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EMPLOYMENT DOWNSIZING AND ITS ALTERNATIVES

STRATEGIES FOR LONG-TERM SUCCESS

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SHRM FOUNDATION'S EFFECTIVE PRACTICE GUIDELINES SERIES

EMPLOYMENT DOWNSIZING AND ITS ALTERNATIVES

STRATEGIES FOR LONG-TERM SUCCESS

Wayne F. Cascio

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FOREWORD

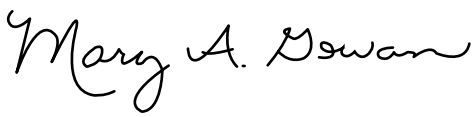
Dear Colleague:

Many organizations have faced or will face the decision to downsize their workforce. Especially in tough economic times, companies struggle with how to best manage their most valuable resource—their human resources—while staying viable as a business. It is this challenge that led us to prepare this Effective Practice Guidelines report, *Employment Downsizing and Its Alternatives.*

In 2004, the SHRM Foundation developed the Effective Practice Guidelines series, a resource that we believe is one of the best available for busy HR professionals like you. Recognizing that you have little time to keep up with results of academic research—and let's face it, some of it is challenging to wade through as well—we created this series. By integrating the latest research findings on what works and expert opinion on how to conduct effective HR practice into a single publication, we make theory and practice accessible to you.

Recent reports in this series, all available online, include *Recruiting and Attracting Talent, Developing Leadership Talent, Retaining Talent* and *Human Resource Strategy.* This report on downsizing is the 10th in the series. For each report, a subject matter expert is chosen to be the author. After the initial draft is written, the report is reviewed by both academics and practitioners to ensure that the material is research-based, comprehensive and presented in an easy-to-use format. We also include a "Sources and Suggested Readings" section as a convenient reference tool.

This series supports our vision for the SHRM Foundation to "maximize the impact of the HR profession on organizational decision-making and performance by promoting innovation, education, research and the use of research-based knowledge." Overall, the Foundation has a strategic focus on initiatives designed to help organizations maximize leadership talent. We are confident that the Effective Practice Guidelines series takes us one step closer to making our vision a reality. Feel free to let us know how we are doing!



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Dr. Cascio received his Ph.D. in industrial and organizational psychology from the University of Rochester. He has served as president of the Society for Industrial and Organizational Psychology (1992-1993), chair of the SHRM Foundation (2007) and chair of the HR Division of the Academy of Management (1984). He was also a member of the Academy of Management's Board of Governors from 2003 to 2006. In 1999 he received the Distinguished Career award from the HR Division of the Academy of Management. Dr. Cascio received an honorary doctorate from the University of Geneva (Switzerland) in 2004, and in 2008 the *Journal of Management* named him one of the most influential scholars in management in the past 25 years. Currently he serves as editor of the *Journal of World Business.*

Studies have tracked the performance of downsizing firms versus nondownsizing firms for as long as nine years after a downsizing event. The findings: As a group, the downsizers never outperform the nondownsizers.

EMPLOYMENT DOWNSIZING AND ITS ALTERNATIVES: STRATEGIES FOR LONG-TERM SUCCESS

Employment downsizing has become a fact of working life as companies struggle to cut costs and adapt to changing market demands. But does this practice achieve the desired results? Studies have tracked the performance of downsizing firms versus nondownsizing firms for as long as nine years after a downsizing event. The findings: *As a group, the downsizers never outperform the nondownsizers.* Companies that simply reduce headcounts, without making other changes, rarely achieve the long-term success they desire. In contrast, stable employers do everything they can to retain their employees. More than three million Americans lost their jobs in 2008. However, 81 percent of the top 100 companies in *Fortune's* 2009 list of "Best Employers to Work For" had no layoffs that year.

Employment downsizing is often implemented during economic downturns as a reactive, tactical action. The most successful organizations, however, use downsizing more strategically as part of an overall workforce strategy. Layoffs become just one tool in a portfolio of alternatives to improve firm performance. Management may view this as an opportunity to enhance the organization's medium- and long-term agility through well-planned and targeted coaching, change and career-management interventions.[1]

Cisco Systems, a company that has changed its workforce strategy in recent years, laid off 20 percent of its workforce in 2001 due to tough times. In 2008, the firm implemented employment downsizing *only as a last resort*, after deploying several other alternatives. The new, measured approach was more consistent with Cisco's long-term talent management strategy of *building* internal talent rather than *buying* it in the external labor market.[2]

This report will explore why downsizing happens and how to do it right. It will also address the alternatives to downsizing and the consequences of a downsized workforce.

WHY DOWNSIZING HAPPENS

Firms all over the world undertake downsizing with the expectation that they will achieve economic benefits. The belief that there are only two ways to make money in business—cutting costs or increasing revenues—leads to this expectation. Anyone who pays a mortgage knows that future costs are more predictable than future revenues. Payroll expenses are fixed costs, so by cutting payroll—other things remaining equal—firms should reduce expenses. Reduced expenses translate into increased earnings. Earnings drive stock prices higher, and this makes investors and analysts happy. The key phrase above is "other things remaining equal." Many organizations define workers only in terms of how much they cost and fail to consider the value they create. For this reason, other things often do not remain equal, *so many of the anticipated benefits of employment downsizing do not materialize.*

In addition to a smaller payroll, a downsized organization often means:

- Lost business as a result of fewer salespeople.
- Lack of new products since there are fewer R&D staff members.
- Reduced productivity when high performers leave as morale decreases.

Such missed opportunities—resulting from downsizing—can have a huge negative impact on the fortunes of an organization. Beyond missed opportunities, large layoffs tend to result in a substantial decline in employee morale and commitment and a significant increase in stress.[3] And for the bottom line, research indicates that companies with very deep layoffs *underperform* the market by as much as eight percent over the ensuing three years.[4]

So why are firms still resorting to layoffs? In many cases, downsizing is a *cloning response* as companies copy their rivals. Sometimes, this seems to be the only choice if a company wants to remain competitive when rivals reduce wages to cut costs. There is also a tendency—known as the *vividness heuristic*—to give undue attention and weight to particularly vivid or newsworthy examples of downsizing.[5] Companies that have reaped dramatic benefits from downsizing and redesigning business processes, such as General Electric and Procter & Gamble, become templates for how the process works—disregarding thousands of companies that cut payrolls but continued to struggle. Executive overconfidence exacerbates this problem. A chief executive officer is far more likely to see himself or herself pulling off what Jack Welch did at GE than to recognize the probability that layoffs will make only a trivial difference.

Some companies resort to downsizing because CEOs are worried about complaints from shareholders and analysts. Even before Citigroup announced recent layoffs, for example, a chorus of critics insisted that the company was a bloated giant that needed to get its costs under control. Even if the job cuts did not improve the stock price, they served as a signal that the company was listening. The layoffs did not, however, prevent Citigroup from filing for bankruptcy in November 2009.

To avoid common problems, caution and planning are essential before choosing to downsize. The next section offers suggestions for putting downsizing in the context of a well-crafted business strategy.

WHEN IS DOWNSIZING THE ANSWER—AND HOW TO DO IT RIGHT

Given the speed and depth of the economic crisis that began in 2007, many companies experienced precipitous drops in sales and revenue. Those drops hit single-line businesses especially hard, because the drops could not be offset by stable revenues or even increases in other lines of business. With credit markets frozen, many organizations had little choice but to downsize their workforce in an effort to save the jobs of those remaining. In this case, downsizing was a reaction to an *emergency situation.*

Downsizing can also be part of a broader *workforce strategy* designed to align closely with the overall strategy of the business. For example, a new business strategy that pursues different products or services and new types of customers may motivate firms to lay off employees with obsolete skill sets and hire new employees with the skills to implement the revised business strategy. In this case and some others (see "A Downsizing That Worked" on the next page[6]), downsizing does make sense.

PRACTICES TO AVOID WHEN DOWNSIZING[7]

While downsizing can be an appropriate tool in some cases, making the following mistakes virtually guarantees that an organization will not reap the intended benefits from a reduction in force.

A Downsizing That Worked

Taiwan Semiconductor Manufacturing Co. (TSMC), which commands half of the global contract chip-making market and employs 23,000 people, faced a record drop in revenues in the first quarter of 2009. To contain costs, TSMC implemented forced unpaid leaves as well as employment downsizing of about 3 percent of the workforce.

The results: In the second quarter, revenues were 80 percent higher than in the first quarter, and the factory-utilization rate rose from below 40 percent to 70 percent. TSMC rehired 700 workers it had dismissed previously, and it offered additional compensation to those who did not wish to return.

Using downsizing as a first response rather than a last resort.
When downsizing is a knee-jerk reaction, it has long-term costs. Employees and labor costs are rarely the true source of the problems facing an organization. Workers are more likely to be the source of innovation and renewal. As one observer noted, "Anyone can lay off personnel, cut budgets and change an organization chart. It takes true genius and creativity to grow a business."[8]

Failing to change the way that work is done.
Firms that cut workers without changing business processes in an effort to become more efficient simply take the same amount of work and load it onto fewer workers. Burnout and stress are typical byproducts of this approach, which does nothing to solve more fundamental problems facing a business—and investors know it.

Failing to involve workers in the search for ways to reduce costs, waste and inefficiencies.
Employees on the ground may see more clearly than the CEO where potential savings are. For example, as part of a broader effort to reduce costs at Commercial Vehicle Group, Inc., the CEO asked four employees to devise a plan to save an additional $50,000. The group identified $600,000 in potential savings, including office supplies and cell phones. "They went after everything," said the CEO.

Ignoring the effects on other stakeholders.
The ripple effects of employment downsizing are substantial—touching customers, suppliers and the local community. Try to avoid some of those effects by working with customers, suppliers and even vocational-training providers to collaborate on finding solutions.

Underestimating the damage to a strong company culture.[9]
Employee morale is the first casualty in a downsizing. When a firm institutes its first round of downsizing, employees' initial reaction is usually a sense of betrayal. Long-term consequences of altering the work environment include increased voluntary turnover and decreased innovation. This is one of the reasons why firms such as Aflac, SC Johnson, Synovus Financial and Southwest Airlines have never downsized employees.

Failing to evaluate results and learn from mistakes.
Employment downsizing is generally not a one-time event for most organizations. Make the effort to listen and learn from managers, survivors, customers and others in order to improve the processes and outcomes the next time.

DOWNSIZING STRATEGIES

Generally speaking, an organization that decides to eliminate redundant employees does so by using four broad strategies: *attrition, voluntary termination, early retirement incentives* and *compulsory termination*.[10]

Attrition, in which firms do not replace a person who leaves, is the simplest method. With this approach, employees have the opportunity to exercise free choice in deciding whether to stay or leave, and thus the potential for conflict and feelings of powerlessness is minimized. At the same time, however, attrition may pose serious problems for management, because it is unplanned and uncontrollable.

Voluntary termination, which includes **buy-out offers**, is a second approach to downsizing a workforce. The main advantage of a buy-out is that it gives employees a choice, which tends to reduce some of the stigma

associated with the loss of a job. The buy-out plans recently offered by Ford Motor Company and General Motors are typical.[11]

- At Ford, offers ranged from $35,000 for workers with 30 or more years of service, who could keep their full retiree benefits, to a flat payment of $100,000 to younger workers who agreed to leave the automaker and to give up retiree health care and Ford pensions. For workers who chose to go to college or vocational school for four years, Ford provided tuition, half their usual pay and full medical coverage. Workers who chose this plan could keep any accumulated pension but had to leave behind any retiree health benefits. Almost half of Ford's hourly production workers (38,000 workers) took one of the offers.
- At GM, 35,000 workers accepted checks ranging from $35,000 to $140,000 to retire early. Another 12,600 employees at GM's former parts unit, Delphi, did the same, helping the automaker slash $5 billion in costs.

Early retirement incentives (ERI), in which a company offers more generous retirement benefits in return for an employee's promise to leave at a certain time in the future, is a third downsizing strategy and one that is often part of a larger buy-out scheme. Sometimes, early retirement offers are staggered to prevent a mass exodus. Retention bonuses with different quit dates may be used to ensure an orderly exit.

From an organizational viewpoint, managers assume that early retirement opens up promotional opportunities for younger workers, but one research study found that it is difficult to predict accurately how many older workers will take an ERI. Typically, about one-third of those offered ERIs accept them, but there is a great deal of variation.[12] On the positive side, poor performers are more likely to take ERIs because they lack confidence about future pay increases.

Compulsory termination, in which departing employees are given no choice, is the final downsizing strategy and is typical of plant closures and the wholesale elimination of departments or business units. Although it is, of course, unappealing to employees, the managers who make the decisions do have the opportunity to design and implement criteria based on the needs of the business.[13] Eliminating jobs or entire business units also makes it less likely that employees will prevail in lawsuits alleging discrimination.

The Downside of Buy-Outs

- *Buy-outs are expensive.* Employees with long-term service find them attractive.
- *The best workers may leave.* There is demand for their skills, and low-performers may stay because they are less marketable.
- *Both high- and low-performing workers will leave out of fear.* They worry that they could be dismissed later without any financial cushion.

SELECTING EMPLOYEES FOR DOWNSIZING

Once the decision to implement layoffs has been made, a variety of decision criteria are available to determine who goes and who stays. Generally speaking, employers are free to use whatever criteria they wish in terminating employees as long as the criteria:

- Don't discriminate based on membership in a protected class.
- Are not arbitrary or capricious.
- Are based on legitimate business reasons.

Across-the-board cuts in every department are perhaps the least effective downsizing option. Such cuts emphasize standardized treatment of employees, but they ignore the strategic importance of different departments to a firm's overall success *and* ignore different performance levels of

Problems With Early Retirement Incentives

- *Incentives may not work.* Lump-sum bonuses, such as one-week's extra pay for each year of service, are relatively ineffective in persuading older workers to retire early.
- *Perceived inequity.* Employees who are ineligible for an ERI, but perceive the benefits to retirees as overly generous, are more likely to quit.
- *High performers may leave.* Open-ended, nontargeted ERIs may cause your most highly skilled employees and managers to disappear.

employees. Suppose one department is comprised of superstars and another is comprised of slackers. Why should the same percentage of superstars and slackers be laid off? *The Economist* magazine described this problem as "Snip, Snip, Oops!"[14]

Identifying specific departments or functions based on strategic importance is a more enlightened way to go. In this scenario, companies try to retain *pivotal talent*—those employees with skill sets needed to execute business strategies in the coming years.[15] A firm may move in stages, first selecting specific departments or functions, and then turning to a multiple-hurdle or *funnel approach.* In this approach, managers identify critical skill sets and then take explicit steps to retain employees with those skills, letting them know how important they are to the organization's future success.

Job performance becomes the *most important factor* when there are more people with critical skill sets than there are available positions in the downsized organization. Generally speaking, employers tend to retain people who have performed well in the past and who have not had disciplinary problems. Unfortunately, in some organizations, the lack of reliable and valid measurements of performance forces reliance on other criteria.

Once the available pool of employees is limited to those with critical skills, high performance and few, if any, disciplinary problems, and the firm still has more workers than required—what is the next step? At this point, many employers use *seniority or tenure* with the organization as the criterion for decision-making.

Ultimately, reducing the workforce can be an opportunity to address performance problems that have festered over the years and to terminate employees whose performance has been weak. However, in all downsizing scenarios, sound professional practice requires that firms:

- Conduct adverse-impact analyses before implementing a strategy.
- Document the criteria and processes used in downsizing.
- Have results and materials reviewed by an attorney specializing in employment law.

Note that even when some adverse impact is expected from downsizing, this option is still viable if the criteria used are job-related and reflect legitimate business needs.

GUIDELINES FOR DOWNSIZING: AN INITIAL CHECKLIST
✔ Identify departments and functions that are strategically critical, along with critical employee skill sets going forward.
✔ Identify criteria that reflect legitimate business needs.
✔ Use a "funnel" approach to selection; that is, evaluate employees by critical skill sets first, followed by job performance, disciplinary actions and seniority (to break ties).
✔ Document the criteria and processes used.
✔ Conduct analyses to ensure that there is not a disproportionate effect of layoffs on members of protected classes and have all analyses and documentation reviewed by an attorney.

HR matters enormously in good times. It defines you in the bad.

Jack and Suzy Welch, *BusinessWeek* (March 11, 2009)

BEST PRACTICES FOR MANAGING THE DOWNSIZING PROCESS

Effectively managing the process of downsizing is just as important as defining appropriate criteria for downsizing decisions. Following is a list of sound professional practices for the downsizing process.[16]

Be transparent about the current conditions that the organization faces and the potential impact on the workforce.

Employees want to hear the truth, and they want to hear it from the CEO. In small businesses, employees often sense when a company is in trouble. Pretending things are fine will only hurt a leader's credibility. Provide regular updates at least every four to six weeks, including reports on year-over-year revenue, net income, current business strategy and future prospects. Invite employees to ask questions and raise concerns. Allow them to identify redundant jobs, wasted activities and bloated cost structures, elimination of which will improve efficiency and cut costs. People who know what is going on can be part of the solution. Beyond that, if people know that their employer tried to use other options to preserve jobs and had to use downsizing as a last resort, that will help to ease the pain.

Treat laid-off employees with respect and sensitivity.
Give soon-to-be-terminated employees plenty of advance notice and, if appropriate, tell them that the organization will write a strong letter of reference on their behalf. Be sure that immediate supervisors—not HR professionals—deliver the news of the layoff to affected employees and that they do so in private. The immediate supervisor must be able to make the business case about the need for layoffs and the criteria for dismissals. Some companies have an HR representative present along with the immediate supervisor during this process. Allow employees to vent and always treat them respectfully. The role of HR in this situation is to listen and to empathize, not to argue. Finally, create a severance plan that provides tangible economic benefits and reflects management's compassion and understanding of the impact of the termination. Outplacement assistance for job-hunting and networking can be particularly valuable, but ensure that severance arrangements are consistent across units and divisions.

Ensure that procedures used to make decisions are seen as just and fair.
Research has demonstrated time and again that procedures used to select, notify and support employees are critically important. This is known as *procedural justice*. When laid-off employees perceive downsizing procedures to be fair, they tend to file fewer claims of wrongful termination, and voluntary turnover among surviving employees is much less frequent. Indeed, procedurally fair treatment has been demonstrated to result in reduced stress and increased performance, job satisfaction, commitment to an organization and trust.[17] When employees feel that they have not been treated fairly, they may retaliate in the form of theft, sabotage and even violence. One way to promote perceptions of fairness is to give employees a sense of personal control by offering options, such as choice in the forms of severance, actual departure date and outplacement assistance.[18]

On the day of discharge, give employees options on how they want their exit handled.
Allow workers a choice regarding when and how to collect their personal things and say their good-byes. Let them depart with as much grace and dignity as possible. Don't allow an unwarranted fear of sabotage govern the exit process, but use these sensible security measures:

- Protect computer systems by taking away access codes from terminated employees.
- Ask employees to turn in building-access cards to thwart them from returning to the premises.
- Do not march long-time, loyal employees out of the building with security personnel, carrying boxes of their personal belongings and passing by surviving co-workers.

Give survivors a reason to stay and new hires a reason to join.
Explain how the decision to cut staff is necessary for the organization's long-term health. Give survivors hope by describing future business plans, targets and details. Describe a future full of promise, one that will allow the company to seize business opportunities. Encourage everyone to participate in inventing the future. Explain that the firm will be investing in those who remain, building skills by retraining everyone in the new ways of operating.

Carefully examine the impact of employment downsizing on all HR systems.
Recognize that downsizing is just one tool in a portfolio of strategies to improve firm performance. That portfolio includes workforce planning, staffing, compensation, performance management, training, job safety and employee relations. How should each area change in light of the new strategy or environment facing the organization?

- Japanese electronics giant Matsushita Electric Industrial shaved billions of dollars from its cost base by cutting its domestic workforce by 19 percent between 2001 and 2005 and by closing 30 factories. At the same time, Matsushita boosted spending on research and development and renewed its focus on creating innovative products. Two years later, its stock was up 33 percent.

DOWNSIZING: MISTAKES TO AVOID

Juries in Connecticut and Minnesota have awarded large sums to claimants for company-sanctioned behavior that harms the dignity of employees. And state courts in Maryland have held that defamation can be based on actions rather than words.

Among many horror stories about inhumane ways to lay off workers, here are three that give one pause:[19]

- An employee was met at her cubicle by her manager and whisked away to her boss's office before she could put down her briefcase. She was handed a packet of paperwork, told to report to HR the following morning to sign papers and asked to leave immediately.
- HR reps asked the group of laid off workers not to contact former co-workers so as not to "depress" them.
- In the UK, a firm sent a series of text messages to its 2,500 employees on their mobile phones, telling them to call a number. The recorded message they got said, "All staff who are being retained will be contacted today. If you have not been spoken to, you are therefore being made redundant."

These stories have one theme in common: utter disrespect for employees and their feelings. To avoid such disasters, use the common-sense guidelines outlined in the box below.[20]

DOWNSIZING OUTSIDE THE UNITED STATES

Multinational employers often have globally distributed workforces, so much of the cost-cutting and employment downsizing is taking place outside the United States. It is risky to assume that layoff strategies that work well in the United States will work elsewhere. In fact, the process takes more time and requires more flexibility than many managers realize. Below are three steps that every employer should be prepared to take.[21]

Be able to justify the layoff.
In most European countries, especially in France, a company has to demonstrate a financial loss for several quarters, not just a generalized sense that the economy is turning down, before laying off workers. Japan also requires evidence of financial losses for several quarters. In addition, the business must show that it is close to bankruptcy for the layoff to be considered economically valid. Some countries also require court approval or negotiation with government agencies for a major layoff. This is true, for example, in the Netherlands, Colombia and China.

Be prepared to consult with employee representatives through worker councils or trade unions.
Throughout the European Union and in many countries in the Asia-Pacific region, talking with worker representatives is essential. Employees in many countries outside of the United States have employment contracts with rules regarding severance and notice of termination. In Mexico, for example, employees receive three months' pay plus an additional 20 days of pay per year of service. The International Labor Organization provides detailed information on its web site about each country's requirements. Most countries base the amount of notice required on the employee's length of service to the company.

Follow relevant laws in the selection process.
In many cases, the determination of who goes and in what order is determined by statute. In the Netherlands, the rule is "last in, first out." In other countries, social criteria determine layoffs.

For expatriate employees, it is important to consider the country in which they are working, as well as any employment agreements they have apart from what they are entitled to under local laws. It is especially important to have expatriates sign releases of legal claims for all of the jurisdictions in which they have worked during their tenure with the company.

Downsizing Process Guidelines

- ✔ Don't keep employees in an information vacuum. That leaves them anxious, confused and prone to accepting rumors as truth.
- ✔ Don't make efficiency–using mass e-mails or large meetings, for example–the top objective in informing employees of their pending discharges.
- ✔ Don't let unwarranted fear of sabotage govern the exit process.

UNDERSTANDING LEGAL ISSUES, SEVERANCE AND OUTPLACEMENT

Legal issues[22]

The following section is not an exhaustive treatment of legal issues associated with downsizing, reductions in force (RIFs) or relevant case law. Rather, the purpose is to offer some general guidance in three broad areas: implementation of downsizing, releasing liability and employee

furloughs. *Please consult an attorney who specializes in employment law for advice regarding specific situations.*

Employers should be able to provide documented business reasons to justify downsizing, explain how they decided which employees to include and show the criteria used to determine who stayed and who was let go. Employers also should conduct a legal review for unfairly discriminatory impact on protected classes of employees, provide legally required notice to employees, obtain signed releases of liability from employees and consider the impact of various federal and state laws on the overall process.

Acceptable criteria include:

- Individual performance.
- Required skills and abilities after the downsizing.
- Existence of disciplinary actions or conduct/safety violations.
- Attendance/punctuality.
- Tenure/seniority.
- Cost-savings potential.

It is best to consider employees in all functional areas, but if that is not possible, then be prepared to justify why only certain departments or functional areas are being considered.

When considering the impact of downsizing on protected groups, be aware of a ruling by the U.S. Supreme Court in a June 2008 case *Meacham v. Knolls Atomic Power Laboratory*. Plaintiffs claimed that the effects of a layoff fell disproportionately on older workers and filed suit under the Age Discrimination in Employment Act. Of 31 workers laid off, 30 were over the age of 40. The Court held that *the employer bears the burden of proof* that this workforce reduction was based on "reasonable factors other than age." Knolls met that burden. It provided sufficient evidence to show that managers rated factors other than age in determining whom to lay off. Those factors included performance, flexibility and critical skills, all shown to be reasonable in this case.[23]

Some specific legal requirements all HR professionals should be aware of are outlined below.

Notice to affected employees

Under COBRA (Consolidated Omnibus Budget Reconciliation Act of 1986), employers with 20 or more employees must provide notice of the availability of **medical coverage** at group insurance rates for as long as 18 months after the employee leaves—whether the worker left voluntarily, retired or was dismissed for reasons other than gross misconduct. Similar notice is required if an employee's hours are reduced and the employee is no longer eligible for health benefits under the employer's plan.

The federal Worker Adjustment and Retraining Notification (WARN) Act requires employers of more than 100 workers to grant **60 days' written notice** before closing a plant or before laying off more than one-third of a workforce in excess of 150 people, or 500 or more employees at a single employment site. The law excludes from those tallies employees who work fewer than 20 hours per week. Penalties for noncompliance include 60 days' back pay, benefits and possibly legal fees.[24] Companies with fewer than 100 workers typically are not required to provide their workers with any notice at all. The notice is intended to give workers time to look for employment and local governments a chance to provide group job counseling and training.[25]

There are **three exceptions**—or delays—to the 60-day notice period: **natural disasters, unforeseeable business circumstances** and a **faltering company**. In the latter case, the law permits employers to withhold notice if giving notice would jeopardize a new business opportunity that might save some of the jobs that otherwise might be lost. Employers need not notify employees of the potential for layoff every time a business downturn occurs.

Releases of company liability and agreement by the employee not to pursue legal action

In 2008, 93 percent of U.S. companies required employees to sign a release in exchange for severance, up from 76 percent in 2001.[26] For a release to be valid, it should:

- Be voluntary and offer adequate consideration (for example, the severance package should exceed the benefits to which the employee was already entitled by contract or law).
- Clearly state that the employee is releasing any and all claims against the employer.
- State that the employee acknowledges that he or she received all wages and other amounts due.
- State that the employee acknowledges adequate consideration given for the release.
- Advise the employee to consult with an attorney.

Releases under the Age Discrimination in Employment (ADEA) and Older Workers Benefit Protection (OWBPA) Acts

Age-discrimination complaints to the EEOC are rising. In fact, they jumped 29 percent between 2007 and 2008. In fiscal year 2008, the EEOC obtained more than $114 million in monetary awards for plaintiffs through enforcement and litigation actions.

For a waiver of age claims to be valid in a group termination, employees must be given information about the "decisional unit." Such a unit might be an entire company, a division, a department, employees reporting to a particular manager or workers in a particular job classification. After defining a decisional unit, an employer must identify:

- The job titles and ages of employees in the unit eligible or selected for "the program," as well as the job titles and ages of employees not eligible or selected for the program.
- Employees eligible for the program and any time limits applicable to it.

How much detail is enough? At least one court has ruled that the employer need not list the eligibility factors for each employee separately, but only the factors that were applied in general, such as job criticality and performance. The eligibility requirements are admissible in court. To the extent that the stated requirements are inconsistent with subsequent testimony, that can work to the detriment of the employer.

See box below for a list of basic requirements for a valid release.

Workers' compensation, Family and Medical Leave Act (FMLA) and union representation

Employees who are out on workers' compensation leave or FMLA leave can be included in RIFs. If there is no current collective bargaining agreement or if the agreement does not address a RIF, the employer may be required to bargain over the decision to lay off union members and over details such as severance pay and benefits. If a collective bargaining agreement does address layoffs, both parties must follow the agreement, but the employer may still have to bargain over the decision itself or its details if the union requests bargaining.

Employee furloughs

The use of mandatory furloughs rose sharply in 2009, largely as a strategy to control labor costs while retaining talent.[27] While layoffs might put some employers at a disadvantage when the demand for the company's products or services rises, furloughs allow employers to realize immediate savings in costs while retaining employees over the longer term. Several important **legal risks** accompany such programs, including concerns about disparate impact on protected groups, the WARN Act and employee benefits. Two of the main risks are **wage-and-hour concerns** and **labor relations**.

Wage-and-hour concerns

The major problem with furloughs and wage-and-hour laws (the Fair Labor Standards Act) is maintaining compliance with the salary-basis requirement for exempt employees. Federal law does not require the payment of the predetermined weekly salary when a furlough is for one or

Requirements for a Valid Release of Liability Under ADEA and OWBPA

- It must be written in a manner that can be understood by the average individual eligible to participate.
- It must refer specifically to claims arising under the ADEA.
- It must not attempt to include claims that may arise after the date of execution.
- Consideration for the waiver or release of ADEA claims should exceed that to which the employee already would be entitled.
- The employee must be advised in writing to consult with an attorney prior to executing the agreement.
- The employee must be allowed at least 21 days to consider the agreement (45 days if terminated during a RIF or if leaving voluntarily through a group-incentive program).
- The release must allow the employee to revoke the agreement up to seven days after signing.

more **full workweeks**. But when a furlough is for less than a full workweek and a salaried, exempt worker performs **any** work during that week, a private-sector employer must pay the exempt employee's full weekly salary. To do otherwise is to negate the exempt status of the salaried worker. FLSA regulations do provide a special exemption to this rule for public-sector entities.

- If the organization uses work-sharing programs, in which employees work partial workweeks, it is important to check state regulations to ensure that work-sharing can be used with nonexempt and exempt employees.
- Check state law to determine if an extended furlough might trigger an obligation to pay final wages. Legal experts note that under federal law, an employer can require that a worker use accrued paid time off or vacation days for time not worked during a partial workweek, as long as the worker receives the same pay for the workweek that he or she would have received in salary. If an exempt employee does not have accrued vacation, then the employer must pay the employee's guaranteed salary during a shutdown of less than one week in order to maintain the exempt employee's salary status.
- Finally, when an exempt worker is off for an entire week, it is important to instruct the employee, in writing, that he or she is *not to perform any work at all*, including checking voicemail, reading or writing e-mails, remotely accessing company software, calling in for status updates or other work-related matters. *This risk is so great that employees should acknowledge in writing that they have been so instructed.*

Labor relations issues

If a furlough is contradicted by language in a collective bargaining agreement, then an employer must get the union's consent before implementing it. The same is true if an employer wants to use a method for furloughing employees that is not in the agreement—for example, an approach other than seniority, such as rotating furloughs among all employees. Unless the employer has reserved the right to implement a furlough through its management-rights clause, then it will have to bargain with the union over the use of a furlough.

SEVERANCE AGREEMENTS

Some employers offer severance agreements to workers who have been terminated, either voluntarily or involuntarily. Doing so softens the blow of an involuntary termination, preserves the future good will of employees and avoids the risk of future lawsuits by having each employee sign a release of claims.[28] A severance package may include any combination of the following components:

- **Salary continuation:** usually an amount based on job title and years of service.
- **Insurance benefits:** in the case of terminated employees, COBRA benefits may apply, and the company may pay the COBRA premium, or some portion of it, for a specified period of time.
- **Uncontested employment benefits:** the employer agrees not to challenge an exiting employee's application for such benefits.
- **Outplacement services:** assistance in finding a new job or time off to apply/interview for new jobs.
- **References:** agreement on what information will be disclosed to future employers. Be sure to seek legal advice regarding any omission that might lead to future liability for that omission.
- **Other assistance that might be specific to a given individual's situation:** for example, forgiveness of a loan or transfer of a company cell phone to an employee.

Consulting firms Right Management, Mercer, Hewitt Associates, and Lee, Hecht, Harrison have all conducted recent surveys of severance practices. Here are some key findings:

- Most companies offer a standard one to two weeks of pay for every year of service.
- Although severance-policy features tend to differ by employee group, they are applied consistently to all individuals within a group. Typical features include:
  - *Continuation of benefits:* 74 percent of organizations offer these to executives, but only 61 percent offer them to nonunion and hourly workers.
  - *Outplacement:* 69 percent of organizations offer these services to executives, 57 percent offer them to professional and technical employees, and 49 percent offer them to clerical workers and technicians.
  - *Minimum length of severance payments:* typically between two and four weeks.

  - » *Maximum length of severance payments:* 26 weeks for most employees and one year for executives.

- Despite recent widespread cost-cutting, most organizations either maintained their severance policies (65 percent) or made them more generous (19 percent).

Right Management's study of severance practices, conducted across 28 countries and based on 1,500 responses, found that with respect to severance and termination policies:[29]

- By law, 63 percent are required to provide a certain amount of advance notification to the employee.
- Globally, 73 percent of terminated employees are required to sign a waiver or release of legal claims before they can access severance benefits; that figure is 96 percent in the United States.
- Employees laid off in the United States earn the least amount of severance pay worldwide, no matter what level of employee or amount of tenure with the organization.

Severance pay and benefits are not legally required in the United States, but if a firm does offer them, HR should develop guidelines for managers on what to offer and be consistent in applying those guidelines. Managers may subject their firms to unnecessary risks if their decisions are later shown to be arbitrary and capricious or if the effects of their decisions are detrimental to protected groups.

Outplacement

Outplacement describes the efforts made by a downsizing company to help its redundant employees find new jobs. Typically, a consulting firm provides help—not only for those who leave, but also for those who remain in the company.

Usually, outplacement includes two elements: counseling for emotional stress caused by the employee's job loss and assistance with the job search. The sooner a terminated employee is reemployed, the better for the employee's financial, career and mental health. In addition, reemployment makes it less likely that an employee will become disgruntled, file a lawsuit or cause problems for those who remain at the firm.

Outplacement is also a tangible expression of an organization's social responsibility. By providing professional support, it signals genuine interest in enhancing each employee's career success. Outplacement helps survivors see their organization as a fair and considerate employer. Outplacement consultants can play a critical role in helping newly terminated employees navigate the unfamiliar terrain of new methods and technologies for the job search. And simply offering access to office services and administrative support sends a message that the former employee is not alone.

Benefits of Offering Outplacement Assistance

- Protects the organization's image.
- Demonstrates corporate social responsibility.
- Lessens chance of employee lawsuits.
- Minimizes unemployment-insurance payments.

Outplacement can mitigate the damaging effects of unemployment on family life by including the spouse in counseling sessions. Subsequent career assessment and job-search assistance may include an interest inventory, help in building a résumé and advice on job-interviewing skills and salary negotiation.[30]

Consultants strive to enhance a former employee's networking and presentation skills, as well as host networking events to connect people. Networking is particularly important as *nearly 50 percent of laid-off individuals find jobs by networking.* Outplacement firms should be able to answer two basic questions: How many clients find jobs before their outplacement programs end, and how long does it take, on average, for clients at various levels to find jobs?

Finding the Right Outplacement Firm

- Select a provider based on its track record in placing clients, as well as the quality of its services relative to their costs.
- Be sure that the individuals selected are proficient in both counseling and coaching roles.
- Choose a provider familiar with the industry, including types of jobs and their requirements. Ideally, choose someone with contacts within the industry.
- Ask what types of individual attention each employee can expect.
- Commence outplacement services on the day an employee is laid off.

THE COSTS OF DOWNSIZING

Some of the direct and indirect costs associated with employment downsizing are shown in the table below.[31]

Short-term considerations

Of the costs shown in the table below, almost all of the direct costs are short-term—realized in the year they are incurred, except the costs of rehiring former employees and severance and pension payouts, which may continue for longer periods. Among the indirect costs, decreased productivity, reduced morale and aversion to risk among survivors begin to accrue immediately and may also continue for longer periods.

The direct costs of layoffs can be staggering. Laying off highly paid technology workers in the United States, Europe and Japan results in direct costs of about $100,000 per worker. In 2008, for example, IBM spent $700 million in employee-restructuring actions.[32]

Besides money, in terms of time lost at work, a 2009 survey of 1,000 U.S. workers found that employees reported spending an average of nearly three hours a day worrying about their job security. Bosses who stay behind closed doors only make this situation worse.[33] It is important to emphasize that these findings are self-reports, not the results of controlled research on actual levels of productivity. Nevertheless, they are cause for concern.

Longer-term considerations

As the table below makes clear, the indirect costs—often longer-term—of employment downsizing may be even larger than the direct costs. Consider the opportunity costs of lost sales, for example. This hidden cost occurs when experienced sales and marketing representatives with strong client relationships are let go or leave out of concern that they will lose their jobs. In domestic or multinational businesses, where relationships with customers and suppliers have to be nurtured over long periods of time in order to inspire enough trust to transact business, the opportunity costs of lost sales may be considerable.

The shock of changing from a nondownsizing organization to a downsizer is a major reason why rates of voluntary turnover increase among remaining workers. An organization that lays off 10 percent of its workforce can expect to see a 15.5 percent rate of voluntary turnover among surviving employees, compared with a 10.4 percent turnover rate among companies with no layoffs.[34] Since the fully loaded costs of turnover (separation, replacement and training) can be 1.5 to 2.5 times the annual salary paid for the job, those additional costs can be huge.[35]

Layoffs at high-involvement workplaces—those with management strategies that give employees the skills, information and motivation to be competitive—can be markedly more detrimental than layoffs at an average company.[36] *All in all, the significant indirect costs associated with employment downsizing may wipe out the direct savings in labor costs.*

Direct and Indirect Costs of Downsizing

Direct costs	Indirect costs
• Severance pay, in lieu of notice.	• Recruiting and employment costs of new hires.
• Accrued vacation and sick pay.	• Low morale, risk-averse survivors.
• Supplemental unemployment benefits.	• Decreased productivity among survivors.
• Outplacement.	• Increase in unemployment tax rate.
• Pension and benefits payouts.	• Lack of staff when economy rebounds.
• Administrative processing costs.	• Start-up costs (recruiting, training, staffing).
• Costs of rehiring former employees.	• Voluntary terminations of those who remain.
	• Opportunity costs of lost sales.
	• Potential lawsuits from aggrieved employees.
	• Potential strikes by unions in some countries.
	• Loss of institutional memory and trust in management.
	• Brand equity costs–damage to the company's brand as an employer of choice.

International variation

Institutional infrastructures vary considerably across countries. So some of the costs shown in the table—including unemployment taxes, supplemental benefits, pension and benefits payouts—may apply quite differently. Other costs not shown in the table may apply in specific countries.

Downsizing: The Hard Questions

- Why does employment downsizing make sense for the organization?
- What is the business case for employment downsizing?
- What is the problem that the organization is trying to solve?
- If the problem is short-term cash flow, are there alternative ways to cut costs?
- Do prospective layoffs include hard-to-find skill sets?
- How will the downsizing affect high performers who are difficult to replace?
- What are the short-term payoffs from a downsizing strategy?
- What long-term threats to the organization's strategic success might be associated with employment downsizing?
- What long-term costs might the organization incur by implementing employment downsizing?
- Do the long-term benefits associated with employment downsizing outweigh its short-term costs?

ALTERNATIVES TO DOWNSIZING

There are many alternatives to downsizing employees, but a key consideration is whether senior managers believe that the downturn in business is temporary or permanent.

If permanent, the only alternative to layoffs is to retrain employees to develop new lines of business.

- Lincoln Electric, a Cleveland-based manufacturer of arc-welding equipment, did just that when sales dropped 40 percent in the early 1990s. Rather than lay off its high-school-educated employees, it offered to retrain volunteers in sales and marketing techniques. Out of 1,200 employees, about 90 volunteered for the training. They were deployed into "leopard" teams—named so because their jobs were to find "spots," or opportunities to exploit, in the marketplace. They did just that, selling home welding kits through big-box retailers. By the late 1990s, the company enjoyed $800 million in sales it never would have had but for the efforts of the leopard teams.

If senior managers believe that the downturn in business is temporary, there are many potential ways to cut costs (see box "Alternatives to Employment Downsizing for Temporary Downturns").

Today, companies are searching for more ways to reduce costs than in prior downturns, when they relied principally on layoffs. Why? First, the speed and depth of the recession that began in 2007 is forcing employers to cut costs steeply. At the same time, however, firms worry about retaining enough talented workers to cope with increased demand once the economy recovers.

Alternatives to Employment Downsizing for Temporary Downturns

- Cut temporary staff.
- Eliminate overtime.
- Offer voluntary retirement.
- Freeze salaries.
- Cut salaries.
- Delay raises.
- Freeze hiring.
- Reduce work hours.
- Use temporary layoffs (furloughs).
- Use furloughs with incentives.
- Cancel business trips and costly perquisites.
- Reduce or suspend matching contributions to company-sponsored savings plans.
- Raise employee contributions to benefits plans.
- Postpone or eliminate bonuses.

A 2009 survey of 513 U.S.-based companies by consulting firm Towers Perrin revealed the most popular cost-saving tactics and the percentage of companies implementing each:[37]

1. Freeze or reduce hiring: 60%
2. Cut travel and entertainment: 60%
3. Reduce pay or raises: 60%
4. Scale back employee events: 51%
5. Conduct targeted layoffs: 40%

Unfortunately, it is not clear when or if workplaces will ever return to "normal." A survey by Watson Wyatt

Worldwide found that 10 percent of companies that imposed mandatory furloughs were not planning to return employees to their prior schedules. More than half of respondents expected smaller staffs three to five years from now.[38]

CREATIVE ALTERNATIVES TO DOWNSIZING

Redeployment

According to a 2009 survey of 268 senior business and HR leaders by Right Management, 22 percent said that they always offer redeployment before implementing employment downsizing, while 29 percent said that they sometimes do so.[39] Many employers are shifting underused staffers into customer-facing positions like sales to help boost revenue.

- When a hiring freeze sidelined recruiters for Southwest Airlines, the company assigned 82 recruiters to other departments—from flight operations to the general counsel's office. Over six months, Southwest saved $250,000.[40]
- Vermont's Rhino Foods, which makes the cookie dough for Ben & Jerry's ice cream, took a different approach—sending 15 factory workers to the nearby lip-balm manufacturer Autumn Harp for a week to help with a holiday rush. Rhino paid the employees and then invoiced Autumn Harp for the hours worked.

Furloughs and reduced hours to cut payroll costs

The theory behind unpaid leaves, or furloughs, is that by sharing the pain of the downturn more broadly among the workforce, organizations will keep talented employees, win additional loyalty and position themselves better for recovery. As one chief financial officer said, "By furloughing employees or taking salary cuts, you buy yourself more time to make smart decisions."[41] Besides, furloughs are cheaper than paying severance costs.

- In China, accounting giant Ernst & Young offered its 9,000 mainland and Hong Kong employees a chance to take one month of unpaid leave. About 90 percent of the firm's auditors opted in, thereby reducing payroll costs by 17 percent.
- Pella, the Iowa manufacturer of windows and doors, instituted a four-day workweek for about a third of its 3,900 employees. The company believes that the economy will rebound faster than many expect and does not want to be caught shorthanded when demand picks up.

Pay cuts and pay cuts with incentives[42]

Pay cuts are an alternative way for companies to avoid layoffs while reducing their labor costs, thereby preserving jobs.

The danger with pay cuts is that they can create deep emotional scars and damage morale. Low morale can lead to lower productivity, with the net effect that labor costs rise. Traditionally, managers were willing to cut bonuses, eliminate raises and even slash benefits, but base pay was sacrosanct. Now, the key to making pay cuts palatable is to *ensure that stars still make more than their lesser-performing colleagues, even after a pay cut.* After all, top performers always have choices.

A number of firms have implemented tiered pay cuts, with those at the top of the organization taking the largest cuts and, in some cases, all of them.

- At Winnebago Industries, Inc., the CEO took a 20 percent pay cut, while other senior executives took a 10 percent cut. The pay of all other salaried workers was reduced 3 percent.
- At Hewlett-Packard, the CEO took a 20 percent cut, while other employees forfeited between 2.5 and 15 percent of their pay.

Finally, some firms are using stock-based incentive compensation on a sliding scale.

- Vail Resorts grants stock compensation to its full-time, year-round employees. Says CEO Rob Katz, "It's partially to ease the blow, but it's also giving people some ownership to participate in our future success."
- At San Jose-based Xilinx, Inc., a world leader in the design of programmable logic chips, the company shaved 10 percent from its gross expenses by offering unpaid sabbaticals of up to a year and allowing employees to swap a portion of their salaries for stock options.

Rings of defense[44]

Corning, Inc., the maker of glass for flat-panel screens, employs a "rings of defense" strategy as sales dip. The first level, or outer ring, is to freeze hiring

and cut discretionary spending. The second level includes shifting many employees to four-day workweeks and beginning to eliminate 1,400 temporary and contract workers. The third ring is to cut jobs, consolidate factories and freeze salaries. Corning cut 3,500 people, or about 13 percent of its workforce, in 2009. A final ring, implemented only if sales continue to fall, is to sell assets and cut pay, benefits and research-and-development spending.

Work sharing

Also known as "short-time compensation," work-sharing is a state-based program offered in 18 states, allowing employers that reduce work hours to apply to have unemployment benefits replace part of employees' lost pay. Rules and payouts vary, but typically companies must maintain health and retirement benefits and get approval from any unions involved. The 26- to 52-week payouts usually make up about half of workers' lost wages.[45]

- Springfield, Missouri-based Megavolt moved employees to three 10-hour days per week as a way to cope with the downturn. Workers kept their jobs, while the lost 10 hours per week qualified them for state unemployment benefits in Missouri, softening the blow of lost income.

Moving to smaller office space by allowing telework

Telework—once viewed as a perk—is now seen as a business necessity.

- The CEO of the accounting firm BDO Seidman told employees that flexible work schedules—allowing people to work when and where they want—is enabling the company to prevent layoffs. Savings in real estate are a big reason for that.
- Capital One cut a full 20 percent of its real estate costs by allowing telework.

Still, three big obstacles stand in the way of more widespread adoption of telework: concern over the safety of documents, fear of lowered productivity and lack of trust in employees.[46]

Subsidies to companies that do not lay off workers

Outside the United States, governments have taken a different approach to preserving jobs.

- **Singapore** assembled a "resilience package" that includes corporate tax cuts, subsidies to companies that do not lay off workers and payments that cover 90 percent of the costs of employee training. This has kept unemployment low, at least in the short run. At Kato Spring, which bends wires into springs for consumer electronics, the program kept idled workers busy learning new skills, even as the company cut managers' pay and laid off 15 percent of its 200 workers. Six months later, orders rebounded and the company no longer needed the program.[47]
- **Denmark's** approach allows liberal hiring and firing, and the country has imposed limits on the duration of its high unemployment benefits. Denmark also invests more than any other country, as a percentage of its gross domestic product (4.4 percent), in retraining those who have lost jobs. The Danes call this approach "flexicurity." The cost is covered by tax revenues, which account for 50 percent of GDP, second only to Sweden. About two-thirds of Danes who are laid off have a new job within a year. In the aggregate, the unusual mix of the free market and big government helped Denmark cut its unemployment rate in half, from about 10 percent in the early 1990s to less than 5 percent in 2006.[48]

Planning for alternatives to layoffs in advance

Always consider the alternatives before resorting to downsizing, especially if managers forecast that business declines are temporary and the company employs hard-to-find skilled workers. When forecasts show that business will be depressed for an extended time, functions and jobs need to be analyzed to determine which are most critical and which are more peripheral. Try to use layoffs as a last resort, but have a plan based on the firm's priorities established in advance.

CONSEQUENCES OF EMPLOYMENT DOWNSIZING

EFFECTS ON LAID OFF INDIVIDUALS

Not surprisingly, laid off employees are often stressed out, particularly as their buy-out packages dwindle. One study tracked 756 people for two years after they were laid off and discovered a pattern to the spiral of stress: The layoff leads to financial insecurity, which

sets off depression. That, in turn, causes people to feel that they have little control over events. Next comes hopelessness, sleeplessness, headaches, chronically upset stomachs and fatigue. The way out? Help jobless people to reach out to others, network and focus on their strengths.[49]

The Disposable American by Louis Uchitelle argues that a layoff-happy business culture in the United States is creating a society of downwardly mobile, insecure workers. Some employees can now expect to go through that experience twice or even three times before they reach age 50.[50] Layoffs produce a variety of negative mental and physical health consequences, but one study found that these consequences may be lessened for those who accept voluntary buy-out packages. The fact that the process is voluntary introduces elements of choice and personal control—both of which are antidotes to uncontrollable and undesirable events that tend to be associated with psychological and physical distress.[51]

EFFECTS ON SURVIVORS

Those who remain employed at a firm after downsizing often feel guilty and depressed.[52] Many studies have found that morale, loyalty and trust in management decline after a downsizing, as do organizational commitment, job satisfaction and job involvement. At the same time, stress levels, intentions to quit and actual levels of voluntary turnover all increase, due—at least in part—to the loss of a sense of personal control over important events in one's life. This constellation of symptoms is known as *survivor syndrome*.[53]

The managers who do the firing are often overlooked as casualties of the process, which is highly stressful and exhausting. Many require counseling.[54] David Pottruck, former co-CEO of Charles Schwab & Co., Inc., describes his experience:

> "Facing up to our first layoff was probably the worst feeling that I ever had in business. I went through a period of incredible sadness and sense of failure. I couldn't imagine the way we had let down these people and these families who had to depart. We made every effort to undertake that process with as much dignity and generosity for employees as we could. We wanted to make sure that those who were still here respected the way the company dealt with those who left. Because if there were other layoffs[…] we don't want to see any destruction of employees' loyalty to the company."[55]

For both laid off employees and survivors, keep in mind that there is something known as the *psychological contract* guiding the relationship between workers and employers. Employees infer a set of expectations from their employer's actions, including the expectation of fair treatment. Downsizing is often interpreted by workers as a breach of the psychological contract, and surviving employees may respond by withholding effort and involvement, or through absences or quitting.[56]

EFFECTS ON THE ORGANIZATION

Keeping workers engaged and involved

A recent study[57] examined how continued investments in "high-involvement" practices that strongly engage employees in the workplace help maintain productivity. These high-involvement work practices cover a wide range of routines, from team-based production to gain-sharing and flexible work design, to information-sharing and opportunities for training and development.

Workplaces that continue to invest in such practices—even during layoffs—may avoid productivity losses.

Knowledge-based organizations

From high-technology firms to the financial-services industry, knowledge-based organizations depend heavily on their employees—their stock of human capital—to innovate and grow. Here, human relationships and social networks generate learning and knowledge that become a firm's institutional memory. Because a single individual has many relationships in such an organization, indiscriminate downsizing has the potential to inflict considerable damage on learning and memory capacity. Such a loss damages ongoing processes and operations, forfeits contacts and may lead to lost business opportunities.

Evidence indicates that damage to knowledge-based organizations is far greater than might be implied by a simple tally of the number of individuals let go. Organizations at greatest risk include those that operate in rapidly evolving industries, such as biotechnology, pharmaceuticals and software, where survival depends on a firm's ability to innovate constantly.[58]

Overall firm performance

It is reasonable to question the *long-term impact* of employment downsizing on employee productivity, company profitability and stock prices. There are studies that show that downsizing has positive effects,[59] negative effects[60] or no effects[61] on firm performance. Two recent studies used large data sets to examine the impact of downsizing on accounting measures of firm performance as well as on stock-market performance.[62] Both found that *companies that conducted large-scale layoffs significantly underperformed*—compared with those that conducted few or no layoffs—with respect to profit margin, return on investment, return on equity, market-to-book ratio and industry-adjusted total return on common stock.

A recent analysis of 41 studies covering 15,000 layoff announcements in more than a dozen countries over 31 years concluded that layoff announcements have an overall negative effect on stock-market prices. This remains true whatever the country, period of time or type of firm considered.

Circumstances do matter, though. Companies that fired people because of financial difficulties fared worse than those that fired offensively, as part of a general restructuring. But neither group fared as well as stable employers that avoided layoffs.[63]

In terms of employee productivity, several authors have reported that productivity declines following downsizing, but savings in unit labor costs offset the declines, with market value being unaffected.[64]

Downsizing and innovation

What about the effect of employment downsizing on innovation? Downsizing presents several obstacles to innovation, including:

- Risk-averse survivors.
- Lack of resources for innovation.
- Lack of talented employees.
- Low levels of employee morale and enthusiasm for innovation.
- High workloads among survivors.[65]

When downsizing drags on over a long period of time, employees' enthusiasm for innovation also wanes as they reduce cooperation with co-workers and information exchanges with them. Interestingly, the size of a workforce reduction had no significant impact on innovation.[66]

What does affect innovation is *continued investment in research and development*, even during recessions. One study examined 177 large companies (with market values exceeding $100 million) that increased R&D spending by more than 10 percent during the recession years of 2001-2002. Subsequently, their share prices significantly outperformed the S&P 500 index over one-, three- and five-year periods by 96%, 110% and 103%, respectively. [67]

EFFECTS IN THE LARGER COMMUNITY

Virtually every account of the effects of large-scale employment downsizing on local communities, whether the industry is automobiles, tobacco or shipping/logistics, arrives at the same conclusion about the *ripple effects of the downsizing*. Workers and managers who were well-paid prior to being laid off can no longer support thriving service industries—restaurants, dry cleaners, spas, hair salons, medical practices, daycare providers, just to name a few. As a result of reduced spending, local businesses have to lay off even more workers, thereby pushing local unemployment rates higher. Home foreclosures also rise, as laid off workers can no longer afford their mortgages. Many are forced to relocate elsewhere to find comparable jobs. Retraining is essential for many of them because the skills required in their old jobs do not transfer. [68]

Underemployment is another problem. Underemployed workers are employed, but not as they desire—whether in terms of compensation, hours or level of skill and experience. The underemployed are often competing for available jobs with the unemployed.[69] In early 2009, underemployment reached almost 15 percent, or one in every seven Americans of working age.[70] Their stories are poignant and, in many cases, heartbreaking.[71] Of course, the downward mobility associated with underemployment has negative effects on families, children and communities.

Business leaders must always be mindful of the short- and long-term costs of layoffs. Before making a decision to downsize, managers should consider the variety of effective alternatives available.

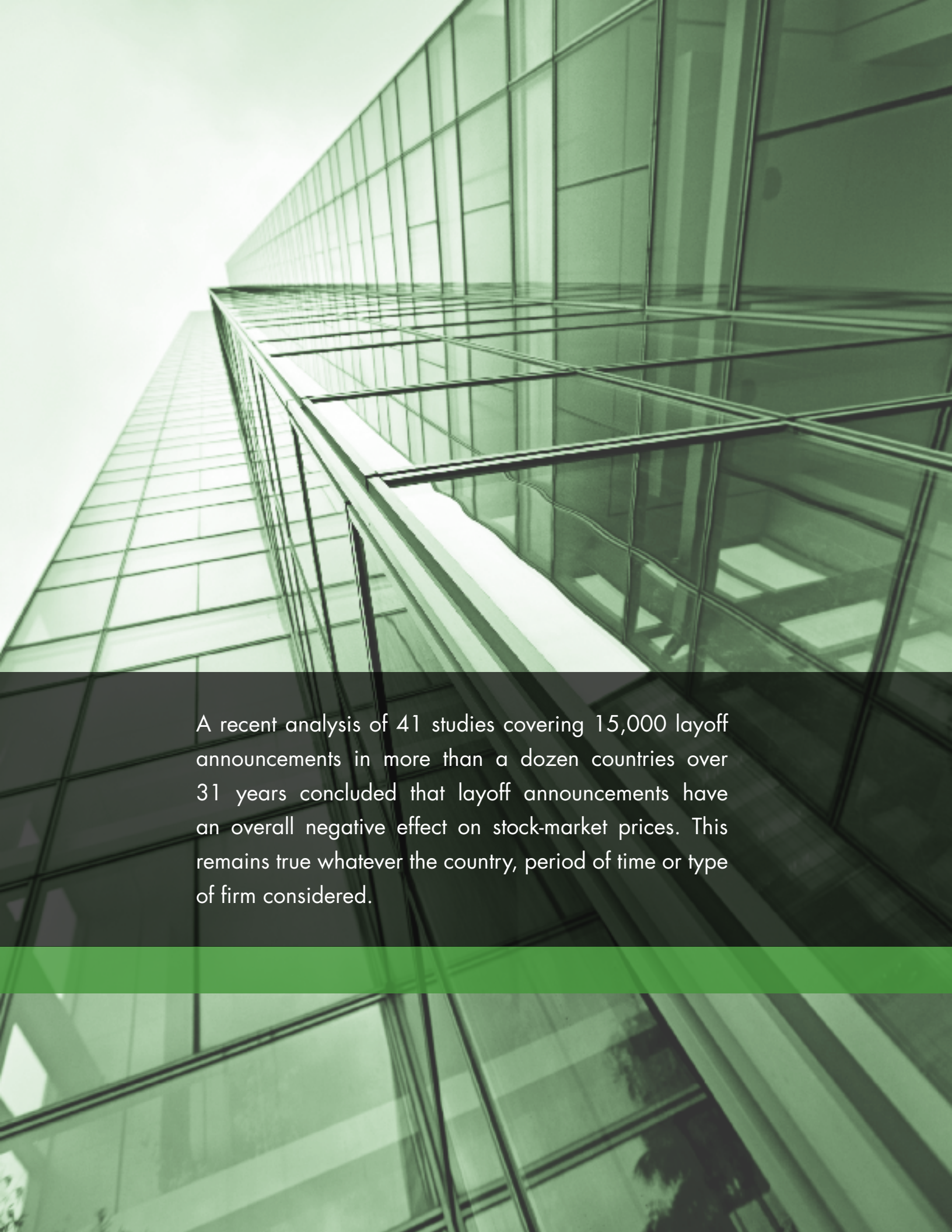
CONCLUSION

Employment downsizing is not a cost-cutting cure-all, nor does it guarantee that short-term savings will exceed long-term costs. At the same time, cash flow is the lifeblood of any organization, and some level of employment downsizing may be necessary to preserve it.

Business leaders, however, must always be mindful of the short- and long-term costs of layoffs. Before making a decision to downsize, managers should consider the variety of effective alternatives available. When downsizing is the best solution, organizations should use the guidelines suggested throughout this report to treat employees humanely and with dignity, and to be proactive in dealing with the reactions and needs of survivors.

Downsizing: How Should HR Professionals Prepare?

- Seize the opportunity to help shape the agendas and strategies of the organization with respect to workforce issues.
- Educate executives about the effects of employment downsizing on those laid off, survivors, the psychological contract, high-involvement workplaces, knowledge-based organizations, long-term financial performance and communities.
- Ensure that managers are cautious in implementing downsizing strategies that can impose such traumatic costs on employees, both on those who leave and those who stay.
- If employment downsizing is necessary, take steps now to address the unpleasant symptoms associated with "survivors' syndrome." Doing so will help control stress, voluntary turnover, drops in productivity and innovation, and other unpleasant side effects.



A recent analysis of 41 studies covering 15,000 layoff announcements in more than a dozen countries over 31 years concluded that layoff announcements have an overall negative effect on stock-market prices. This remains true whatever the country, period of time or type of firm considered.

GLOSSARY OF TERMS

Downsizing—a broad term that refers to reductions in a firm's use of financial, physical, human or information assets.

Employee furloughs—mandatory time off work with no pay. Used as an alternative to a layoff, employee furloughs can occur in both public- and private-sector organizations as a way to reduce expenses. In mandatory employee furloughs, employees take unpaid or partially paid time off from work. The employees generally have either scheduled time off or callback rights and expectations. To furlough employees with contracts, including union-represented employees, the contract must be renegotiated. During employee furloughs, benefits usually continue, which is one of the factors that distinguish a furlough from a layoff.

Employment downsizing—refers specifically to a reduction in a firm's use of human assets. It is an intentional, proactive management strategy to reduce the size of an organization's workforce. Sometimes known as a "reduction in force" (RIF), it may be accomplished through attrition, early retirements, voluntary severance agreements or layoffs.

Financial restructuring—a change in the configuration of a firm's physical or financial assets and its financing of debt or equity.

Layoffs—involuntary terminations of employment; one form of employment downsizing.

Organizational decline—failure to anticipate, avoid, neutralize and adapt to external or internal pressures, resulting in the erosion of an organization's resource base.

Organizational restructuring—planned changes in the formal patterns of operations and command. Although it is sometimes used as a synonym for "downsizing," restructuring need not result in a smaller workforce.

Plant closing—the act of shutting down a plant's operations and laying off or redeploying employees who worked at the plant.

Redeployment—a restructuring strategy in which at least some employees are offered the opportunity to transfer internally from one organizational unit to another. Typically, employees leave units with low demand for others with high demand or direct customer contact.

Outplacement consultants can play a critical role in helping newly terminated employees navigate the unfamiliar terrain of new methods and technologies for the job search.

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SOURCES AND SUGGESTED READINGS

Books

Cascio, W. F. (2002). *Responsible restructuring: Creative and profitable alternatives to layoffs.* San Francisco: Berrett-Kohler.

This book draws on an 18-year study of S&P 500 firms to show that firms that restructure through downsizing are not more profitable than those that don't. It also presents 13 myths versus facts about employment downsizing and shows that firms that view their employees as assets to be developed, rather than simply as costs to be cut, tend to search for alternatives to downsizing. The book presents many such alternatives, along with detailed examples to illustrate them in practice.

De Meuse, K. P., & Marks, M. L. (Eds.). (2003). *Resizing the organization: Managing layoffs, divestitures, and closings.* San Francisco: Jossey-Bass.

A single comprehensive volume of 15 chapters contributed by experts in their respective fields, this book is a helpful guide to the human and cultural aspects of mergers, acquisitions, downsizings and other transitions, along with change-management strategies to address the challenges that each poses.

Klein, H. J., Becker, T. E., & Meyer, J. P. (Eds.). (2009). *Commitment in organizations: Accumulated wisdom and new directions.* New York: Routledge.

This book summarizes what we do and do not know about commitment. It is organized in five sections: the meaning and relevance of commitment, the multiple foci of commitment, building and maintaining commitments, methodological issues and challenges, and integration and future directions.

O'Toole, J., & Lawler, E. E. III. (2006). *The new American workplace*. New York: Palgrave Macmillan.

This book documents the profound changes in the many dimensions of work over the past several decades and explores the consequences of these shifts for American workers. Some of the issues discussed include the growing use of information technology; offshoring, outsourcing and downsizing; the struggle of men and women to achieve work/life balance; the growth of contract and part-time work; and employee participation in decision-making, profits and stock ownership.

Pfeffer, J. (1998). *The human equation: Building profits by putting people first.* Boston: Harvard Business School Press.

This book is built on the premise that culture and capabilities—people-management practices of organizations—are the real source of competitive advantage in today's business environment. It punctures conventional wisdom about effective management practices and uses in-depth company examples to show the link between effective HR management practices and profits.

Uchitelle, L. (2006). *The disposable American: Layoffs and their consequences.* New York: Vintage Books.

This book tells the recent history of the United States as an unchecked rise of layoffs. Relying on empirical data and often poignant first-hand accounts, *New York Times* economics editor Louis Uchitelle argues persuasively that employment downsizing hollows out companies so they can't compete, it hollows out the country by removing middle-class jobs, and it hollows out middle-class employees who are laid off and then too often drop permanently to a demeaning, low-wage way of life.

Book Chapters

Cascio, W. F. (2010). Downsizing and redundancy. In A. Wilkinson, T. Redman, S. Snell & N. Bacon (Eds.), *The Sage handbook of human resource management* (pp. 334-346). Thousand Oaks, CA: Sage.

This chapter begins by defining relevant terminology, then presents an overview of current research in a number of key areas related to employment downsizing, including its prevalence around the world, methods and alternatives. The effects of downsizing and redundancy are examined at multiple levels, including individuals who stay, those who leave, effects on local communities and on the financial performance of firms.

Cascio, W. F., & Young, C. E. (2003). Financial consequences of employment-change decisions in major U.S. corporations: 1982-2000. In K. P. De Meuse & M. L. Marks (Eds.), *Resizing the organization: Managing layoffs, divestitures, and closings* (pp. 131-156). San Francisco: Jossey-Bass.

This study examined more than 6,400 instances of changes in employment from S&P 500 companies in 1982-2000 in terms of two important outcomes: profitability and total return on common stock. Results revealed that neither employment nor asset downsizing yields long-term payoffs that are significantly larger than those generated by stable employers. Stable employers were defined as those in which the complement of employees did not fluctuate by more than 5 percent.

De Meuse, K. P., Marks, M. L., & Dai, G. (In press). Organizational downsizing, mergers and acquisitions, and strategic alliances: Using theory and research to enhance practice. In S. Zedeck (Ed.), *Handbook of industrial and organizational psychology.* Washington, DC: APA Books.

This is a thorough review of theory and research pertaining to three strategic interventions: employment downsizing, mergers and acquisitions, and strategic alliances. The chapter reviews the major effects on people and organizations of these strategic interventions. With regard to employment downsizing, the authors examine organizational outcomes of downsizing and present various factors that are likely to affect the efficacy of downsizing. The chapter concludes with a discussion of the use of theory and research to enhance organizational strategic practices.

Greenberg, J. (In press). Organizational justice: The dynamics of fairness in the workplace. In S. Zedeck (Ed.), *Handbook of industrial and organizational psychology.* Washington, DC: APA Books.

This comprehensive review identifies psychological processes that underlie perceptions of justice in organizations, describes various forms of organizational justice and summarizes research on the benefits of promoting each particular form. The review also discusses various contemporary theories of organizational justice that dominate current research and identifies ways in which perceptions of organizational justice are measured.

Redman, T., & Wilkinson, A. (2009). Downsizing. In T. Redman & A. Wilkinson (Eds.), *Contemporary human resources management* (pp. 381-404). London: Harlow, Pearson.

This chapter describes the potential of employment downsizing to cause major management problems when

it is not handled well. It examines in some depth various methods and alternatives used, with special attention on the processes involved, specifically, consultation, criteria for selection and support both for those let go and for those who remain.

Articles

Brockner, J. (2006). Why it's so hard to be fair. *Harvard Business Review, 84*(3), 122-129.

Companies benefit from process fairness, that is, when employees believe they are being treated fairly. Research shows that practicing process fairness reduces legal costs from wrongful-termination suits, lowers employee turnover, helps generate support for new strategic initiatives and fosters a culture that promotes innovation. What's more, it costs little to implement. This article examines psychological and other reasons that cause managers to resist embracing process fairness.

Brockner, J., Grover, S., & Blonder, M. D. (1988). Predictors of survivors' job involvement following layoffs: A field study. *Journal of Applied Psychology, 73*, 436-442.

The authors surveyed 105 layoff survivors in two organizations that had mild or severe layoffs to assess their job involvement. Results showed that survivors' work ethic and prior role ambiguity were related to their job involvement only when layoffs were relatively mild. As predicted, work ethic was positively related to job involvement and role ambiguity was negatively related to job involvement following layoffs.

Cascio, W. F., & Wynn, P. (2004). Managing a downsizing process. (2004). *Human Resource Management Journal, 43*(4), 425-436.

This article identifies five gaps between research and practice in the area of employment downsizing. It also describes two organizations that successfully bridged that gap as examples of how to manage strategic and interpersonal processes effectively when there is pressure to downsize employees. One organization downsized 8,000 employees as a last resort, while the other took creative steps to avoid any employment downsizing.

Colquitt, J. A., Conlon, D. E., Wesson, M. J., Porter, C. O. L. H., & Ng, K.Y. (2001). Justice at the millennium: A meta-analytic review of 25 years of organizational justice research. *Journal of Applied Psychology, 86*, 425-445.

This is a meta-analytic review of 183 studies of organizational justice. Results show the overall and unique relationships among distributive, procedural, interpersonal and informational justice, along with their relationships to outcomes such as job satisfaction, organizational commitment, evaluation of authority, citizenship, withdrawal and performance.

Dabos, G., & Rousseau, D. M. (2004). Mutuality and reciprocity in the psychological contracts of employee and employer. *Journal of Applied Psychology, 89*, 52-72.

In an empirical study of 80 employer-employee dyads, the authors assessed the joint perceptions of the employee and his or her employer to examine mutuality and reciprocity in the employment relationship. Results indicated that both of these features were associated with productivity and career advancement, met expectations, and intentions to continue working with the employer.

Elovainio, M., Kivimaki, M., & Helkama, K. (2001). Organizational justice evaluations, job control, and occupational strain. *Journal of Applied Psychology, 86*, 418-424.

Based on data collected from 688 employees, the authors found that job control affects occupational strain through employees' evaluations of procedural and relational justice.

Guthrie, J. P., & Datta, D. K. (2008). Dumb and dumber: The impact of downsizing on firm performance as moderated by industry conditions. *Organization Science, 19*, 108-123.

This paper addresses the question, do industry conditions moderate the impact of workforce downsizing on firm performance? It examines this question using matched primary and secondary data on a sample of U.S. manufacturing firms. After controlling for a set of industry and firm-level variables, including firms' prior performance levels, results indicate that downsizing is associated with decreases in subsequent firm profitability and that these negative effects are more pronounced in industries characterized by R&D intensity, growth and low capital intensity.

Iverson, R. D., & Pullman, J. A. (2000). Determinants of voluntary turnover and layoffs in an environment of repeated downsizing following a merger: An event-history analysis. *Journal of Management, 26*, 977-1003.

Based on data from a sample of 415 hospital employees over a five-year period, the authors found that those employees most likely to be downsized were older, full-time, absent less often and had acceptable workloads, yet they experienced lower co-worker support and responded negatively to a change in the structure of the hospital. Those who were younger, white-collar, accepted the change in structure and intended to leave were more likely to resign.

Leana, C. R., Feldman, D. C., & Tan, G. Y. (1998). Predictors of coping behavior after a layoff. *Journal of Organizational Behavior, 19*, 85-97.

In a longitudinal study of laid-off industrial workers, the authors examined the effects of individual differences and situational characteristics on individuals' use of six job-loss coping strategies. In each case, the predictors explained a significant portion of the variance (30-47 percent), although different predictors were significantly associated with each of the six coping strategies. Results also suggested that problem-focused and symptom-focused coping strategies are complementary rather than mutually exclusive.

Mishra, A. K., & Spreitzer, G. M. (1998). Explaining how survivors respond to downsizing: The roles of trust, empowerment, justice, and work redesign. *Academy of Management Review, 23*, 567-588.

The authors developed a stress-based framework of survivors' responses to downsizing. They synthesized prior research findings into a typology of survivor responses identified by two underlying dimensions: constructive/destructive and active/passive. They hypothesize that how survivors appraise the downsizing will shape their responses to it. The authors argue that trust, procedural justice, empowerment and work redesign enhance survivors' assessments of their capacity to cope with the threat.

Mollica, K. A., & DeWitt, R. L. (2000). When others retire early: What about me? *Academy of Management Journal, 43*, 1068-1075.

Based on the reactions of 668 employees who were ineligible for an early-retirement program, the authors concluded that perceptions of overly generous caretaking of those who left under the program were associated with increased intentions to quit, particularly among longer-tenured employees.

Trevor, C. O., & Nyberg, A. J. (2008). Keeping your headcount when all about you are losing theirs: Downsizing, voluntary turnover rates, and the moderating role of HR practices. *Academy of Management Journal, 51*, 259-276.

Using organization-level data from multiple industries, the authors examined whether employment downsizing predicts voluntary turnover rates, whether aggregated levels of organizational commitment mediate this relationship and whether various HR practices affect it. Results revealed a positive relationship between downsizing rates and voluntary turnover rates, mediation of that relationship by aggregated levels of organizational commitment and moderation of the downsizing effect by indexes of procedural justice, job embeddedness and career development.

Zatzick, C. D., & Iverson, R. D. (2006). High-involvement management and workforce reduction: Competitive advantage or disadvantage? *Academy of Management Journal, 49*, 999-1015.

This empirical study examines how layoffs moderate the relationship between high-involvement work practices and productivity and how continued investments in these work practices throughout layoff periods maintain workforce productivity. Findings reveal a negative relationship between high-involvement work practices and productivity, but firms were able to avoid productivity losses by continuing to invest in such practices.

Zatzick, C. D., Marks, M. L., & Iverson, R. D. (2009). Which way should you downsize in a crisis? *MIT Sloan Management Review, 51*(1), 78-86.

This article projects three key lessons: (1) downsizing initiatives must align with a firm's talent-management strategy; (2) it is important to distinguish whether downsizing is reactive or proactive, and whether a firm is control- or commitment-oriented; (3) sometimes core and support workers are managed differently.

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