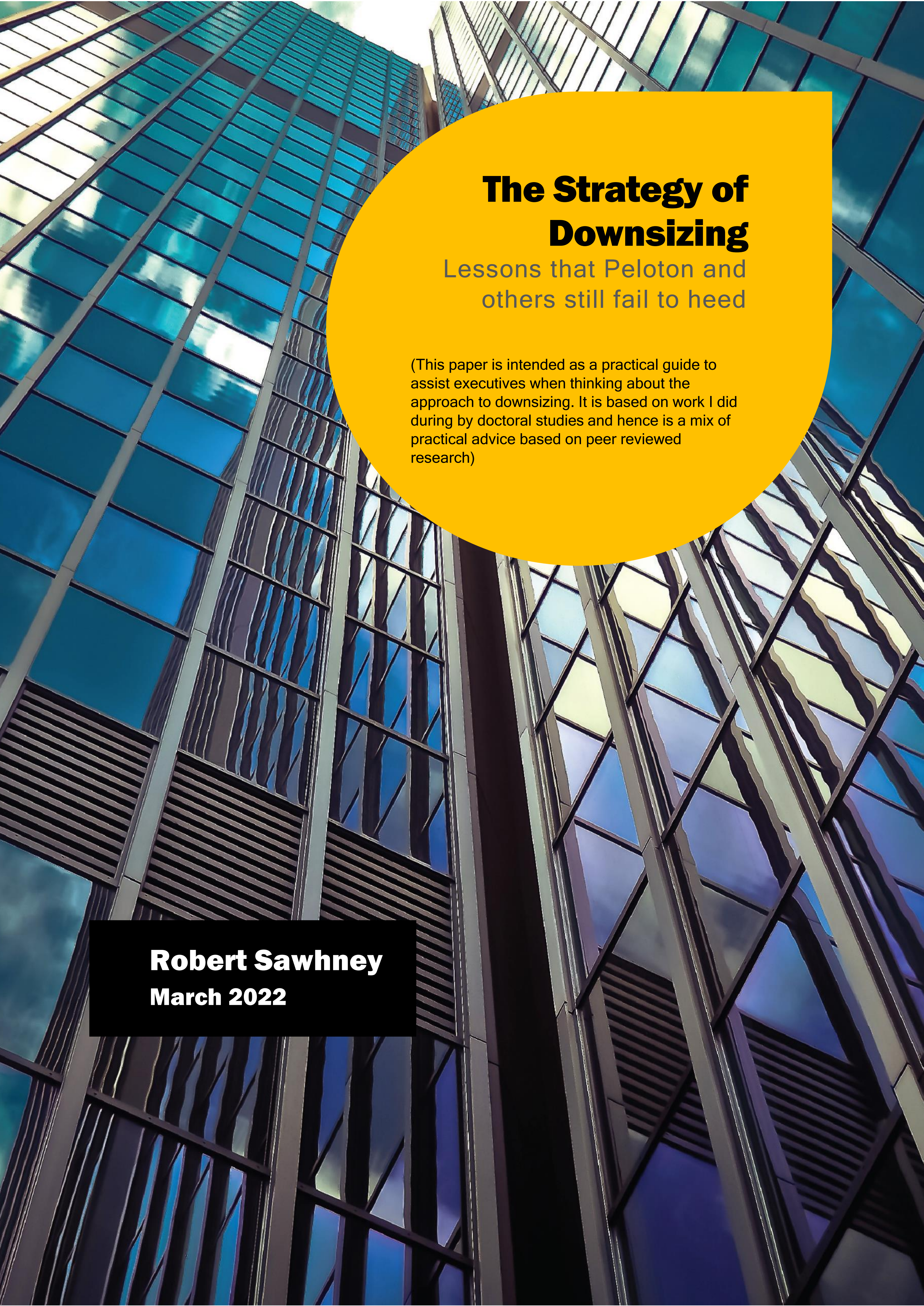

The Strategy of Downsizing

Lessons that Peloton and others still fail to heed

(This paper is intended as a practical guide to assist executives when thinking about the approach to downsizing. It is based on work I did during by doctoral studies and hence is a mix of practical advice based on peer reviewed research)

Robert Sawhney

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ABOUT THE AUTHOR

Robert has had a varied career spanning health and fitness, consultancy, and academia. Currently he works in an international director role for one of the largest fitness solutions providers in the world. He has a BSc in Sports Science and Management from Brunel University and an MBA from the University of Lincoln. He did his doctoral studies in business at a university in Hong Kong.

He is the author of 2 books. Marketing Professional Services in Asia (Lexis Nexis, 2009) which was called one of the most indigenous books on Asian marketing by Professor Oliver Yau (Chair Professor of Marketing at City University HK) and Developing a Profitable Practice in Asia (Ark Group, 2010). He has also published over 50 articles in various newspapers and magazines on the topics of strategy, marketing, and leadership. He has spoken at numerous events as a keynote speaker or panelist around Asia.

His strengths lay in strategic thinking, action, and execution. Having worked with and supported some of the largest key accounts in the world, he also has the in-depth practical experience of achieving targets and helping those around him succeed.

Robert is a keen sportsman having played professional football. He still hits the gym 5x week and plays rugby.

Contact:
LI: https://www.linkedin.com/in/robertsawhney
Twitter: https://twitter.com/SawhneyRobert
Blog: www.strategycompetitiveness.com
Email: chrisstriphk@gmail.com
Phone: +852 90132532, +852 97894589

Introduction

The recent announcement of Peloton laying off 2800 employees again sheds light on the pervasive organizational phenomenon of downsizing. Whatever euphuism is used (rightsizing, restructuring, and yes even smart sizing), downsizing is often the pain experienced by employees for the missteps of management. This is not to say that cost cutting by downsizing per se is wrong for the long term viability of the organization, but rather, the way in which downsizing is done has a huge impact on whether such an initiative can be deemed a success.

Far from thinking just about the potential cost savings from letting a certain percentage of the workforce go, firms need to the think deeply about lost knowledge, the morale and motivation of those who remain (survivors), the perceptions of the market place, as well as the impact on the customer and the ability of the company to deliver on its value proposition (or changing proposition). In addition, the firm should think seriously about the impact on those let go and how they are treated. Not only for human reasons but also for the very real likelihood that the organization will look to re-hire many of these same people should performance improve (there is wealth of research which shows this is often the case as firms yo-yo from hiring to firing in short term reactions to the market).

Whilst it may seem that most firms just downsize workers without exploring alternative options, there are in fact a few exemplar firms that have taken significant steps to cut costs before even considering laying off employees. The one that stands out recently is the example of Ajay Banga, the CEO of Mastercard India, who promised no layoffs. His proclamation that the company made so much money during the good times that it can 'afford' to support staff during harder times should be a manifesto to all firms that manage by quarterly targets and have become beholden to the mantra of shareholder value. Even the bastion of the shareholder value doctrine, Harvard Business School, have come out and stated that what they taught was wrong. In an era of capital value over labour value, share buy backs, PE investment returns, excessive CEO pay, extreme dividends etc, I am going to lay my cards on the table and state that my views on the management of organizations today are beautifully encapsulated in this 3 minute video clip of Scott Galloway on the Bill Maher show. Having said that, the rest of this paper will provide an evidence based approach to successful downsizing approaches.

There is a significant relationship between downsizing and organizational performance, but not in the direction you might think. Research by Wayne Cascio, a professor of management at the University of Colorado and an expert on downsizing shows that firms which made the deepest layoffs when compared to their peers delivered weaker performance for as long as nine years after a recession. His work was with firms listed on the S&P 500 but there is good reason to believe that these results would hold true for knowledge and service oriented firms since human capital is the key ‘product’ in such firms. Other research with fortune 100 firms shows similar outcomes. Those firms which cut over 10% of their work force performed significantly worse than those firms which made smaller cuts. There are in fact a number of approaches to downsizing, some more effective than others. Those firms that simply lay off people without deep consideration of client value and the systemic impacts of layoffs (such as worsening morale, decreased productivity, and damaged reputations) are the most vulnerable since the expected cost savings never materialize.

The table below highlights a continuum of approaches:

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 re-design	Aimed at organization change Moderate term implantation Fosters transition and transformation	Eliminates functions Merge units Eliminates layers Eliminates products Redesigns tasks
Systemic re-design	Aimed at culture change Long term implementation Fosters transformation	Change responsibility Involves all constituents Foster continuous improvement/innovation Simplification Downsizing: a way of life

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

The firms which look at systemic re-design in terms of culture change and transformation are the most successful because they think about the market when making changes and use a transparent, communicative and open approach. They are focused on improving value delivered to the customer and not just on internally driven cost savings and retaining exec remuneration levels. What research shows is that those firms with a high degree of market orientation deliver higher levels of innovation and performance. One can look at this in two ways from a downsizing perspective. Firstly, administrative innovation in terms of downsizing approach (pure layoffs versus systemic re-design) is directly related to market orientation since firms which are more client focused and market driven are likely to make smaller cuts and implement them in a systemic manner. Secondly, market orientation and human capital have a direct influence on innovation and performance as a whole. If firms make deep cuts they are effectively losing a portion of their knowledge and such knowledge is crucial to the innovation capability of the firm. What you have is double whammy on the firm's performance. Since the firm has a low degree of market orientation, they use a simplistic approach to downsizing and resort to mass layoffs, the expected cost savings never materialize. The concomitant negative changes in staff motivation and commitment levels and the lost knowledge of laid off staff all contribute to the decreased innovative capability of the firm. The net result is a firm which was already poorly positioned in terms of delivering client value becoming even worse through downsizing when they expected profitability to improve. It might sound counter intuitive but a substantial body of research shows this to be the case.

Many firms have mission statements etc exhorting the value of people but the point there is a substantial difference between espoused values and values in use. Research conducted in Australia (Farrell and Mavondo, 2003) found that those firms which approached downsizing from a lay off perspective had a negative impact on their learning orientation whereas those firms which used a systemic approach had a positive impact on their learning orientation. This evidence should make firms sit up and take notice of the fact that walking the walk is not the same as talking the talk. Learning and knowledge are key to innovation and firm performance yet you wouldn't believe it based on the indiscriminate downsizing undertaken by many firms. The amazing thing is now many of these firms are looking to re hire again as the economy picks up.

In summary then, there is a myriad of considerations when undertaking downsizing:

- Strategic – what language does the organization use and what steps does it take to transform? What strategies does it consider in terms of work re-design and organizational structure?
- Effectual – types of intervention and impact on morale, trust, productivity, and managerial roles
- Implementation – approaches including level of employee participation, empowerment, procedural and distributive justice etc
- Reaction and perceptual – fairness, communication styles, uncertainty, explanations, job security, career impact etc

Downsizing – what, why and how

It is not always apparent why organizations choose certain actions and how this affects their marketing and strategic management initiatives, particularly if we consider that the overriding objective of downsizing is to improve operating efficiency and competitiveness.

Downsizing can be defined as;

'a set of activities, undertaken on the part of management of an organization, designed to improve organizational efficiency, productivity, and/or competitiveness. It represents a strategy implemented by managers that affects the size of the firm's workforce and the work processes used' (Freeman and Cameron, 1993, p.10).

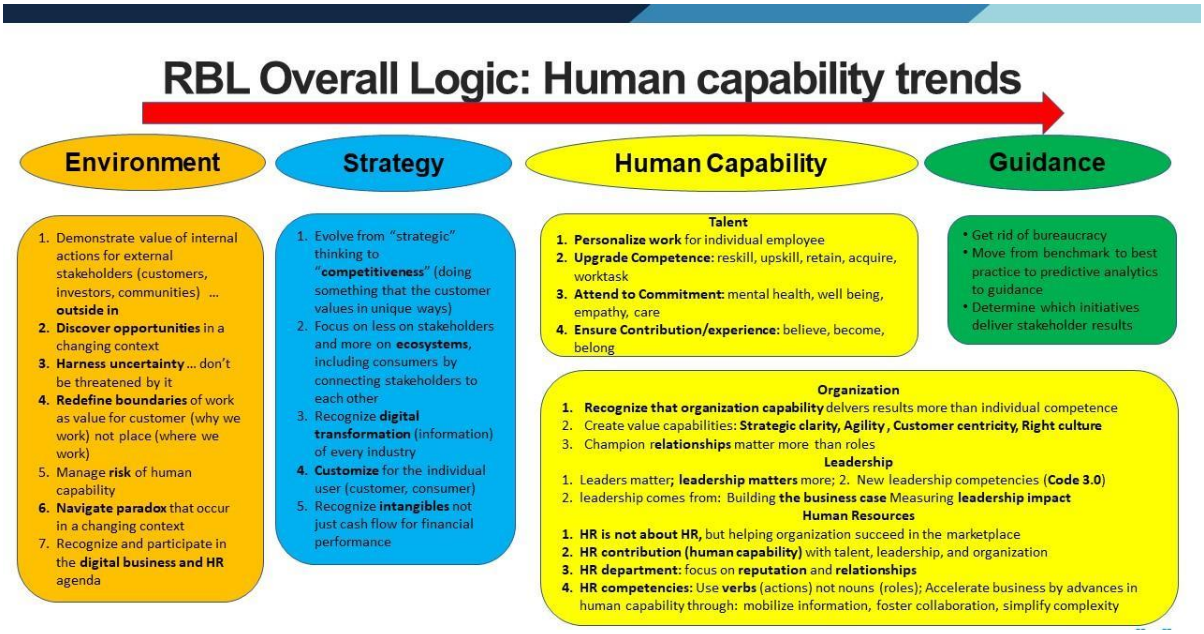
However, this assumes some type of comprehensive plan, which may or may not in fact exist. For example, effects on work processes suggests some kind of re-engineering or systemic intervention, whilst most companies have no plan associated with downsizing other than to reduce costs (Blanchard and Randolph, 1996). Indiscriminate downsizing is not an effective approach.

The body of literature on downsizing is both large and varied, having analysed macro and micro level models to explain the causes and effects of the change (Shaw and Barrett-Power, 1997).

Researchers have studied financial outcomes (e.g. Barker et al., 1998; Cascio et al., 1997; Worrell et al., 1991), changes in organizational structure (e.g. DeWitt, 1993; Littler and Innes, 1999; McKinley, 1992), as well as the impact on those who lose their jobs (e.g. Leana and Feldman, 1992) and those who are survivors (e.g. Armstrong-Stassen, 1998; Brockner, 1988; Mishra and Spreitzer, 1998).

Cameron et al. (1991) has found that the most effective downsizing firms spoke in terms of duality, both a short term internal approach, and a long term external approach. This may be so because an effective change model must be customer focused and market driven in its external relations, and process focused and team oriented in its internal operations (Carr and Johansson, 1995). This is a critical consideration. In my view, strategy is less about choice and more about managing paradoxes. In the strategy of downsizing, organizations must maintain a firm understanding of the value proposition they hope to deliver whilst cutting costs all the while remembering that it is human capability that delivers that VP.

Dave Ulrich (professor at University of Michigan and probably the leading thinker in HR today) has described the future of HR as something much bigger than HR. This means that thinking of people as assets is no longer appropriate. One should be thinking of human capability and how the organization embeds human capabilities to improve performance. Poorly executed downsizing approaches that treats people merely as assets is not the optimal approach needed to improve performance. One needs to take a holistic view of the organization and its environment.



(*Source: The RBL Institute, Dave Ulrich and Joe Grochowski*)

The reasons for different approaches adopted by management are many in number:

- Espoused values and concomitant value structures are one dimension that has been considered by Kabanoff and Waldersee (1995) – there is a significant difference between values in use and espoused values. Every organisation, as part of their mission, claim the importance of their people but it seems very few live those values when the going gets tough. As explained by former Harvard professor Chris Argyris, 'when it comes to complex issues – issues that can cause embarrassment, or may represent a threat to a person or an organization – espoused theories almost never operate. What does operate is the theory that people actually use, which I call their Theory in Use. These are the theories of action that are implied by our behavior, and they are likely to be unknown to us. We all possess a strong propensity to hold inconsistent thoughts and actions: the difference between espoused theories and theories-in-use applies at the level of national strategies, organizational strategies and small group and interpersonal behavior' (Rotman Magazine, 2008)
- Perceived features of over supply are another (Greenhalgh et al., 1988) – this is where the organization makes assumptions (right or wrong) about the nature of workforce oversupply in terms of functions, hierarchy, roles, responsibilities, gender etc and how work is performed
- Mutual trust (Mishra and Mishra, 1994) – mutual trust can be both positive and extremely destructive. In the destructive sense, a lack of trust by senior management often leads to unilateral layoffs with little advance communication or consultation. Research shows that early notification and two way communication enhances downsizing success both in terms of those laid off as well as the morale of those who remain. Additionally, firms that engage their employees openly and honestly when it comes to the need to cut costs often find creative ways to achieve this whilst minimizing permanent layoffs. A great example of this is the changes made at the Burzoo
- Culture - probably the most important determinant of approach is organizational culture. Culture can be defined as the pattern of shared values and beliefs that help individuals understand organizational functions and provide them with norms for behaviour. Schein (1992) distinguishes 3 levels of culture including basic underlying assumptions, espoused values, and artefacts. Corporate theories in use and organizational culture are closely linked and whilst underlying beliefs are not visible, management actions and behaviour are, and these can be used to understand the values that are truly emphasized by the organization. It also gives an indication of management worldview.

Wayne Cascio (University of Colorado), probably the leading researcher on downsizing, highlights a number of myths and missteps that strongly impact the success of a downsizing initiative (this section draws heavily on Cascio and Wynn, 2004 as well as Cascio, 2009):

1. **Indiscriminate downsizing boosts profits** – in an extensive study of over 6000 occurrences in changes in employment for firms in the S&P 500 between 1982 and 2000, Cascio and Young (2003) identified several groups of downsizers for analysis purposes:

- Employment Downsizers: Companies where the decline in employment is greater than 5% and the decline in plant and equipment is less than 5%.
- Downsizing by Reducing Assets (Asset Downsizers): Companies with a decline in employment greater than 5% and a decline in plant and equipment that exceeds the change in employment by at least 5%.
- Combination Employment and Asset Reduction (Combination Downsizers): Companies that reduce the number of employees by more than 5% but do not fit into either of the two categories above
- Stable Employers: Companies with changes in employment between plus or minus 5%.
- Employment Upsizers: Companies where the increase in employment is greater than 5% and the increase in plant and equipment is less than 5%.
- Upsizing by Acquiring Assets (Asset Upsizers): Companies with an increase in employment of 5% or greater and an increase in plant and equipment that exceeds the change in employment by at least 5%.
- Combination Employment and Asset Increase (Combination Upsizers): Companies that increase employment by more than 5% but do not fit into either of the other upsizing categories.

The researchers then observed the firms' financial performance (profitability and total return on common stock) from one year before to two years after the employment change events. The authors found no significant evidence that employment downsizing led to improved financial performance, as measured by return on assets or industry-adjusted return on assets. Downsizing strategies, either employment downsizing or asset downsizing, did not yield long-term payoffs that were significantly larger than those generated by Stable Employers—those companies in which the complement of employees did not fluctuate by more than ±5%.

2. **Lack of employee input** – numerous researchers have found that employee input is critical in downsizing success. Firms must consider both the impact on those who are laid off as well those who remain. Communications should be early and transparent. Negative reactions can be reduced if the underlying reasons are explained clearly and if those reasons are considered valid by the workforce. Seeking workforce input into cost reductions can often lead to alternatives that negate the need for layoffs.
3. **Using downsizing as a first response** - when downsizing is a knee-jerk reaction, it has long-term costs. Employees and labor costs are rarely the true source of the problems facing an organization. Workers are more likely to be the source of innovation and renewal.
4. **Failing to change the way work is done** - firms that cut workers without changing business processes in an effort to become more efficient simply take the same amount of work and load it onto fewer workers. Burnout and stress are typical byproducts of this approach, which does nothing to solve more fundamental problems facing a business
5. **Understanding damage to company culture -** employee morale is the first casualty in a downsizing. When a firm institutes its first round of downsizing, employees' initial reaction is usually a sense of betrayal. Long-term consequences of altering the work environment include increased voluntary turnover and decreased innovation

GUIDELINES FOR DOWNSIZING: AN INITIAL CHECKLIST
✔ Identify departments and functions that are strategically critical, along with critical employee skill sets going forward.
✔ Identify criteria that reflect legitimate business needs.
✔ Use a "funnel" approach to selection; that is, evaluate employees by critical skill sets first, followed by job performance, disciplinary actions and seniority (to break ties).
✔ Document the criteria and processes used.
✔ Conduct analyses to ensure that there is not a disproportionate effect of layoffs on members of protected classes and have all analyses and documentation reviewed by an attorney.

(Source: Cascio, W (2009). Employment Downsizing and its Alternatives: strategies for long term success. Society for Human Resource Management).

According to Robert Reich, ex US labour secretary, the real question is not whether to downsize but how it is done (cited in Mishra et al., 1998). Clearly then, downsizing may well be here to stay. Yet it is an extremely sensitive issue that affects not only individuals and their jobs, but society in general. Therefore, gaining an understanding of downsizing strategies used and what is effective is extremely important if we want to answer questions such as:

- What are the downsizing strategies and processes in use and how are top management developing and implementing these ideas?
- What is the worldview of these managers and do they consider the overall business picture when considering a bout of downsizing?
- Are they ‘qualified’ to play such a major role in the lives of so many people?
- What are the underlying characteristics of the change processes and how can the intended (and reported) actions of top management be reconciled with the views and perceptions of survivors, and how important is this?
- How can a more comprehensive and systemic downsizing plan help an organization and how can it be initiated?
- Is market orientation the missing link in an effective change programme and can it help to produce a model of more successful initiatives?

In addition, Gandolfi (2009) identifies six human consequences of downsizing:

1. Downsizing produces considerable human consequences
2. Downsizing impacts the entire workforce, victims, survivors, and executioners, in a most profound manner
3. Victims generally receive generous outplacement services and financial packages when exiting the downsized firms
4. Survivors often find themselves with increased workloads and job responsibilities while receiving little support, re-training, and resources
5. Survivors suffer from a range of sicknesses in the wake of downsizing
6. Executioners suffer from similar psychological and emotional effects as victims and survivors

Summary

All in all there are a multitude of factors at play when it comes to downsizing, hence it is important for managers to take a systems perspective. As identified in the table on p.4, the best outcomes are those associated with systemic organization re-design where the worst outcomes are associated with pure layoffs. It then seems prudent for managers to turn to the evidence of what works and what does not to ensure many of the issues identified in this paper are avoided. The below tables are both great reference points and starting points when cost cutting is needed and provide a useful summary to the arguments presented here.

Downsizing: The Hard Questions

- Why does employment downsizing make sense for the organization?
- What is the business case for employment downsizing?
- What is the problem that the organization is trying to solve?
- If the problem is short-term cash flow, are there alternative ways to cut costs?
- Do prospective layoffs include hard-to-find skill sets?
- How will the downsizing affect high performers who are difficult to replace?
- What are the short-term payoffs from a downsizing strategy?
- What long-term threats to the organization’s strategic success might be associated with employment downsizing?
- What long-term costs might the organization incur by implementing employment downsizing?
- Do the long-term benefits associated with employment downsizing outweigh its short-term costs?

(Source: Cascio, W (2009). Employment Downsizing and its Alternatives: strategies for long term success. Society for Human Resource Management).

Factor	Relationship
Systematic analysis prior to downsizing	Positive
Gradual, incremental implementation of downsizing	Positive
Increased communication and participation	Positive
Increased employee effort regarding downsizing	Positive
Advanced level of quality culture	Positive
Excellence in creative quality	Positive
Involvement of customers and suppliers in downsizing	Positive
Establishment of own downsizing goals and targets	Positive
Downsizing through natural attrition	Negative
Downsizing through layoffs	Negative
Downsizing through outsourcing	Negative
Less advanced level of quality culture	Negative
No improvement in quality	Negative

Overall Effectiveness Level of Downsizing Approaches *(Source: Gandolfi, F (2010). Organizational Downsizing: a review of two decades of a strategic phenomenon. Sasin Journal of Mgt, Vol 16, No 1, 85-108).*

If the reader is interested in how to enrich jobs in the mass market service industry whilst maximising profit they are referred to the ground breaking work of Zeynep Ton and colleagues from MIT (a good starting point: https://goodjobsinstitute.org/wp-content/uploads/2018/03/Good-Jobs-Solution-Full-Report.pdf).

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