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Delta

Managing the Organization Dynamics of Downsizing

Executive Summary

When managed effectively, downsizing can yield significant economic and organizational benefits. Reducing people costs has an immediate positive impact on the company's bottom line. Additionally, proponents point to longer term benefits of delayering and reducing administrative overhead, such as faster decision making, greater entrepreneurial behavior, and smoother communication.

Unfortunately, most downsizing initiatives are not managed effectively. One study of 288 downsizing companies indicates that less than half met their cost reduction goals through restructuring. Poorly managed downsizing can also result in severe decrements in employee engagement and morale, a general climate characterized by lack of trust in management and reduced loyalty to the company, and, ultimately, decreased company performance.

Top leadership faces unique challenges during downsizing. Effective management requires that leaders address the needs of those employees who are asked to leave, as well as those who stay behind. Surviving a layoff can be an energizing and motivating experience, or it can lead to lack of trust and resentment. Survivors' concerns include worries about future job security, uncertainty about how to

succeed in the new environment, and concern for co-workers asked to leave. During downsizing, it is critical that managers overcommunicate, treat individuals with dignity and respect, and increase managerial accessibility.

After the layoff, managers must allow employees to play a significant role in shaping the post-layoff environment, clarify the new opportunities and career paths available to survivors, and recognize and reward those survivors who engage in desirable post-layoff behaviors. Leaders must communicate the relationship between downsizing and corporate strategy so that employees understand how the workforce reduction supports the long-term success of the company. Additionally, it is the leadership's responsibility to ensure that layoffs are carried out in a way that is consistent with the company's values and core beliefs.

Downsizing: Promises and Pitfalls

Downsizing – the planned elimination of positions or jobs – is expected to yield rapid economic benefits. People costs often exceed 40 percent of a company's total budget.[1] As a result, cutting costs by cutting people appears to be an effective strategy for increasing shareholder return. Additionally, proponents of downsizing point to organizational benefits such as lessened bureaucracy, faster decision making, smoother communications, streamlined operations, and enhanced effectiveness and competitiveness.[2,3]

However, a 2002 survey by Watson Wyatt of 288 corporations revealed that of the 86 percent of companies that reorganized to cut costs in the last major economic downturn, only 47 percent met their cost reduction goals through their restructuring.[4]

Further, an analysis of downsizing at S&P 500 companies between August 2000 and August 2001 indicates that companies that performed few or no layoffs performed significantly better than companies with large layoffs. Of the 25 percent of companies that conducted layoffs, those that reduced their workforce by 3 percent or less did not outperform companies with no layoffs, with both groups posting an average of 9 percent share price increases. Furthermore, share prices remained flat in those companies that downsized between 3 and 10 percent, and plummeted 38 percent among companies that reduced their workforces by more than 10 percent.

Analysis of the root cause of layoffs in these companies indicates that the reason for downsizing is significant to shareholders. When cost-cutting was the reason for layoffs, share prices rose only 2 percent, on average, from the 30 days before the announcement to the 90 days after. In contrast, companies that downsized as part of a strategy to consolidate mergers and leverage synergies enjoyed a 9 percent stock rise in the same timeframe. This is in part due to the fact that many companies will not experience the financial reward of layoffs unless the eliminated jobs are not replaced for six to twelve months, and many companies re-hire the employees they lay off before the benefit can be realized.[5]

Negative Impact of Poorly Managed Downsizing

Additionally, downsizing often falls short because the leadership and management fail to recognize the complexities of downsizing, anticipate problems, or plan strategically.[6] The long-term consequences of poorly managed downsizing can be seen in the following areas:

- ***Employee motivation and morale.*** Studies show that following a downsizing, surviving employees may become narrow-minded, self-absorbed, and risk-averse. Morale sinks, and productivity may drop. Survivors are often consumed with seeking information regarding their own security and searching for reassurance rather than producing.[7]

- ***Operating environment.*** The general climate of a company after a downsizing may be characterized by a lack of trust in management and a belief that employee loyalty and concern for the company are no longer valued.

- ***Organizational capabilities.*** Workforce reductions may result in a loss of expertise and organizational memory, decreased performance standards and insufficient capacity to act. This poses a greater risk for learning organizations, which rely on their human capital and relationships to innovate and grow.[8]

- ***Company reputation.*** The way a company treats its employees greatly affects how it is viewed by the public. Many companies fail to recognize the importance of communications regarding downsizing to external constituents, including shareholders and customers.

Helping Those Who Leave

To minimize the negative consequences of downsizing, employers often try to get as close to their downsizing goals as possible by offering unpaid sabbaticals or “sweeteners” that encourage early retirement and voluntary severance. If the company can afford to wait, attrition may accomplish much of the remaining reduction, so that only a few actual layoffs are necessary.[9]

There are times, however, when the need to terminate some of the workforce is inescapable. In those cases, employers have a number of levers available to minimize the negative impact on those who must leave:

- ***Communicate more to minimize uncertainty.*** Provide as much information and fair warning as possible. Some companies provide “pre-layoff” workshops designed to help employees understand the why, when, and how of being downsized. Regular, open, honest communication is critical to foster employee trust that is crucial during downsizing efforts.[10,11]

- ***Conduct downsizing all at once.*** If possible, avoid a series of unsettling announcements; before long, they feed the sense of downward momentum and have a corrosive, cumulative effect.

- ***Strive for process fairness.*** Procedures are perceived as fair if they are made consistently, without self-interest, on the basis of accurate information, with opportunities to correct and the interests of all concerned parties represented and following moral and ethical standards.[12] Not only is it the right thing to do; a significant business case can also be made for process fairness. Research suggests that former employees are significantly less likely to take legal action against the company if they perceive the process to be fair (1 percent) versus unfair (17 percent). Some estimate the expected cost savings of practicing process fairness at $1.28 million for every 100 employees dismissed.[13]

- ***Treat employees with dignity.*** Allow employees the opportunity to say goodbye. Resist the temptation to suspect or devalue employees who have been cut because of business necessity.

- ***Offer resources.***

  - ***Financial education***. Outplaced employees are interested in answers to financial questions like, "Can my 401(k) come with me?" and "What are the costs of COBRA?"

  - ***Onsite employee support and counseling.*** Onsite professional counseling on the day of layoff announcements can help affected employees process their immediate reactions and feelings and set them up for longer-term outplacement support.

  - ***Outplacement counseling.***[14] Depending on the needs of the employees, this type of resource can emphasize rapid re-employment with effective self-marketing tools and techniques or a process of career evaluation, education, and training.[15] In addition to one-on-one counseling, outplacement centers can also be a gathering place for socializing, networking, and support for groups of affected employees.[16]

  - ***Retraining.*** Companies can contribute to outplaced employees' education, or in training to enhance their skills and help make them marketable for employment elsewhere. This can be accomplished through education fairs or tuition assistance.[17]

  - ***Paid insurance benefits.*** Some companies provide incentive programs such as continuing health and/or life insurance benefits for a specified period of time for employees who voluntarily resign.

- ***Create opportunities.***

  - ***Fund entrepreneurial activities.*** Provide seed funds for employees who start their own businesses.

- ***Referrals, company-to-company loans of employees, and job fairs.*** Companies can form alliances with their sister companies or other area businesses to help displaced employees find employment and provide references.[18]

- ***Temporary work opportunities.*** Instead of the outright severing of ties with the organization, companies may institute a job-share program where two employees share one position, with responsibilities split 50/50. Companies can also retain employees as independent contractors to smooth their individual transitions, while allowing the business to retain some continuity of work. These can be done temporarily until the displaced employee finds another position.[19]

The Effects of Layoffs on Survivors

Downsizing survivors – those who remain after layoffs – are in a fragile state after workforce reductions. Surviving a layoff can be an energizing and motivating experience, or it can lead to lack of trust, resentment, and diminished productivity. Breaking the "psychological contract" between organizations and employees has been linked to increased stress and decreased satisfaction, commitment, and intentions to stay,[20] all key facets of employee engagement.

Similar to employees who are laid off, one of the key determinants of how survivors react is the perceived process fairness of the downsizing process – with loyalty dropping sharply if the process is seen as unfair. Among survivors, perceived process fairness is more likely to generate support for a new strategy, to foster a culture that promotes innovation, and to promote the performance of organizational citizenship behaviors (OCBs).[21,22] OCBs are behaviors that employees perform beyond their job requirements that support colleagues and benefit the organization. Examples include volunteering to help colleagues with heavy work loads and endorsing and supporting organizational objectives. These discretionary behaviors have been reliably linked to positive organizational outcomes, such as efficiency, product quality, and perceived customer service.[23]

Some fairness-related questions that survivors tend to ask include:[24,25]

- Was the layoff justified?
- Was the layoff consistent with the company's culture?
- Did the company provide ample advance notice?
- In implementing the layoff, how well did the company attend to details?
- Did management provide a clear and adequate explanation of the reasons for the layoffs?
- Were cutbacks shared at the higher managerial levels?
- What decision criteria were used to determine which employees would be laid off versus those who were retained?
- Did the company provide tangible caretaking services to help soften the blow for those laid off?
- Did the company involve employees in the layoff decision process?

Survivors are influenced not only by the perceived fairness of the layoff, but also by the changes in their work setting which often accompany layoffs. Specific concerns include:

- ***How much should I worry about the possibility of future layoffs?*** Survivors' job insecurity generally increases after layoffs. This is understandable, since many organizations downsize in waves rather than on a one-shot basis. High levels of job insecurity lead to negative effects on survivors' productivity, engagement, and morale.

- ***How does my job compare to the one that I had before the layoffs?*** Survivors are concerned that the quantity and quality of their work may change. First, with fewer people left to do the work, the sheer volume of workload often increases. Second, the nature of the work in terms of important attributes such as autonomy, variety, and complexity may change.

- ***What is my future here?*** Layoffs often leave survivors uncertain about their future opportunities within the organization and the long-term viability of the business. The organizational climate may also lead survivors to engage in career re-assessment and to consider the impact of the layoffs on their industry or job-type.

- ***Where should my loyalties lie?*** Survivors of downsizing are acutely aware that the psychological contract between the organization and employees has been broken and may experience a shift in loyalty balance from the organization to self.[26] This may also be accompanied by shifts in personal priorities, from a focus on career to a focus on self and work/life balance.

- ***What are the reactions of my fellow survivors?*** In times of stress or uncertainty, people take cues from their co-workers to help them determine what they should be thinking or doing.

- ***How do I interact with my colleagues who were let go?*** Employees who remain with the organization may experience guilt associated with surviving the layoff and may feel awkward when interacting with their colleagues who were laid off.

Helping Those Who Stay Behind

To best help survivors weather downsizing, managers need to conduct layoffs fairly, help survivors cope with negative changes (e.g., increased workload) in the workplace, and encourage survivors to focus on the future of the organization and positive changes (e.g., career opportunities). Appropriate managerial actions before the layoff include providing ample notice, soliciting the commitment of key people to the new organization, and preparing managers for what to expect and how to act during the difficult process of downsizing. During the layoff, it is critical that managers overcommunicate, treat individuals with dignity and respect, and increase managerial visibility and accessibility.

After the layoff, the surviving workforce will need to regroup. A number of action steps can facilitate this process:

- ***Soliciting employee input.*** As soon as management believes that the acute trauma of the layoff has subsided somewhat, survivors should be given every opportunity to play an active role in shaping the post-layoff work environment. This allows employees to regain some of the sense of control that was threatened during the layoffs.[27 28]

- ***Rightsizing the work.*** A common complaint among survivors is that they not only have to do their own jobs, but they also have to do significant portions of the work previously performed by those who were laid off. Downsizing organizations must work hard to eliminate low-value work.[29 30]

- ***Maximizing job enrichment.*** The post-layoff environment provides especially fertile ground for redesigning the work survivors do in order to make it more psychologically interesting. Interesting jobs result in more motivated employees, as well as greater loyalty and productivity.

- ***Making certain that survivors recognize new opportunities.*** Survivors, seeing the opportunities that accompanied the "old way of doing things" disappear, may conclude that their chances for success in the post-layoff environment are limited. Leaders must communicate to employees that they are important assets to the organization, and that they can co-create opportunities.[31]

- ***Making career paths explicit.*** The massive restructuring that often accompanies downsizing could leave survivors uncertain about their longer-term prospects with the company. Therefore, it is important to make clear to the survivors – especially the star performers – the new sources of rewards in the company, as well as ways to achieve those rewards.

- ***Recognizing survivors for engaging in new, desirable behaviors.*** People often learn by watching the outcome of others' behaviors. Public recognition can encourage survivors to undertake the behaviors necessary to help the company adapt to and recover from the layoffs.

Leadership Challenges

Executive leadership plays a critical role during downsizing. As with any major organizational initiative or transformation, it is the duty of top management to ensure that the downsizing effort is aligned with the firm's long-term business strategy and managed with attention to the needs of various stakeholders – employees, customers, and shareholders. The leadership challenges during downsizing are even greater, given the uncertainty, fear, and risk to organizational performance inherent in large-scale restructuring or workforce reduction. Key challenges are to:

- ***Communicate the relationship between downsizing and corporate strategy.*** While the layoff may be a logical consequence of corporate strategy, not everyone may see the connection. Stakeholders need to understand how the workforce reductions support the long-term success of the company.[32]

- ***Engage in open dialogue.*** A strong temptation for leaders is to emphasize the business necessity of the layoffs and to distance themselves from discussing the personal cost to the organization. Yet most employees want leaders who are not afraid of personal communication. Admitting that the downsizing decision was a wrenching one shows that the leader is a real person experiencing and struggling with a painful situation. Similarly, leaders must encourage expressive behavior, giving survivors a chance to talk about what they are experiencing. These are important steps in rebuilding trust.[33 34]

- ***Stay true to the company's values.*** It is critical to behave consistently with the company's core beliefs and values during times of retrenchment and economic difficulty. Leaders should promote discussion of the company's values and demonstrate how the downsizing is being managed according to these beliefs.

- ***Model desired behaviors.*** Survivors' judgment of fairness depends upon both the substance and style of how the layoff is handled. It is important to do the right things (substance) and to do things right (style). When asking for sacrifices from employees, for instance, it is important for higher levels of management to become cost conscious too.

- ***Emphasize winning and the "Upside of Downsizing."*** Much of the dialogue between leaders and employees will be driven by the immediate need to weather the worst of the layoffs. Leaders must ask for patience, understanding, and willingness to adapt to the new organizational circumstances – all important to surviving layoffs. But the message must also focus on thriving, not just surviving. Leaders must emphasize the benefits of the new organization and project confidence that the layoffs position the company for future success.

- ***Seek feedback and course-correct accordingly.*** As restructuring is oftentimes not a once-off event for organizations, it behooves leaders to take the opportunity to gather feedback on the process and communications and learn for the future. Taking a "pulse-check" on those affected and the survivors is an invaluable mechanism to course-correct during the current downsizing effort and learn for future restructuring efforts.[35]

Leadership Opportunities – the Bifocal Leader

While downsizing efforts represent many leadership challenges, they also create unprecedented opportunities for leaders to develop and lead a resilient workforce toward a promising future. While it is necessary to view operating efficiencies and cost management as important in any economy, CEOs cannot afford to lose sight of another important view – the opportunity and need for growth. We call this a "bifocal view": managing costs and innovating for growth in order to increase profits. Our research on bifocal companies points to some common leadership characteristics of leaders who have cut staff to grow their organizations.

- ***Courage:*** Leaders of bifocal companies display real courage in their willingness to take on and manage risk in difficult times. The history of American business during recessions provides outstanding examples of leaders who – making risky decisions while everyone else is retrenching – achieve tremendous success as a consequence. Fred Smith's launch of FedEx during the 1973-1975 recession, as well as Sam Walton's decision to open a record of number of Wal-Mart stores in 1990-1991, are compelling examples of leaders' counter-intuitive responses to economic downturns, leaders who positioned their companies for tremendous future growth. While no CEO can foresee the future, the more courageous of them know that very few US recessions last over a year (and some for a mere six months), so planning for better times ahead only makes sense.

- ***Conviction:*** A second characteristic of these leaders is that they do not waver on their big bets for growth as they navigate their companies through a downturn. One direct consequence of this visible, consistent leadership is that morale in the organization is buoyed until actual growth results are achieved. This is not to say these leaders are blindly optimistic; they do recognize, however, that when things are tough, their organizations need confident, realistic leaders who are looking ahead and planning for when things do improve.

- ***Preparedness:*** Leaders of bifocal companies use contingency planning and scenario building to identify and plan for growth alternatives in downturn scenarios. Though some executives may avoid this type of planning for fear that confronting worst-case options will dampen the morale of the senior team and the rest of the organization, bifocal leaders recognize that the worst-case scenario is the one that wasn't anticipated and for which the company has not prepared.

- ***Realism and flexibility:*** At the same time, leaders of bifocal companies are realists in their thinking. While they challenge the status quo in their search for new paths to growth, they are also adept at understanding when a big innovative idea may not fly, and will direct the organization to modify or abandon it to arrive at a more scalable, cost-effective response to a marketplace need. The combination of realism and flexibility allows bifocal companies to develop focused growth strategies in response to economic downturns.

- ***Perspective:*** Leaders who achieve growth in a downturn see the big picture and have a well-developed understanding of the dynamics and phases of a downturn so as to position their growth moves most adroitly. For example, these executives know that in the middle of a downturn, it is almost impossible to come up with truly inventive solutions. Moreover, these leaders recognize that while downturns don't last forever, damage incurred by straining relationships with stakeholders during a downturn may be permanent. As a result, smart executives look to build loyalty with employees, key suppliers, and major customers during a downturn to add fuel to their growth plans when economic conditions improve.

- ***An Eye for Bargains:*** When market growth is slow, many companies decide to pursue new growth with existing assets. This can stretch and strain part of the organization and individuals to the breaking point. Savvy executives will combat the urge to forgo all major investments until the company is on the up-cycle by making strategic acquisitions to support targeted growth plans. Timed correctly, this can lead to acquiring strategic assets at bargain prices. Consider the case of Sam Palmisano, CEO of IBM, and his acquisition of PricewaterhouseCooper's consulting business for $3.5 billion – as compared to the $18 billion Hewlett-Packard was prepared to offer for the same assets a couple of years preceding.

Summary

As this report makes clear, there are significant long-term risks associated with downsizing, including the possibility that the process used to make reductions in the workforce may itself constrain the organization's potential for future growth through the loss of expertise, motivation, ability to take risks, etc. To counteract this threat, leaders should design (as early in the process as is feasible) a game plan to go through reductions in a way that actually "builds" for the future. This is a time to invest in those who are leaving and simultaneously strengthen the understanding, skills, morale, and work climate of those who will stay.

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Oliver Wyman is an international management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational change and transformation, and leadership development.

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- Manage the dynamics of change
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- Use communications to engage and mobilize
- Apply metrics to measure performance and impact

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