The Upside of Downsizing

Introduction

There’s an oft-repeated but imprecise bit of wisdom, first popularized by President John F. Kennedy, that the word “crisis” is written in Mandarin by combining the characters for “danger” and “opportunity.” The translation isn’t quite right, but the underlying principle is: every crisis presents both imminent threats and potential benefits. The same is true whenever companies embark upon a large-scale reduction in headcount—a phenomenon we’ve come to think of as “the upside of downsizing.”

To be clear, we’re not suggesting that downsizing is ever a cause for celebration. No reasonable person relishes the prospect of slashing large numbers of jobs and endangering the livelihoods of employees and their families. Moreover, downsizing done badly creates enormous risks that company leaders should keep firmly in mind as they search for ways to make their numbers during the current economic downturn.
The organizational trauma from indiscriminate, across-the-board job reductions inflicted with a blunt-edged spreadsheet can be massive and long-lasting. Even the best-executed downsizing disrupts the normal flow of business, diverts attention from the marketplace, and undermines employee loyalty. It consumes huge amounts of management time and attention. It makes the most talented employees anxious about the future and vulnerable to recruitment raids by predatory competitors.

Even worse, organizations that bungle their downsizing expose themselves to all those risks without enjoying any of the anticipated benefits. During the last recession, in 2001–2002, one study found that only 47 percent of the large companies engaged in major downsizings actually met their cost reduction goals. Another study showed that 54 percent of the companies surveyed hired back many of the people they laid off. And research reported in the *Harvard Business Review* showed that in the last recession, shareholders actually punished rather than rewarded companies involved in the biggest job reductions.

Yet, despite those potential risks, successful leaders understand that downsizing—undertaken as a strategic, carefully targeted process rather than as an indiscriminate exercise in sweeping job cuts—offers enormous possibilities. Based upon our work in industries ranging from financial services to health care, from manufacturing to the media, the evidence is clear: the upside of downsizing is that it provides a unique window of opportunity to improve performance by fundamentally changing the size, structure, culture, and operations of the organization.

A former head of HR for a major investment management group explains it this way: “There are two related but distinctly different aspects of a Reduction in Force (RIF): the strategic and the tactical. If you are not careful in how you approach the RIF, the whole exercise becomes very tactical, activity-driven, and cost-savings-focused. That’s not necessarily a bad thing, but you can miss the opportunity to achieve so much more.”

Here’s why. Over the years, it has become something of a cliché to talk about “the burning platform”—the disaster scenario leaders have to create as a pre-condition to readying the organization for major change. Downsizing dispenses with the need to paint any theoretical pictures; people can smell the smoke and feel the flames, and the change imperative becomes real, imminent, and intensely personal. The result is one of those rare moments when leaders have the full
The attention of everyone in the organization, on both an intellectual and a visceral level. This is not an opportunity to be wasted.

“Downsizing creates an opportunity for senior leadership to convert nervous energy into constructive energy,” explains a longtime CEO who has managed downsizing at four very different companies. That combination of energy and attention can be channeled, to the organization’s great benefit, into a heightened sense of urgency, clear focus, and shared purpose.

The ultimate goal of downsizing isn’t to shrink the company but, rather, to improve it. Another CEO, who was forced to reduce headcount by nearly one-third at his company due to a historic industry downturn, acknowledged how painful and disruptive the cutbacks had been. And yet, he added: “We are a much, much better company than we were two years ago. When the market comes back, we will be in a great position—we’ll have a great team, we’ll be more competitive, we’ll be faster and more focused.”

To fully maximize significant downsizing efforts, leaders must be explicit about the rationale for the downsizing and then implement the cost reductions in ways that are consistent with the rationale. The investment management HR head cautions that, “It’s important to be very clear, at the top, about why you are downsizing—is it because you have too much capacity relative to market demands? Are you trying to address serious talent issues, or have you simply become bloated with underperformers? Your tactics should be driven by the root cause of your problems.”

Downsizing—in the context of strategic expense management, rather than immediate payroll reductions—can improve the organization in a number of important ways.

**Downsizing provides an opportunity to streamline the organization’s structures and processes in order to promote speed, simplicity, and customer focus.**

Rather than focusing on headcount, smart companies use downsizing to reexamine how work gets done, and they search for ways to eliminate units, processes, and entire layers of management that don’t create sufficient value. The former CFO of a high-tech manufacturing company explained: “We used downsizing to fundamentally revamp and streamline the structure of each of our plants. It wasn’t just to get costs out, it was to improve the productivity of each factory and our ability to meet our customers’ needs.”

A top HR executive at a global financial services company makes a similar point: “In the wake of an RIF, there is no question that you are forced to eliminate stupid work. Those that remain just don’t have the capacity or time, and it forces a focus on what is important. More often than not it requires restructuring to simplify things.” She adds: “An RIF gives you the chance to reassess how the work gets done, and it gives you license to think creatively.”

The CEO of a more traditional manufacturer said the first wave of downsizing at his company was aimed primarily at shutting plants to match sharply reduced demand in a down market. But over time, downsizing was specifically designed to:

- Eliminate two layers of management from the sales and marketing function and one layer within each plant;
- Combine divisions and broaden the span of control for senior executives;
- Streamline reporting relationships for support functions (by eliminating matrixed relationships); and
Employ rigorous benchmarking to determine optimum staffing for back-office operations at the plants.

As a result, the CEO reported, “The removal of management layers and the simplified reporting structures are creating functional excellence because of a much clearer line of sight and accountability.”

We have also seen situations in which downsizing spurred the completion of unfinished business from past mergers and acquisitions. In reality, the majority of these combinations never produce the anticipated value—in many cases, because it’s just too easy to find plausible excuses to postpone tough decisions. Faced with the inescapable necessity of serious downsizing, some companies go back and look for the savings that were never realized. “Like a lot of companies that were built through a series of acquisitions, we had never really done the necessary integration,” admitted one CEO. “Downsizing forced us to finally take advantage of the synergies we’d always talked about by putting effective integration processes in place.”

**Downsizing can be used strategically to enhance performance and improve the overall level of talent.**

There are several ways in which downsizing can result fairly quickly in substantial improvements in the company talent pool. First and most obviously, headcount reductions can be used—consistent with the applicable legal and contractual limitations, of course—to remove underperforming units, teams, or individuals. One CEO told of using downsizing to force the removal of a deeply entrenched “group of longtime managers who were like a ball and chain around our necks, dragging the whole place down.” And it’s not just top managers who see the need for underperformers to leave; employees often see it the same way. According to one HR executive, “If you do it right, the people who remain should ideally say, “Yeah, they’re not the best performers so it’s about time they go.”

Second, there is the opportunity to generate better performance among those who remain after the downsizing. This brings us back to the notion we mentioned earlier of translating “nervous energy” into “constructive energy.” “Once layoffs have been announced,” says the former CEO of a major health care company, “you need to get the remaining group to focus not on whether they’re next, but on how to take their game to a higher level to help the company perform better and preclude future layoffs.” In terms of motivating high performance, this is an unbeatable scenario: with unusual clarity, people perceive the close alignment of their personal interest in remaining employed with the company’s interest in staying in business.

Third, a strategic approach to downsizing—rather than an exclusive focus on eliminating jobs and expenses—also provides a major opportunity to “trade up” in terms of talent. The executive vice president of a leading financial services company described his experience this way: “The reductions gave us the space and resources to bring in higher performers and people with fresh perspectives and capabilities more suited to the future direction of our organization.”

Finally, that same company experienced one of the secondary effects of downsizing: voluntary departures. The executive explained: “Our moves to reduce the workforce, raise performance standards, and introduce new skills resulted in some of our people self-selecting out of the organization, which was mostly helpful.” That’s a best-case scenario; voluntary departures also represent one of the real risks of downsizing, because there’s always the chance that the wrong people might leave because they’re nervous about the company’s future. That risk underscores the importance of senior management implementing
the downsizing in ways that send clear messages about what’s happening and why, and how these actions pave the way for renewed success.

One HR executive offers this advice for retaining key talent in the midst of downsizing: “You need to paint a compelling picture of the future and reach out, personally, to those you want to have stay. Too often (and quite sadly) it’s the arm around the shoulder that makes all the difference—because the best talent hasn’t felt valued. It’s amazing how the small and easy things make the largest difference.”

Downsizing provides a rare opportunity to dramatically accelerate the development of a new, high-performance culture.

Under normal conditions, corporate cultures emerge through a gradual and sometimes haphazard process, often with less than optimal outcomes. Downsizing, if approached correctly, offers an unusual chance to speed the pace and mold the contours of culture change. Here’s how one CEO described the situation in his company:

“Historically, we did not have a strong performance management culture. As a result, we kept building up a lot of headcount by not doing anything about the people who were a drag on the organization. It wasn’t just the expense; they were weighing down the people who really did care, who really did want to perform at a high level, but who were discouraged by the people next to them who weren’t carrying their weight. Downsizing gave us the courage to finally address some of these problems and get rid of these people. And then we put very aggressive performance management processes in place to keep that from happening again.”

Downsizing can be a particularly powerful tool for shaping culture when used in M&A situations. It can be used as the catalyst for accomplishing the oft-described—but rarely fulfilled—goal of shaping a new culture based on the best that each of the legacy companies has to offer. Here’s how the retired CEO of a major health-care company described what he did:

“Following a major acquisition, we downsized to eliminate duplicative capacity. But the biggest thing was that we used the downsizing to forge a common culture by quickly taking the best of both companies, getting over the hump in terms of eliminating the rest, and then merging those who remained from both companies into a single company. We did it in a very deliberate way—we put a profile in place, identified the top performers who demonstrated the required values, and created a culture in two years that we might never have achieved if we had continued down the path we were on before the acquisition.”

Downsizing can become the platform for instilling an ongoing, strategic approach to expense management.

In the aftermath of any crisis, there is a predictable shift toward organizational equilibrium—a desperate yearning for a return to normalcy. Downsizing is no different. It’s not long before the same managers who zealously took the pledge of fiscal discipline show signs of backsliding, resulting in that insidious corporate disease: headcount creep.

“Resistance to headcount creep must start at the top,” insists the former CEO of a Fortune 400 company. “Senior leaders have to be very, very committed to the idea that if you’re going to add, it has to be an upgrade where there’s clear improvement in productivity or talent or an ability to fill a critical business
need. But in every case, if you’re going to add headcount, you have to show where you’re going to subtract to compensate for it.”

The key to success lies in institutionalizing the emergency practices first introduced as part of downsizing. The close attention to jobs, activities, investments, and expenses of all kinds that don’t create sufficient value has to become the new “business as usual,” rather than an aberration. One company president explained how holding the line on resurgent expenses has become a way of life in the aftermath of major layoffs:

“As a management team, our biggest challenge is the continuing struggle to keep headcount from creeping up again. If somebody can make the case that we cut too deeply somewhere and need to add back, then we have to find somewhere else to cut to compensate for it. I have to personally sign off on every single hiring requisition, and we won’t allow any position to be filled without deep analysis of how it might be eliminated or combined with some other position somewhere else. That’s produced some real frustration among managers, but it has also produced some very creative thinking and new ideas about how to get work done.”

**Downsizing can prompt leaders to build organizational capabilities rather than becoming too reliant on individuals.**

There’s nothing like downsizing to remind us all of how easily any institution can become overly reliant on just a few individuals. It often takes the sudden departure of a key player to demonstrate just how thin the talent bench really is. The loss of one or two longtime employees can quickly underscore just how fragile and fragmented the institutional memory has become. In either case, the bottom line is the same: the organization has come to confuse individual players with organizational capabilities, and downsizing forces management to think in terms of sustaining capabilities when individuals disappear.

A senior communications executive for a financial services company recalls, “When we made our first round of significant job reductions we lost a lot of institutional memory, and we learned from that. We’ve become more disciplined about documenting information and processes so that we are not so reliant on one individual. That was also one of the catalysts for us becoming much better at succession planning and ensuring that we have back-up plans when people leave.”
Conclusion

While clearly, no leader welcomes the prospect of significant organizational downsizing, the process can bring significant upside if approached, managed, and communicated in the right way. Part of this involves leaders approaching downsizing from an opportunistic perspective. If a reduction in force is required, then how can the organization make the most of it? As summed up eloquently by one HR leader, “You shouldn’t look at headcount reduction as being about the numbers. It’s a chance to change the paradigm you are operating in so that you don’t have to go through massive, destabilizing cuts every few years. Turn it around and think about the numbers being the outcome of a well-executed change in your business.”

Endnotes


About Oliver Wyman Delta

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