occur, feeling guilt over receiving pay and benefits while co-workers are struggling with termination and with the uncertainty of career advancement (Cummings & Worley, 2001).

The emotional aftereffects in what is referred to as survivor syndrome include a workforce that exhibits fear, anger, frustration, anxiety and mistrust. Those employees who survive the downsizing intervention must assess how their personal values and beliefs align with that of the newly structured organization. Additionally, symptoms of survivor syndrome pose a real threat to performance and productivity with new roles and additional tasks required of each employee as a result of a smaller workforce restructured to perform an increasing number of responsibilities. The consequences are undeniable when an organization finds itself dealing with a workforce that is willing to assume fewer risks at the expense of productivity (Muirhead, 2004).

The final stage of downsizing involves implementing the organization's renewal and growth process. Organizations often fail in this final stage because they do not share growth plans and renewal strategies with their employees, rendering the downsizing intervention as well as the organization ineffective (Cummings & Worley, 2001). Once downsizing has been chosen as part of the organization's restructuring or as a means to furthering organizational goals, it must be thoroughly planned and all contingencies anticipated. Downsizing should be implemented chronologically as described in the five application stages using downsizing as a strategic intervention (see Figure 1) (Appelbaum, 2001).

While downsizing is viewed as a method in which to achieve savings in the short-term, there are studies that have attempted to measure and evaluate the medium and long-term effects of downsizing. It is known that during the initial stages of downsizing, organizations incur extraordinary large direct costs, such as severance packages, early retirement packages, outplacement services, and other direct and indirect costs. Management can evaluate downsizing by preparing a cost-benefit analysis, which would outline and bring to light the short-term financial implications of the downsizing and shed light on the potential long-term savings or losses (Appelbaum, 2001).

Organizations must fully prepare and outline each stage of the intervention due to the potential negative consequences downsizing has on employees. Failure to do this has short and long-term effects on the workforce (Appelbaum, 2001). Given that downsizing is a traumatic event, no matter how well prepared the workforce is for the impending change, it is in the best interest of the organization that the actual process of job terminations be carried out in the most expedient manner possible. According to Boroson and Burgess (1992), companies often make the mistake of spreading out the downsizing over a period of months and sometimes even years. An increasingly common yet detrimental practice is the repeated implementation of large scale downsizing. Boroson and Burgess (1992) further report that one study by the American Management Association (AMA) of 1,000 companies found that companies are increasingly viewing downsizing as a normal option rather than a desperate measure of last resort. The authors cite the experience of Eric Greenberg, editor of AMA Research Reports, who now believes that the best indicator of future organizational downsizing efforts will be most effective when the approach is well planned, intermittent, recurrent and implemented on a smaller scale. It is suggested that this approach to downsizing will produce a positive impact on financial performance, minimize the negative implications on corporate reputation for social performance and ensure the highest level of managerial commitment to strategic change.

In order to determine whether downsizing as a strategic intervention was successful, the organization must revisit the strategic objectives and goals (Scott, 1999). As downsizing becomes more prevalent there is a growing need to manage the organizational outcomes of workforce reductions (Appelbaum, 2000; Robbins, 1999; Umiker, 1999). According to the literature, research on corporate downsizing shows a need for management to be proactive rather than reactive in implementation of an organizational downsizing program. A timeline has to be implemented and a sequence of events must occur before the downsizing intervention begins in order to ensure success. Mishra and Spreitzer, et. al. (1998) proposes that a successful downsizing process requires planning that begins long before the formal announcement.

Downsizing should be used as a last resort once all other avenues have been explored by the organization as a means to cut costs or generate budgetary savings. Additionally, management needs to show compassion toward the needs of each individual within the organization (Choy, 1999). Open communication with the staff is also critical. Mishra and Spreitzer (1998) state that employees who have full knowledge of the company's finances and industry trends feel personally in control amid the uncertainty of an impending downsizing effort, resulting in less anxiety and distraction. Ideas that help keep the downsizing efforts on track include:

- Developing a detailed plan to train each retained employee within the organization. This will give the organization a well-trained staff to keep the organization moving forward. If this is not done, consultants and others could be hired which would keep the fixed expenses high.
- Do not have voluntary programs for employees leaving with large benefit package. Quite often this creates a situation where the essential employees leave, robbing the organization of its own key people.
- A program for tracking an organization's costs in the downsizing effort should be implemented. "Companies need to install cost controls that are appropriate to the evaluation of a downsizing program. One cannot adequately evaluate the benefits from a downsizing program when its costs cannot even be measured correctly" (Mabert et. al. 1997).

FINANCIAL PERFORMANCE

Organizations competing under various market conditions may choose to implement downsizing with the intent to increase their financial performance. The decision to downsize can be attributed to many factors yet usually surrounds budgetary constraints or short-term business fluctuation. The decision to downsize is utilized mainly in an effort to achieve cost competitiveness (Lowe, 1998). An organization's ability to enhance its financial performance can depend greatly on how the organization chooses to implement downsizing in an effort to create a positive effect on its financial performance.

When an organization finds itself dealing with financial issues such as decreasing sales or rising costs, downsizing becomes a common response that allows the organization to implement cost-savings as a short-term goal. The data clearly shows that the downsized firms consistently under-perform the firms which did not downsize on "several financial indices in the year of the announced layoff and each of the two subsequent years" (DeMeuse, Bergmann, Venderheiden & Roraff, 2004). Management should not limit their focus on short-term goals, but should also include long-term assessments in deciding whether to implement downsizing as a strategic intervention.

While downsizing may lead to short-term financial gains, research indicates that the long-term effects of such can lead to a decrease in financial performance. A study entitled Downsizing and Firm Performance: Panacea or Paradise Lost (Lowe, 1998) examined the financial performance of several organizations over a three year period following their decision to downsize the organization. Accordingly, organizations which chose to focus on downsizing as it relates to employee headcount over physical assets actually saw a decline in their return on assets (ROA) while other organizations saw a negligible decline in ROA (Lowe, 1998). Organizations that chose to implement employment downsizing on a larger scale experienced similar results, thus indicating that the employment downsizing neither helped nor hindered the organization's financial performance.

A longitudinal study titled New Evidence Regarding Organizational Downsizing and a Firm's Financial Performance (DeMeuse, Bergamnn, Vanderheiden & Roraff, 2004) reported that downsizing has little effect on financial performance unless the dismissals are very large. Organizations that implement large-scale downsizing (interventions of 10% or greater) significantly under-perform those corporations that implement smaller interventions. A possible contributory factor to under-performance might be attributed to employee perceptions that a psychological contract between the organization and employees has been violated. This infringement of the implied psychological contract negatively affects behavior, attitude, and ultimately, performance and productivity.

Interestingly, the same study identifies that the relationship between frequency of downsizing intervention and financial performance are less significant. For companies that implement a sequence of small employment cutbacks, employees appear to be more accepting of the process in that the downsizing intervention emerges as a rational and legitimate strategy, responsive to a competitive environment. This acceptance lessens the negative feeling commonly attributed to management and, therefore, diminishes the negative impact on performance and corporate financial performance.

Not to be overlooked is the potential disruption that might occur beyond the walls of the organization. A perceived breach of a psychological contract has far-reaching implications for organizational stakeholders. Suppliers, shareholders, customers and communities all have direct influence on an organization's ability to remain competitive and viable. In the absence of sound reasoning for the decision to initiate a downsizing intervention (supported by a well-defined strategic plan), stakeholders possess the ability to support or reject the effort. The financial repercussions are undeniable.

REPUTATION FOR CORPORATE SOCIAL PERFORMANCE

According to strategic management researchers, there is no convincing evidence that downsizing leads to long-term, superior organizational performance (Cascio, Young & Morris 1997; DeMeuse, Bergmann, Vanderheiden & Roraff, 1997; Zyglidopoulos, 2003). This has led to much discussion concerning the relationship between downsizing and the notion of reputation for corporate social performance (RCSP) (Sloan & Underwood, 1996; Zyglidopoulos, 2003). It is imperative that corporate leaders acknowledge and fully address the potential consequences on a firm's reputation for corporate social performance when the decision is made to move forward with the downsizing intervention. The "term 'reputation for corporate social performance term' (RCSP) refers to the firm's reputation for principles, processes and outcomes related to the social impact of the firm's operation" (Zyglidopoulos, 2003). The decision to downsize leaves an imprint of the organization's reputation for social performance (Zyglidopoulos, 2003).

Zyglidopoulos (2003) identifies two primary explanations why downsizing decisions should be expected to have an impact on a firm's RCSP. First, there are implicit social and psychological contracts that relate to the ethical obligations of managers towards their employees and it is reasonable to expect that downsizing decisions will have a negative impact on a firm's RCSP; and second, it has been argued that downsizing practices have been granted legitimate business practice status (Lamertz & Baum, 1998; Zyglidopoulos, 2003).

RCSP is all about competitive advantage and sustainability. As was discussed in the previous section concerning financial performance issues, recall that stakeholders will generally accept the decision to downsize when implemented rationally and there exists a perception that psychological contracts between affected parties have not been breached. Financial performance is symptomatic of internal issues; whereas RCSP is the root cause created by contributory external factors. Negative consequences can be significantly diminished if management utilizes the five application stages using downsizing as a strategic intervention identified in Figure 1 as a basis to implement the intervention. Each of the stages should be addressed chronologically, with equal emphasis placed on each stage. No one stage is more important than the other. The five application stages for downsizing as a strategic intervention require that all stages are purposefully applied to ensure compliance and effective application.

Despite the growing importance of RCSP, corporations appear to be their own worst enemy when it comes to developing a reputation for corporate social performance. Many organizations have no strategic plan to manage what should be a corporate priority. Research reports that about fifty percent of corporations report that they infuse, to some degree or another, a component addressing RCSP within the strategic plan. Approximately one-third had not addressed the issue at all and about twenty-five percent reported they only planned for crisis situations (Williams, 2004).

Not surprisingly, organizations that failed to take into account the influence of trust on their reputation for corporate social responsibility also scored poorly on their performance with people management, organizational change and management ethics. Trust and credibility are factors that significantly influence an organization's reputation. It has also been established that RCSP can produce a positive effect on profitable outcomes – particularly corporate financial performance. (Williams, 2004).

Corporate reputation for social performance directly impacts an organization's bottom line. Yet few would dispute the difficulty in attempting to quantify RCSP as an intangible asset whose value is often not considered until an organization is faced with a developing crisis such as the need to implement a downsizing intervention. As difficult as it is to quantify RCSP, assessing the financial impact after the fact is much easier to accomplish in the short-term following the decision to downsize. Less predictable are the long-term effects that will undoubtedly impact the bottom line.

RCSP, despite being intangible, directly influences an organization's ability to attract and retain a talented workforce sufficient to maintain competitive advantage. Considering that it can take years to develop and sustain a strong and resilient reputation, corporations acknowledge that a single major negative event can erase decades of effort in building a reputation. The results of a tarnished corporate reputation will produce dramatic effects across the spectrum of organizational stakeholders, eventually decreasing an organization's market share and profitability (Muirhead, 2004).

Charles J. Fombrun, Executive Director of the Reputation Institute and Professor of Management at the Stern School of Business, New York University, states, "Company survival and profitability depend on the ability to attract support from four holders of resources: employees, customers, investors and communities. People must be persuaded to join and work for the company; customers must be induced to buy; investors must be encouraged to supply credit and equity financing; and communities must welcome the company to the neighborhood. Having a good reputation among these resource providers is therefore crucial if a company is to build and sustain a competitive advantage" (Muirhead, 2004).

MANAGERIAL COMMITMENT TO STRATEGIC CHANGE

A study conducted by Hopkins, Hopkins and Mallette (2001), suggests that managerial commitment is basically loyalty to the organization and share three common components: acceptance of the organizational values, willingness to exert effort on behalf of the organization and a desire to remain an employee of the organization. The need to factor these three components at the managerial level becomes a key component prior to the implementation of downsizing. Managerial commitment must be viewed as being essential to the effective functioning of the organization (Hopkins et. al., 2001).

Hopkins, et. al. (2001) discusses psychological contracts that exist between the employee and the organization. There are two dimensions of psychological contracts: rational and general contracts. Rational contracts entail employee commitment to the organization's values and the employees' ability to fully identify with the organization's needs. Rational contracts seek to create a long-term relationship with the organization including job security and advancement opportunities. General contracts refer to the extent to which employees believe the organization has lived up to the implicit promise made when the contract was initially entered into (Hopkins, 2001).

As downsizing occurs, the organization must understand and communicate the changes needed from its managerial staff. Managerial responsibility for change often involves such contradictory demands as balancing human and economic values, combining organizational and personal interests, motivating people and having responsibility of an employer-employee relationship. Managers typically face uncertainty and complexity in their work during such strategic changes as downsizing (Lamsa, 2000). Managers are expected to assume responsibility for change and guide others during the implementation of the strategic intervention for downsizing. High levels of managerial commitment are expected and they are implicitly viewed as committed to change: working for it and believing in its good intent (Lamsa, 2000).

A 1999 study conducted by Lamsa and Savolainen's, entitled <u>Exploring Commitment in Different Contexts of Change</u>, states that managerial commitment may not be as self-evident as often presented. Managements' duty of loyalty to complex, demanding and problematic changes can be questioned (Lamsa, 2000). Although managers need to commit themselves to the strategic course of action of the organization, a very high level of loyalty and commitment can also make them lock into a course of action that is outdated, risky, or even unethical (Lamsa, 2000).

The vast majority of research on downsizing and the implications on performance and productivity relates to the technical core of the workforce. Few inquiries address the implications at the managerial level. The fact exists that a significant threat to the organization implementing a downsizing intervention is the potential loss of the most competent and valued middle and upper-level managers, in that they possess the knowledge, skills and abilities to seek new employment opportunities. Still, Lamsa and Savolainen (2000) conclude that the middle and upper-level managers' intent to separate from an organization might be less attributable to one's level of competence and more attributable to an erosion of corporate commitment. This position is consistent with other studies that report a diminishing managerial commitment is a direct negative result of a downsizing intervention plan (Armstrong-Stassen, 1998).

CONCLUSION

The authors have examined the application and implementation of downsizing as a strategic intervention. Incorporating downsizing in the strategic management plan can increase organizational efficiency by maintaining a focus on core competencies that promote competitive advantage and potentially increase market share.

Cummings and Worley's (2001) five application stages for downsizing as a strategic intervention was applied in the areas of financial performance, reputation for corporate social performance and managerial commitment to strategic change. Management should be aware that large-scale downsizing may produce significant levels of under-performance. In contrast, smaller-scaled, repetitive downsizing interventions have less of an impact on financial performance, although the relationship between frequency of downsizing intervention and financial performance are less significant. There should also be a managerial acknowledgment that psychological contracts between the organization and employees must be maintained and that downsizing must be implemented as a rational and legitimate business strategy in response to the environment.

Management must recognize and fully address the potential consequences of reputation for corporate social performance. A firm's reputation in the midst of a downsizing effort can result in dire consequences from which an organization may be unable to recover. Despite years of building a strong corporate reputation, a single damaging event can quickly unravel the threads that hold the organization to its stakeholders. When a corporation utilizes downsizing as a strategic intervention specifically infused within its strategic plan, the process is generally granted legitimate business practice status. There is a clear correlation between reputation for corporate social responsibility and financial performance.

Downsizing as a strategic intervention has an undeniable impact on managerial commitment to strategic change. This report reveals that middle and upper-level managers' intent to separate from an organization might be attributable to one's level of confidence or an erosion of corporate commitment and that commitment is influenced by three shared components: acceptance of the organizational values, willingness to exert effort on behalf of the organization and a desire to remain an employee of the organization. A diminishing managerial commitment to the downsizing intervention effort will result in an irrefutable negative influence directly affecting financial performance and reputation for corporate social performance.

Finally, prior to the implementation of downsizing as a strategic intervention, organizations should identify alternative methods that will direct the organization toward the achievement of its organizational goals. If a decision is made to implement downsizing, the implication of the strategic decision to downsize should be fully explored.

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