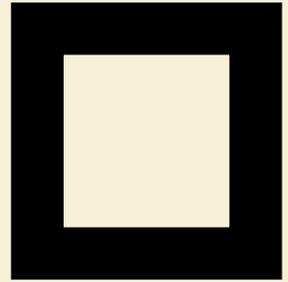


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REVIEW



READING

CUTTING BUSINESS MYTHS DOWN TO SIZE

The value of downsizing is one of the most pervasive, and destructive, myths in the business world. Freek Vermeulen says that learning the truth about the practice can teach managers important lessons. It might even save their companies.

Somewhere in their schooling, most students were forced to read classic mythology — from Apollo to Zeus. All in all, the stories weren't that bad; and some even helped a student cope with life. Reading about Icarus (with self-invented wings made of wax and feathers, flying so successfully that his giddy overconfidence took him too close to the sun, melted the wax and sent him crashing) taught the reader a good lesson about defining one's core competence and not pushing oneself far beyond that.

Today, myths are more likely to be seen as unreal stories that hold little value and even less truth. There's a website that lists the 'Top 10 Urban Legends & Myths'; and, if you think there are alligators living in the New York sewer system, you should go to that site right away. *Mythbusters* is a popular television show (on several continents) that debunks what is often widely accepted as true by people who should know better. Then again, some very smart people in the business world are equally victims of management myths: they believe

something without testing it and, worse, act on that belief. The good news is that sometimes the effects of such actions are not all bad. On the other hand, acting on myth, in business, can bring you down as fast as Icarus.

Down and out

Let me focus on just one myth that has been pervasive in business for years: when business sags, the first thing one needs to do is cut people. The practice of 'downsizing' (or rationalising, restructuring, reorganising — making people redundant) is a trend that has now been going on for at least a decade and

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Women in leadership, John Kay on strategy and fresh thinking from Jules Goddard.



ICARUS: PLEASE DO NOT TRY THIS AT HOME



REVIEW

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a half. Companies — even if they are not in financial difficulties — engage in systematic programmes to reduce the headcount in their organisations. Top managers think that, because a lot of companies downsize, it *must* work.

Dig deeper. Sure, the short-term benefits are clear: downsizing leads to lower costs (sometimes accompanied by a positive response from the stock market to the announcement of the programme). If other costs are managed, one can bank on profits returning (or increasing); and thus the wisdom of pushing people out of the firm is self-evident. But is this line of thinking true?

There is evidence of sizeable long-term detrimental influences, such as reduced innovation and lower employee commitment and loyalty. However, such consequences are only noticeable in the long run. Usually, when a firm faces a serious problem (for example, the lack of new products in the pipeline), top management does not realise that the lack of innovation is caused by the downsizing programme that they engaged in a decade or more ago.

Cause and effect are often tricky things to determine in the world of business. When a certain management practice gives companies immediate benefits, corporate leaders are inclined to assume it must be a good one. However, the presence of short-term benefits does not mean that the overall, long-term consequences will be all that healthy. Yet, when those consequences finally materialise, many leaders don't quite grasp that it is their own practices from years before that caused them. The efficacy of downsizing may be the most destructive myth in business in terms of how many lives it has affected, and how many companies have suffered for their short-sightedness.

Does downsizing work?

So, let's think a bit more about this practice of downsizing. What is the evidence to suggest it is a good practice? Does it actually work... like, *ever*? No, it doesn't.

The practice started in the early

1980s, when an economic slowdown more or less forced firms into it; yet downsizing was no passing trend. In the ensuing decades, many firms have continued to engage in systematic workforce reductions. Just tune into any daily business news programme to hear about the latest corporate trimming; in almost every case, one can read comments by the firm's leaders affirming the need for, and the benefits from, cutting headcount. I always see visions of profitability dancing in the managers' heads. Others have found that such a vision was, after all, a mirage.

Professors James Guthrie, from the University of Kansas, and Deepak Datta, from the University of Texas at Arlington, decided to research the issue in a systematic way. They managed to obtain in-depth data on 122 firms that had engaged in downsizing. The professors performed various statistical techniques to examine whether the downsizing programmes had improved their profitability. The answer? No, they did not.

Beforehand, James and Deepak had thought that downsizing would likely be harmful for companies that rely heavily on people (such as firms in industries in which research and development is very important, firms with low capital intensity) and firms that are in growth industries (since it would be more difficult to justify mass lay-offs there). And they were right; in those types of businesses, downsizing programmes significantly reduced firms' subsequent profitability.

However, they had also expected the reverse to be true: that firms in industries in which people were less central to the companies' competitive advantage (firms in industries with low R&D, firms with high capital intensity) and firms in low-growth industries would be able to get away with downsizing programmes and increase their profitability as a result. Yet, what they expected did not prove to be true. Even in such businesses, downsizing didn't help a single bit, and it usually lowered performance. In fact, they couldn't find *even a single business* in



which downsizing proved beneficial. The average company did not benefit from a downsizing effort, no matter what situation and industry they were in. Of course, firms in trouble need to do something. However, simply reducing headcount, based on these studies, won't do the trick.

Why do downsizing programmes usually not work? Well, for starters, as you can imagine, it is not a great motivator for the survivors. Academic studies confirm that organisational commitment usually decreases after a downsizing programme and voluntary turnover rates surge. Hence, downsizing is not something to be taken lightly and should be avoided if at all possible. But sometimes, of course, a company's situation may

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have become so dire that avoidance is not possible. What then? Who might be able to get away with it?

Professors Charlie Trevor and Anthony Nyberg from the University of Wisconsin-Madison decided to examine this question, surveying several hundreds of companies in the US on their downsizing efforts, voluntary turnover rates and HR practices. As expected, they found that, for most companies, voluntary turnover rates increased significantly after a downsizing programme. Many of the survivors, earmarked to guide

the company through its process of recovery, decided to call it a day and continue their employment somewhere else — a nasty and unexpected aftershock for many slimmed-down companies that became quite a bit leaner than intended.

Next, however, Trevor and Nyberg examined who could get away with a downsizing programme or, put differently, what sorts of companies did not suffer from such an unexpected surge in voluntary turnover after their downsizing programme. And the answer was pretty clear. Companies that had a history of effective HR practices aimed at assuring procedural fairness and employment justice — such as having an ombudsman who is designated to address employee complaints, confidential hotlines for problem resolution or the existence of grievance or appeal processes for non-union employees — did not see their turnover heighten after a downsizing effort. Apparently, in such companies, the remaining employees were confident that the downsizing effort had been fair and unavoidable.

Similarly, Trevor and Nyberg found that companies with paid sabbaticals, on-site childcare, defined benefit plans and flexible or nonstandard arrival and departure times did much better in limiting the detrimental effects of a downsizing programme. The surviving employees were more understanding of the company's efforts, had higher commitment or simply found the firm too good a place to desert.

In general, research shows that downsizing can work, but only if you have always taken seriously commitment to your people. Instead, if your employees sense that you may be taking the issue lightly, they will vote with their feet. Or as *Fortune* once observed of most firms that downsize: “rather than becoming lean and mean, [they] often end up lean and lame.” And this is the problem with those who manage by myths. Acting on beliefs that are built on half-truths or untruths will not only cause the myth to go bust; it can also take your career or your firm with it. ■

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