

BusinessWeek

HARVARD BUSINESS ONLINE May 1, 2009, 10:52AM EST

The Tricky Truth About Downsizing

Axing workers doesn't necessarily make a business lean and mean, says Harvard's Freek Vermeulen

By [Freek Vermeulen](#)

Posted on [Strategy Freek](#): April 30, 2009 9:43 PM

Downsizing has always been a popular practice in the corporate world—even for firms not in distress. But today, with many companies in distress, downsizing efforts are on the rise. So I thought I might as well look into what we know about the effects of such efforts from academic research to see when they can be a good idea.

The answer? Not very often. On average, they simply don't work. For example, professors James Guthrie, from the University of Kansas, and Deepak Datta, from the University of Texas at Arlington, examined data on 122 firms that had engaged in downsizing and statistically analyzed whether the program had improved their profitability. And the answer was a plain and simple "no." The average company did not benefit from a downsizing effort, no matter what situation and industry they were in.

So why do they usually not work? Well, for starters, as you can imagine, it is not a great motivator for the survivors. Academic studies confirm that usually organizational commitment decreases after a downsizing program and, for example, 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 have become so dire that downsizing efforts must take place. 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 exactly this question, surveying several hundreds of companies in the US on their downsizing efforts, voluntary turnover rates, and HR practices. As expected, they too found that for most companies, voluntary turnover rates increased significantly after a downsizing program. Many of the survivors, earmarked to guide the company through its process of recovery, decided to call it a day after all and continue their employment somewhere else. It's a nasty and unexpected aftershock for many slimmed-down companies—they became quite a bit leaner than intended!

Next, however, professors Trevor and Nyberg examined what sort of companies did not suffer from such an unexpected surge in voluntary turnover after their downsizing program.

And the answer was pretty clear: Companies that had a history of harboring HR practices that were aimed at assuring procedural fairness and justice—such as having an ombudsman who is designated to address employee complaints; confidential hotlines for problem resolution; the existence of grievance or appeal processes for nonunion employees, etc.—did not see their turnover heighten after a downsizing effort. Apparently, remaining employees were confident that, in such a company, 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 program. The surviving employees were more understanding of the company's efforts, had higher commitment, or simply found the firm to good a place to desert.

In general, it shows downsizing can work, but only if you have a history of a strong commitment to your employees. Absent this, if your employees sense that you're taking the issue lightly, they will vote with their feet. And you may end up losing rather more people than you had bargained for. Or as Fortune Magazine once observed, most firms that downsize, "rather than becoming lean and mean, often end up lean and lame."

Freek Vermeulen is an Associate Professor of Strategic & International Management at the London Business School. He is an expert on the topic of growth, examining issues such strategic innovation, stimulating organic growth, international strategy, and the role of acquisitions and alliances.

Xerox Color. It makes business sense.

Copyright 2000-2009 by The McGraw-Hill Companies Inc. All rights reserved.

The McGraw-Hill Companies