

SHRM Foundation Executive Briefing

Use and Management of Downsizing as a Corporate Strategy

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Overview

The recent economic crisis has led to an increased use of downsizing by corporations to manage costs. This briefing uses a question-and-answer format to summarize research on the common mistakes, costs, alternatives and best practices associated with downsizing.

What are some common mistakes in downsizing?

Here are three common mistakes in downsizing. The first is perhaps the most common, namely, failure to be transparent with employees and to communicate openly and honestly. Employees want the truth, and they want to hear it from the CEO. Vague descriptions of future plans and when they might materialize will drive your very best people out the door. The second common mistake is a failure to involve employees. Far too often, bosses see employees and their associated costs as the problem instead of seeing employees as important parts of the solution. If the objective is to cut costs, employees can be amazingly creative when their own jobs are at risk. The third common mistake is a failure to recognize that when the recession ends, the company—after going through a downsizing—may not have the numbers of people (with the right mix of skills) it will need to grow.

What are some direct and hidden costs of downsizing?

In the case of high-technology workers, the direct costs of downsizing are about \$100,000 per person. These costs are typically comprised of some combination of the following: severance pay, accrued vacation and sick

pay, outplacement costs, pension and benefits payouts, administrative-processing costs, the costs of increased voluntary terminations among those who remain, and the costs of rehiring former employees. Indirect costs include productivity losses among survivors, potential lawsuits from downsized former employees, loss of institutional memory (how things get done), increases in a firm's unemployment tax rate, low morale and risk-averse survivors. Another hidden cost is lost sales when experienced sales and marketing reps with strong client relationships are let go or leave out of concern they will lose their jobs. Beyond that, there are brand-equity costs, as layoffs damage a company's brand as an employer of choice.

Do companies that downsize outperform competitors that don't?

As a rule, they do not, especially if the only thing they do is cut employees. Cutting employees without changing anything else simply means that the same amount of work needs to be done by fewer employees. Studies have tracked the performance of downsizing firms versus no-downsizing firms for as long as nine years after the downsizing event. As a group, the downsizers never outperform the no-downsizers. In contrast, stable employers do everything they can to retain their employees. In 2008, for example, more than 3 million Americans lost their jobs. In contrast, *Fortune's* 2009 list of "Best Employers to Work For" revealed that 81 out of the top 100 employers had no layoffs in 2008.

Are there alternatives to downsizing employees?

Yes, there are many, but a key consideration is whether senior management believes that the downturn in business is temporary or permanent. If permanent, the

only alternative to layoffs is to retrain employees to develop new lines of business.

If the downturn in business is temporary, here are examples of other ways to cut costs:

- Cut temporary staff.
- Eliminate overtime.
- Offer voluntary retirement.
- Freeze salaries.
- Cut salaries.
- Delay raises.
- Freeze hiring.
- Reduce work hours (e.g., four-day workweek).
- Use temporary layoffs (furloughs).
- Cancel business trips and costly perquisites.
- Reduce or suspend matching contributions to company-sponsored savings plans.
- Raise employee contributions to benefits plans.
- Eliminate bonuses.
- Allow work sharing.
- Have a mandatory holiday shutdown.
- Redeploy workers.
- Rescind hiring offers, perhaps using “apology bonuses” of one- to three-months’ pay.
- Delay facility expansions.
- Move to smaller office space (e.g., by allowing some employees to work from home).
- Offer unpaid or partially paid sabbaticals.
- Bring outsourced work back in-house.

What are some exemplary practices in downsizing?

First, lead by example. CEOs at companies as diverse as FedEx, Winnebago Industries, Advanced Micro Devices and Hewlett-Packard all took pay cuts of 20 percent and reduced the pay of lower-ranking managers and staff, on a sliding scale, by 2.5 percent to 15 percent (higher-paid employees took bigger cuts). Second, ask senior managers to develop a “business-decline grid” that lists various phases of business decline, along with the symptoms of each stage. For example, in phase one, symptoms might include a drop in capacity utilization, profits below plan for more than one month and delays or cancellations of orders from customers. In phase four (“Code Red”), losses in the business for two quarters or more, loss of significant market share from

core products and continued loss of employees may be among the symptoms. At each stage, ask employees to identify actions to be taken, along with the expected results of those actions. A third exemplary practice is to offer incentives to offset pay cuts. These might include stock-based incentive compensation on a sliding scale, granting additional vacation time or allowing employees the opportunity to earn back their lost pay by generating increased business over a specified target level.

How should companies tell employees they are being laid off?

Employees need to be let go by their immediate supervisors, who have been trained to deliver a consistent message. They should not be notified via e-mail, by disabling security badges or by passing responsibility to HR or—even worse—to an outsider, such as an outplacement consultant. HR’s responsibility is to ensure that departing employees are treated with the same kind of dignity and respect they received when they were hired. If layoffs are not governed by a collective-bargaining agreement (i.e., based on seniority), keep the focus on job performance and use the layoff as an opportunity to get rid of poor performers. Recognize that if prior communications to employees have been steady, transparent and truthful, and if the organization has demonstrated by its actions that layoffs are a last resort, not a first resort, then it is reasonable to expect that employees will respond with acceptance, even gratitude, for those efforts.

Should firms worry about stress and productivity issues among those who survive the downsizing?

Absolutely. A Cigna study found a significant increase in stress-related medical claims among layoff survivors, and a January 2009 SHRM study found that 65 percent of survivors worry about being laid off within the next six months. A considerable body of research supports the following adverse reactions among survivors, though not all of them appear in every case: decreases in employee attitudes (job satisfaction, commitment, morale, trust in management, loyalty); increases in anger, guilt and stress; increases in tardiness, absenteeism, intentions to quit and actual quits; disruptions in social networks that adversely affect organizational learning; and reductions in employee creativity, innovation and customer service. The

result is that at the very time when companies need innovation and creativity to develop new products, new services and new streams of revenue, employees tend to become risk-averse and self-absorbed. Survivors reportedly spend an average of nearly three hours a day worrying about their job security—that's more than one-third of each workday. While the hit to productivity is obvious, it is important to keep in mind that these are self-reports and that controlled studies of actual productivity losses do not exist. What we do know is that when bosses stay behind closed doors and do not mix, mingle and communicate with surviving employees, 76 percent of those employees say it triggers thoughts of being laid off. The remedy? As a manager, do everything you can to reduce uncertainty among survivors.

What steps should companies take to preserve morale among survivors?

Treat departing employees fairly and humanely. Survivors are looking for signals that might reveal how they are likely to be treated if they lose their jobs. Thus, when eBay reduced its global workforce by 10 percent, it allowed its departing U.S. employees to stay on for up to four weeks to take care of personal needs and to say good-bye to colleagues. In addition, all U.S. employees received at least five months of severance pay, four months of paid health care benefits, plus one to three months of outplacement

services. Beth Axelrod, eBay's senior VP of HR noted: "How you treat the leavers has a strong impact on how the stayers feel about the company." Beyond that, senior managers must be able to articulate a vision for the future of the company and its employees, explaining how and why the company will be better off as a result of the downsizing. Thus when Mountain View, Calif., test publisher CPP, Inc. decided to close its Washington, D.C., office, CEO Jeff Hayes explained—to both the employees affected and those who were not—that revenues from traditional (non-Internet-based) scoring services were down 70 percent. Employees understood the need to cease offering those services, which were provided by the D.C. office. Morale remained high as the company offered opportunities for redeployment to some employees and generous severance to those who did not wish to relocate.

Conclusion

Even in the most challenging economic times, organizations benefit by exploring and trying alternatives before turning to downsizing as a cost-cutting panacea. For companies that must reduce headcount, research provides guidance on best practices for downsizing and managing survivors. ■

About the Author

Wayne Cascio holds the Robert H. Reynolds Chair in Global Leadership at the University of Colorado at Denver. Dr. Cascio has consulted with more than 150 organizations on six continents. He was named by the *Journal of Management* as one of the most influential scholars in the field of management over the last 25 years and received an honorary doctorate from the University of Geneva (Switzerland) in 2004. Dr. Cascio has published more than 135 articles and book chapters, and 21 books, including *Investing in People* (with John Boudreau, 2008) and *Responsible Restructuring: Creative and Profitable Alternatives to Layoffs* (2002).

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