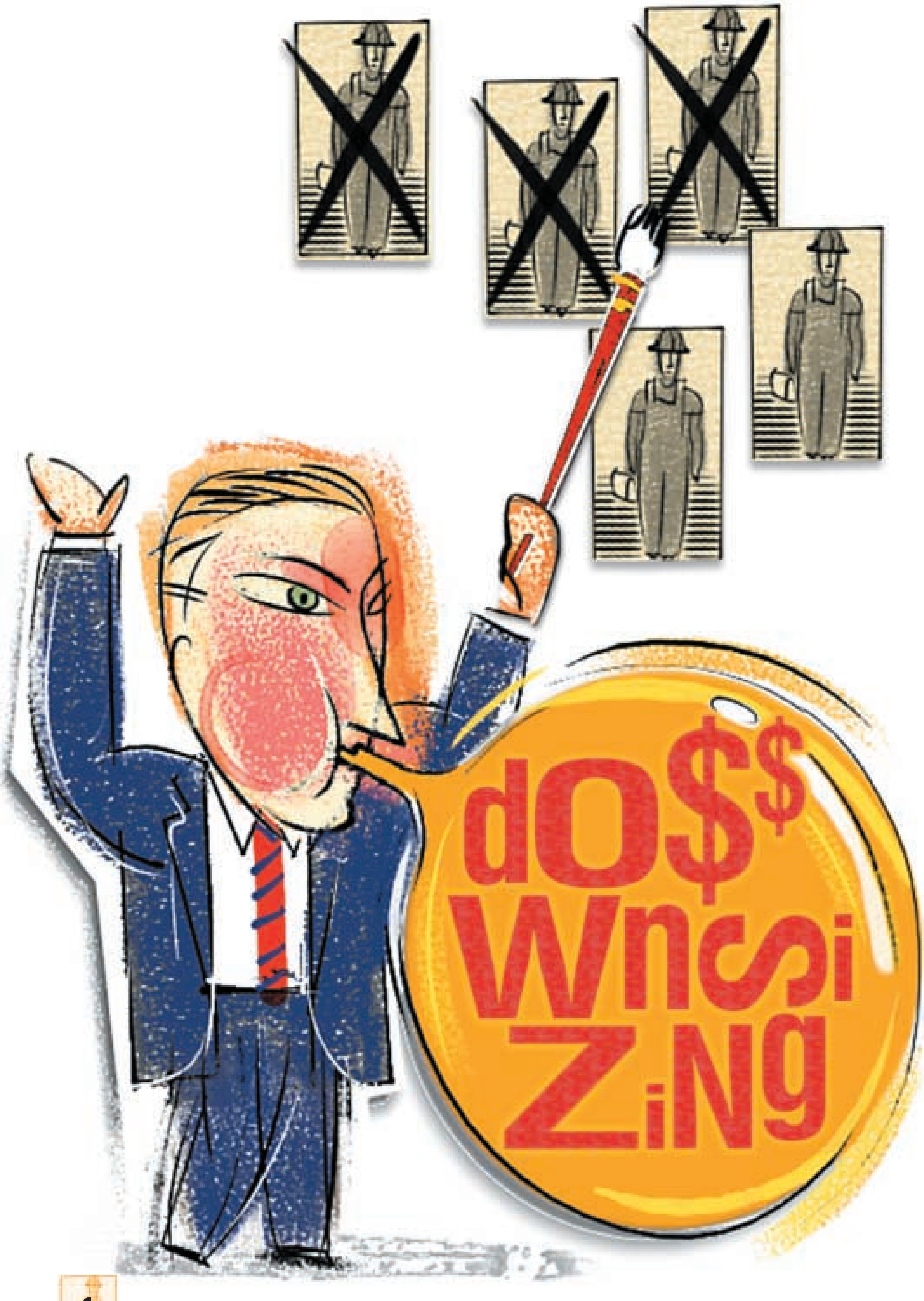
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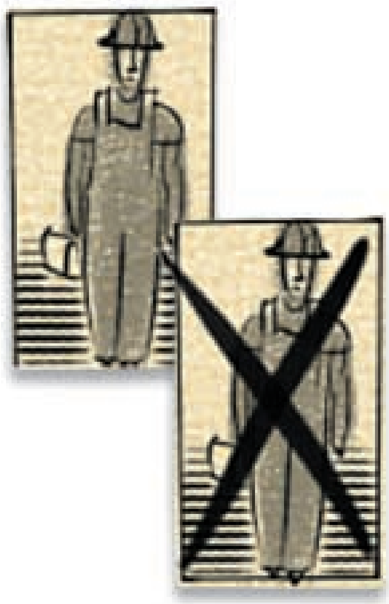


Organisational downsizing

Gain from the pain?

by Peter Carswell

A COMPANY'S DECISION to downsize impacts on many people – often adversely. It affects not only those who actually lose their jobs, but also those employees who remain, those who have to tell colleagues their jobs have gone, all the families and friends, as well as the community in which the organisation is based.

Not only that, downsizing may not be good for the company's own health. "Redundancies are the first and fatal act in the company's own demise, like smoking more cigarettes to cure cancer" (Parker, 1997). This is the view of Professor Craig Littler, a researcher involved in a five-year longitudinal study looking at both short- and long-term effects of organisational downsizing. It is a view shared by many and supported by research (for example, Cascio, 1993). Consequently, any information that can assist an organisation in effective decision-making on this topic and help to reduce the negative impacts of organisational downsizing should be a vital area for academics and practitioners alike to explore.

This paper presents an analysis of organisational downsizing implemented in New Zealand from 1996 to 1999. It attempts to address three aims: firstly, to describe recent patterns and trends of downsizing among New Zealand organisations; secondly, to help understand more about the effects of downsizing on financial performance over time; finally, to look at the moderating role of the downsizing magnitude and annual occurrence on financial performance. The results indicate that downsizing in New Zealand may be on the decline. Furthermore, downsizing may not result in improved returns, but in worsened financial performance.

The study is based on the responses of 155 for-profit companies employing 50 or more people. As **Table 1** shows, all industry classifications, as defined by Statistics New Zealand, were represented in relative proportions corresponding to the overall industry mix. The data was gathered via a postal survey that asked whether the company had downsized, to what degree, for what reasons, and the process adopted[1].

In the following section, a literature overview is provided of the degree and impacts of organisational downsizing over the past 10 years. The data from the study is presented and analysed according to the aims mentioned above. The results are then discussed and potential management implications outlined.

WHAT IS DOWNSIZING, WHO'S DOING IT AND WHY?

Downsizing is an intentional decision that results in a net decrease in the workforce and is often associated with an implied or explicit reference to an increase in profitability (Kozlowski, Chao, Smith and Hetlund, 1993). Statistics from the US suggest that incidents of downsizing are increasing (Laabs, 1999). Closer to home, research indicates that rather than increasing in occurrence, the rate of downsizing has remained reasonably steady (Littler, Dunford, Bramble and Hede, 1997; Dawkins, Littler, Valenzuela and Jensen, 1999).

Littler et al (1997) analysed data from 653 Australian and 668 New Zealand organisations that responded to a survey on downsizing behaviour they engaged in from 1993 to 1995. Results show that 57 per cent of Australian and 48 per cent of New Zealand organisations downsized during that period.

Dawkins et al (1999) report on a similar study that surveyed 1222 Australian

[1]For an analysis of the impact of the process adopted on the financial return, contact the author.

TABLE 1

Industry breakdown of sample

Industry	*Percentage of total enterprises with 50+ employees	Percentage of total responding companies
Primary production	4%	7%
Service-based industries	35%	35%
Goods-based industries	61%	58%
Total	100%	100%

*Statistics New Zealand (1999)

FIGURE 1

Drivers for downsizing – why downsize?

In response to:	In order to:
Pressure from institutional investors	Lower overheads
Deregulation of markets	Simplify bureaucracy
Reduce threat of hostile takeover	Facilitate communication
Pressure from global competition	Enhance entrepreneurship
Technological advancement	Increase productivity
Changes in ownership structure	Reduce duplication

organisations on their downsizing behaviour from 1997 to 1998. This study found that 62 per cent of organisations had downsized in this period.

This suggests that downsizing continues to be a popular management technique for restructuring organisations and is argued to be applicable to both declining and growing organisations (Cascio, 1993). In declining organisations, the downsizing is often termed as "reactive" (Worrell, Davidson and Sharma, 1991) and is done in an effort to turn around firms with poor or declining performance. Pro-active downsizing is used in growing firms and is often used to maintain competitiveness or to correct performance downturns before they become severe. Drivers for both scenarios are presented in **Figure 1**.

Irrespective of whether an organisation is in a growth or decline phase, the desired outcomes of downsizing are often the same. It is typically portrayed as a means to achieve a lower cost structure (Iqbal and Shetty, 1995), simplify bureaucracy, speed decision-making, facilitate communication, enhance entrepreneurship and increase productivity (Cascio, 1993).

More recent incentives for companies to downsize are due to changes in ownership structures, technological advancement and deregulation of industries.

IMPACTS ON STAKEHOLDERS FROM DOWNSIZING

As mentioned earlier, a downsizing incident affects a large number of organisational stakeholders. While the impact of downsizing on survivors and victims is reasonably well documented (Brockner, 1990; Cameron, 1994), relatively little empirical research is available concerning the impact on the company's shareholders. This is problematic because, to some extent, all downsizing is an obvious attempt to cut expenses and improve earnings (Iqbal and Shetty, 1995).

The reality, however, is that profitability does not necessarily follow downsizing. For example, an often-cited study on the financial impacts of downsizing is the Wyatt consulting firm's survey of 1005 downsized companies. It found that only 46 per cent of the companies achieved their expense-reduction goals, 32 per cent increased profits to the degree anticipated, 21 per cent met their expectations for improving return on investment and 22 per cent reached their targets for increased productivity (Bennett, 1991).

More recent work by Morris, Cascio and Young (1999) examined the financial performance of 3268 companies listed on the Standard & Poor's 500 Index from 1981 to 1992. The researchers did not find any significant, consistent evidence that downsizing led to improved financial performance. Performance improvement appears to depend on the *reason* for the downsizing. Firms that engaged in aggressive asset restructuring improved their profitability and outperformed their industries. Those that did not restructure in such a way tended to experience a decline in their profitability and did not match their industries. This suggests that laying off employees to improve financial performance may not lead to the intended improvement in a firm's financial performance if it is not accompanied by thoughtful restructuring of the firm's assets (Morris et al, 1999).

Irrespective of the reason for companies engaging in downsizing, people will be impacted upon to varying degrees

De Meuse, Vanderheiden and Bergmann (1994) conducted a further study examining the financial impact of downsizing. Their aim was to establish whether reductions in workforce significantly related to changes in a corporation's performance. De Meuse et al (1994) showed that for a one per cent drop in employment as a result of downsizing, profits dropped by 0.29 per cent in the first year, while return on equity dropped by 0.23 per cent. The conclusion is that not only did downsizing not restore profitability, it did not even halt the slide/downward trend.

While the above studies have examined the impact of downsizing on company financial performance, they have generally not explored factors that may moderate such a relationship. For example, companies today are admonished to be prepared for constant change. Is there a point, however, where change can occur too frequently? Does the frequency of downsizing episodes in any one year have a moderating impact on financial performance? Furthermore, can a company cut staff numbers too deeply? Or, alternatively, not cut deeply enough? The impact on profitability of downsizing size and number of annual episodes has not been addressed in the literature to date. Consequently, one of the aims of this paper is to explore the moderating role of such factors.

Irrespective of the reason for companies engaging in downsizing, people will be impacted upon to varying degrees. Unfortunately, this downsizing is carried out with very little certainty that the impact on the bottom line will be positive. In fact, the literature indicates the chances are better than average that the financial impact will be negative. The following section presents and analyses the data from a New Zealand-based study that examined aspects of recent downsizing trends, including whether the financial return of companies which downsize reflects that found in similar overseas studies.

TO WHAT DEGREE HAVE NEW ZEALAND ORGANISATIONS BEEN DOWNSIZED?

The results from this study suggest that the overall frequency of downsizing across the three years measured is relatively stable (see **Table 2**). When compared with research conducted in the early and mid-1990s, it seems that overall downsizing may be carried out less frequently. This trend is different to that found in America (Laabs, 1999) and Australia (Dawkins et al, 1999).

These differing results across time and countries may be indicative of the role the national economic cycle plays in determining how frequently organisational downsizing occurs. Downsizing statistics in New Zealand between 1993 and 1995 found a higher incident rate than the present study (Littler et al, 1997; Russell McVeagh McKenzie Bartleet and Co, 1995). While this was a period of economic growth in New Zealand, it was just after one of the country's worst economic recessions (Dalziel and Lattimore, 1999). Consequently, the results of these studies may reflect New Zealand companies reacting to the economic decline that occurred between 1990 and 1992. The results of this present study are based on a time when the New Zealand economy has

TABLE 2
Total respondents' downsizing behaviour

	Year of downsize		
	1997 (N=155) %	1998 (N=155) %	1999 (N=155) %
Yes	25	36	31
No	75	64	69
Total	100	100	100

TABLE 3

Frequency of downsizing incidents

Number of times companies downsized	1997 (N=39) %	1998 (N=56) %	1999 (N=48) %
	Year of downsize		
Once	69	73	69
Twice	13	11	17
Three times	8	5	6
Four times	0	4	2
More than four times	10	7	6
Total	100	100	100

higher growth. As such, it is consistent that in such a market, downsizing would occur less frequently.

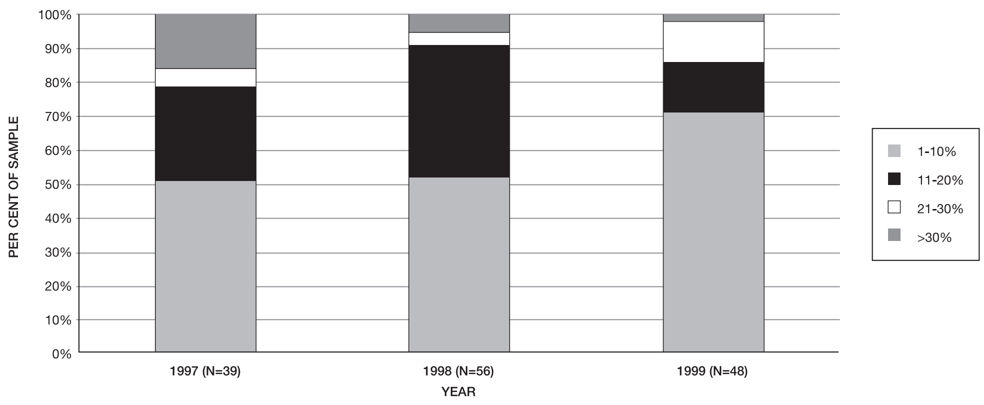
Of those responding companies that downsized, **Table 3** shows the number of downsizing incidents companies engaged in for any one financial year. From the respondents, most companies downsized only once. This pattern of downsizing is different than that found in previous New Zealand research (Littler et al, 1997) which reported a greater number of organisations engaging in multiple downsizing initiatives in any one year. Again, this result may be a reflection of the business cycle discussed above and the recession in the early 1990s (Dalziel & Lattimore, 1999).

Littler et al's (1997) data was drawn from incidents of organisational downsizing from 1993 to 1995. As such, organisations may have been in a more reactive phase than one of growth. Consequently, it is feasible for downsizing to occur more frequently when organisations face such an economic climate and are struggling to remain competitive. The results of this study, therefore, may be a reflection of more planned downsizing than a result of reacting to market forces. This proposition is supported by the respondents who reported that downsizing was more commonly a result of a proactive measure rather than reacting to a financial shortage.

In terms of the size of the downsizing, **Figure 2** shows that from 1997 to 1999, a slight increase occurred in small-scale downsizing (less that 10 per cent of employees shed). Due to this increase, a corresponding slight decrease was seen in large-scale downsizing (annual shedding of more than 30 per cent of company's total workforce). The two medium-sized downsizing demarcations this study

FIGURE 2

Percentage of staff downsized each year



It seems that, for the respondents, the number of organisations downsizing each year, the number of times in a year an organisation downsizes and the magnitude of the downsizing are decreasing

reports on also changed in distribution over time. In both 1997 and 1998 financial periods, the proportion of staff removed is concentrated in the lower of the two sizes (11-20 per cent of staff shed). In 1999, however, this pattern changes with distribution being almost equal among the two medium downsizing depth options.

These results are slightly different to the only other comparable New Zealand statistics found in Littler et al's (1997) study. This present study reported more medium-sized downsizing interventions. In Littler et al's (1997) study, it was found that approximately 10 per cent of participants had shed between 11 and 20 per cent of their staff. In this study, the corresponding figure was 26, 27 and 13 per cent for the years 1997, 1998 and 1999 respectively. The percentage of respondents that engaged in small- (1-10 per cent) and large-scale (more than 20 per cent) downsizing are comparable to that found in Littler et al's study.

The above frequency statistics from this study, taken in combination with each other, may suggest an interesting pattern. It seems that, for the respondents, the number of organisations downsizing each year, the number of times in a year an organisation downsizes and the magnitude of the downsizing are decreasing. As such, this may indicate a more planned approach to downsizing, rather than it being implemented in a more reactionary manner.

FINANCIAL IMPACTS

The median values for the four profitability measures of the downsizers and non-downsizers are presented in **Table 4** and illustrated graphically in **Figures 3** to **6**.

Return on equity

Figure 3 illustrates that before and including the year of downsizing, little difference occurred in the median ROE scores. One year after the downsizing, however, the non-downsizers have a significantly higher median than the downsizers (23.1 per cent and 12.7 per cent respectively). Two years after downsizing, the difference in the medians for the two groups is even greater.

Of the four measures of profitability, this is the only one in which downsizers and non-downsizers were significantly different *after* the change initiative. This is, nevertheless, an important finding as ROE measures the actual return to the proprietors of the firm based on

TABLE 4

Median values of financial performance measures for downsizers and non-downsizers

Performance measure		Year -2	Year -1	Year 0	Year +1	Year +2
Profit margin (%)	[Downsizers]	10.4	8.1	7.3	7.3	9.5
	[Non-downsizers]	10.0	10.2	9.8	9.6	9.2
Sales per employee ($)	[Downsizers]	349092*	350806*	324881*	328807	308262
	[Non-downsizers]	164175	168508	177555	196849	238600
ROA (%)	[Downsizers]	11.3	10.5	9.2	8.2	6.5
	[Non-downsizers]	12.9	12.8	12.6	12.6	11.4
ROE (%)	[Downsizers]	20.3	19.6	17.5	12.7*	12.6
	[Non-downsizers]	17.3	18.8	20.8	23.1	26.9

Note: figures were rounded off to one decimal place. N=78 downsizers; N=69 non-downsizers.
*p < .05

FIGURE 3

Comparison of median ROE for downsizers and non-downsizers

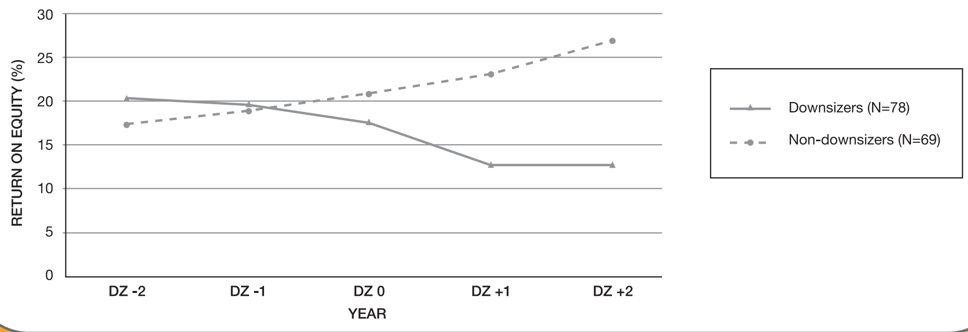


FIGURE 4

Comparison of median sales per employee for downsizers and non-downsizers

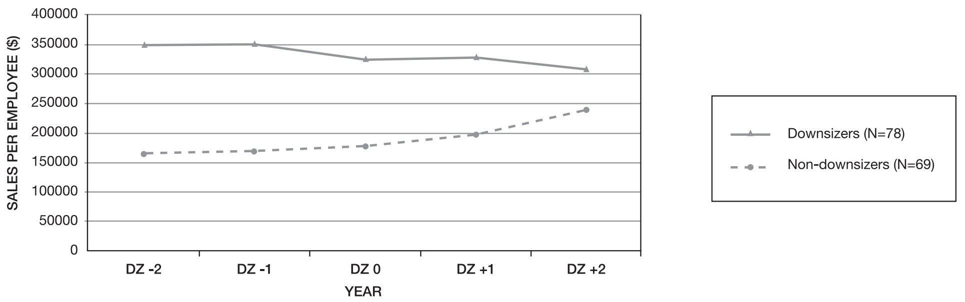


FIGURE 5

Comparison of median profit margin for downsizers and non-downsizers

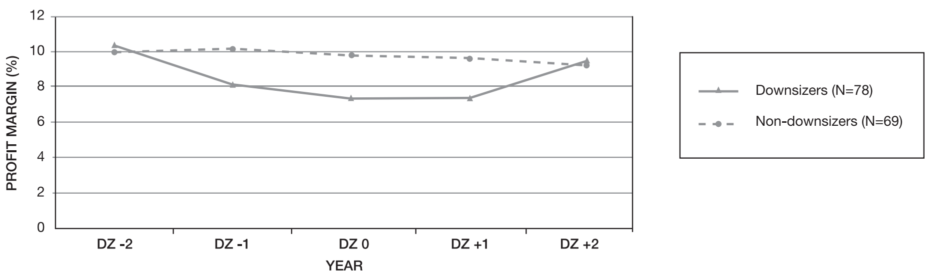
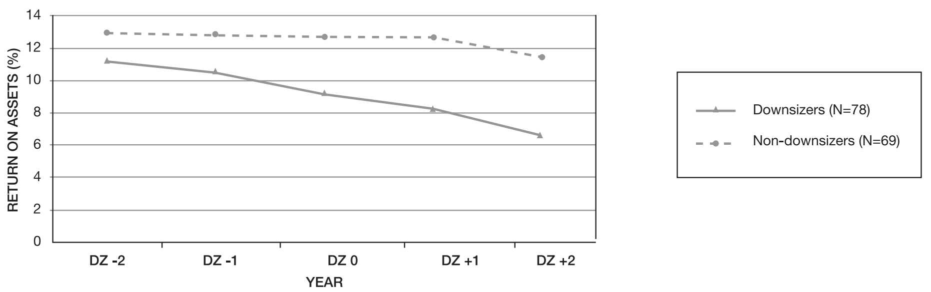


FIGURE 6

Comparison of median ROA for downsizers and non-downsizers



In the five years, the difference in profit margins between the downsizers and non-downsizers was not statistically significant

their own investment. Consequently, it is the best of all the measures used in terms of testing whether downsizing helps achieve the basic purpose of a firm (De Meuse et al, 1994). Because downsizing did not increase the ROE, it could be argued that it also did not improve the organisation's efficiency (Elayan et al, 1998). In fact, the opposite seemed to be the case. Evidence of decreasing median ROE suggests the organisations became less efficient.

A further implication is that ROE is a measure on the return on risk (Stickney and Brown, 1999). Therefore, the decision of non-downsizers not to eliminate positions may have paid off in terms of an increasing trend in ROE, whereas the decision of the downsizers to eliminate positions may not have.

Sales per employee

Before downsizing, the median sales per employee for downsizers was significantly greater than for non-downsizers. This is a counter-intuitive relationship as one would expect the more efficient the workforce, the less likely it is the company would shed staff. Interestingly, in the two years subsequent to the downsizing, the difference was eliminated. This was a combined result of non-downsizers reporting an increase in this financial indice and downsizers reporting a decrease.

In the case of downsizers, this could mean one of two things. Either the median total sales for the organisations were reduced, or, as the reduced ROE would suggest, it is a reflection of a less-efficient workforce. The latter conclusion is supported by Brockner (1990), who showed that downsizing can lead to reduced morale in those who remain after the event. Accordingly, reduced efficiency is not entirely unexpected.

Profit margin

In terms of profit margin, the non-downsizers stay reasonably constant over the time measured. The downsizers, however, are almost identical to the non-downsizers before the change. The group median then starts to decrease in respect to non-downsizers until the greatest difference is reached in the year of the downsizing. Two years after downsizing, however, the two groups return to having almost identical profit margins. Overall, in the five years, the difference in profit margins between the downsizers and non-downsizers was not statistically significant.

Return on assets

Measurement of the ROA medians for the two groups across the five years, as Table 3 and Figure 6 illustrate, shows that the non-downsizers remain reasonably constant, whereas the downsizers decrease across time.

TABLE 5

Impact of frequency of downsizing on profitability measures in the year of downsizing

Profitability measure	1997 downsizers (*F* statistic)	1998 downsizers (*F* statistic)	1999 downsizers (*F* statistic)
Profit margin	.927	1.107	1.444
Sales per employee	.581	.760	.216
ROA	2.590*	4.451*	3.510*
ROE	2.091	1.966	1.045

$^{*}p < .05$

TABLE 6

Return on assets in the year of downsizing as a function of the number of downsizing incidents in the year

Number of downsizing incidents in a year	1997 downsizers mean	1997 downsizers difference	1998 downsizers mean	1998 downsizers difference
Once	6.5		6.6	
		14.4*		6.6
Twice	20.9		12.0	
		3		14.6*
Three times	23.9		26.6	
Four times	No data		No data	
More than four times	13.3		12.0	

*$p < .05$

TABLE 7

Impact of size of downsizing on profitability measures in the year of downsizing

Profitability measure	1997 downsizers (F statistic)	1998 downsizers (F statistic)	1999 downsizers (F statistic)
Profit margin	4.058*	1.733	2.362
Sales per employee	1.069	.791	2.588
ROA	11.129*	3.945*	.668
ROE	6.280*	2.551	.173

*$p < .05$

TABLE 8

Profitability in the year of downsizing as a function of the percentage of total staff downsized

Per cent of total staff laid off in the year	Profit margin mean (%)	Profit margin difference	ROA mean (%)	ROA difference	ROE mean (%)	ROE difference
1-10%	7.9		7.0		18.3	
		16.8*		5.1		7.7
11-20%	24.7		12.1		26.0	
		2.1		29.8*		19*
21-30%	22.6		41.9		45.0	
		19.4*		38.1*		40.5*
>30%	3.2		3.8		4.5	

*$p < .05$

TABLE 9

Return on assets one year after downsizing as a function of the percentage of total staff downsized

Per cent of total staff laid off in the year	Profit margin mean (%)	Profit margin difference
1-10%	7.0	
		3.1
11-20%	10.1	
		25.6*
21-30%	35.7	
		31.4*
>30%	4.3	

*$p < .05$

If a company needs to downsize, it may be better to spread the loss over two or three episodes during the year

MODERATING ROLE OF MAGNITUDE AND OCCURRENCE

Table 5 shows that the frequency of annual downsizing has an impact on the ROA indice. These differences can be seen in **Table 6**. Data for 1999 downsizers has not been included, as not enough financial data was available at the time of analysis to meaningfully analyse for differences (*t*-test).

Looking at the pattern of distribution, it appears ROA is related to downsizing frequency in a bell shape. In particular, those companies that downsized twice in 1997 had a significantly higher ROA than those that downsized only once. For those that downsized in 1998, it appears three incidents was the key figure for maximum ROA. Downsizing more than three times in a year is related to reduced ROA.

An examination of the impact of the size of the annual layoff on the companies' profitability indicates a relationship between the two. **Table 7** shows that in 1997 all measures of profitability, except sales per employee, are potentially dependent on the percentage of staff laid off during the year. In 1998, only ROA is affected by layoff size. Similar to the impact of frequency, **Table 8** shows that absolute size of the layoff is related to profitability in a bell-shaped relationship. For all three measures of profitability, mid-sized layoffs have significantly higher means than small- or large-scale downsizes. This pattern is also followed in the ROA measure one year after the downsizing, as indicated in **Table 9**.

DISCUSSION AND MANAGEMENT IMPLICATIONS

While not all measures of profitability were significantly different after downsizing, an examination of Figures 3 to 6 suggests that a pattern develops across time. While the profit margin increased for downsizers after the downsizing intervention, the other three measures declined in the year of downsizing and the two succeeding years. For the non-downsizers, the median profit margin remained almost constant. As well, the measure of sales per employee and ROE increased in the year of downsizing and the two subsequent years. The measure of ROA showed a slight decrease two years after the comparison organisations engaged in downsizing.

This pattern of changes in financial performance over time for downsizers and non-downsizers is similar to that found by previous research (Cascio and Morris, 1994; Cascio et al, 1997; Mentzer, 1996; and De Meuse et al, 1994). All these studies provided evidence that indicated downsizing didn't realise cost efficiencies to the extent that might have been expected before making reductions in levels of employees.

Ensuring that the appropriate number of positions are removed from the organisation may help moderate this relationship. The results of this study suggest that it may be important to "cut" deeply enough to improve return on investment, but not so "deep" that more positions are removed than are needed to perform effectively. Conversely, it may be equally ineffective if only a small percentage of positions are eliminated, resulting in a level of excess staff remaining. Such a finding has never been empirically reported on before so this result needs to be viewed in a tentative light and opened up to further consideration and debate. Of course, each situation could be different, but this finding reinforces the need for constant monitoring of staffing levels and good planning whenever layoffs are being considered.

Further, results of this study indicate that if a company needs to downsize, it may be better to spread the loss over two or three episodes during the year rather than a one-off or, alternatively, four or more times.

This result may be a reflection of staff who are more used to change and are less affected than those who do not experience such regular adjustment. It also may indicate that there are limits to how much change an employee can experience before it starts to impact negatively on performance. Furthermore, it lends support to the point made above of the need to constantly monitor staffing levels. If it's clear that reducing the number of positions is the only option available, then this should be done in a timely manner.

Combining the results of these two moderating factors, the implication for management may be to ensure any cuts made are "deep" enough first time, although profitability may be improved if such layoffs occur over a number of episodes.

One of the key reasons often given for downsizing is to strengthen a firm's financial performance (Cascio, 1993). The results of this study do not support this rationale. Instead, these results may suggest firms that engage in downsizing continue to perform more poorly than companies that do not initiate such change. Furthermore, companies that intentionally reduce staff numbers may not improve their own financial performance during the year of downsizing or the two subsequent years.

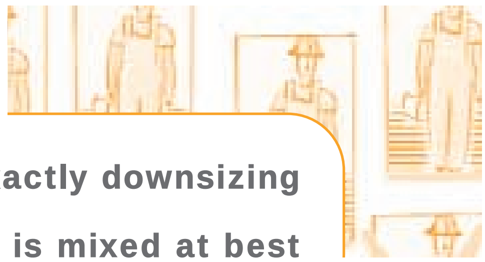
Some critics of the trend illustrated by these results may argue that reducing employee numbers enables companies to survive during times of crisis (De Meuse et al, 1994). The logic of this argument is that the company might have been forced into bankruptcy had drastic measures not been undertaken to reduce labour costs (Cascio et al, 1999). However, avoidance of bankruptcy was cited very infrequently as a motivation for downsizing.

An alternative argument, that may help explain the decreasing profitability of downsizers, lies in the direct and indirect costs of downsizing. The direct costs include such items as redundancy pay, accrued holiday and sick pay, outplacement, superannuation scheme payouts and administrative processing costs. The indirect costs may cover recruiting and employment costs of new hires, low morale among remaining employees, training, potential charges of discrimination, heightened insecurity and reduced productivity (Cascio, 1995).

CONCLUSION

Downsizing is a word that evokes strong emotions. For some it may mean loss of employment, for some the survival of their business, and for others it may mean the hope of an increased return on their share portfolio. Whatever the hoped-for, or feared, outcomes of such an action, research to date on how exactly downsizing does impact on an organisation is mixed at best. This paper attempts to build on the previous work by adding a New Zealand perspective to it. It adds to the body of knowledge by suggesting that the percentage of staff laid off and the frequency of annual occurrence may moderate the profitability of the downsized organisation.

Overall, the respondents reported fewer incidents of downsizing than in previous literature looking at New Zealand downsizing in the mid-1990s. Downsizing also seems to have been implemented for more proactive, strategic reasons in the later phase.



Research to date on how exactly downsizing does impact on an organisation is mixed at best

Even with these moderating factors, this study has provided some evidence to suggest that downsizing may not provide the hoped-for financial returns. In fact, the respondents who downsized reported worse measures of profitability after they downsized than before they implemented the changes. It appears that, at least in the short term, the "costs" associated with downsizing may outweigh any corresponding benefits. Consequently, if downsizing does have an adverse effect on corporate performance, then much more deliberation and care needs to go into the proactive planning and implementation of the process in order to temper or eliminate negative outcomes.

FURTHER READING

Readers who would like to know more about the financial impacts of downsizing are referred to Cascio et al (1997). For an examination of patterns of downsizing in the Australasian region, the work by Littler et al (1997) is recommended.

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