

## 10 COMPELLING REASONS NOT TO DOWNSIZE

Almost daily, newspapers, business magazines, radio and television carry reports of corporations, large and small, that are downsizing. Their attention is chiefly focused on the impact to the employees, as they are the ones most acutely experiencing the immediate effects. But what are the effects on the companies? Downsizing, rightsizing or any of the number of synonyms for radically cutting expenses and employees, may provide a decrease in operating expenses in the near term, but how will they impact the longer term future?

In my experience over several decades of business cycles, I have witnessed a succession of economic contractions and expansions and although at times the outlook has appeared bleak, in fact, far bleaker than our present circumstances, every decline has been followed by a subsequent period of growth. It was not that long ago that we awoke to "Black Friday" when the stock market appeared to teeter on the brink of a cataclysmic collapse. What followed however, was the beginning of what proved to be one of the longest lived economic booms in memory. The lesson here is that there will be a new economic tomorrow and in all likelihood it will begin by mid 2002.

Therefore, it is with eyes wide open that business leaders need to carefully consider the long range effects their present cost cutting actions will have on their organizations. This is especially true as the nature of those cuts, especially where they concern personnel, are fundamentally different today from what they were in the past. Circa 1950's, 60's, 70's 80's and even much of the 90's, downturns in employment for the most part meant layoffs. Certainly, there were specific industries where structural decline resulted in large scale permanent job losses. However, in general, most cutbacks precipitated layoffs vs. permanent terminations. Not so today. The new order is that of permanent severance. For many the proverbial "pink slip" has turned to bright red.

Moreover, the level of employee being severed has also changed dramatically. In previous decades, the cuts were heavily weighted toward production personnel and were therefore, first line, blue collar worker oriented. Today, with our heavy reliance upon technology to drive the economic engine, the cutbacks in both the

manufacturing and service sectors are skewed toward white collar workers. Additionally, more senior workers in their 40's, 50's and 60's have borne the brunt of the reductions more heavily than ever before, as their higher cost compensation and benefit packages are targeted for maximum near term bottom-line savings.

Conjointly these changes have set in motion what could become a veritable time-bomb for companies that decide to pursue cost reductions through massive staff cuts. The negative consequences will likely include:

1.Lack of a recallable employee pool. Historically, layoffs inherently communicated at a minimum the possibility, if not the probability, of being recalled by the employer when economic conditions improved. Many furloughed employees expected to eventually return to their employers and, reacted to the layoff accordingly by taking interim and part-time jobs. Today many severed employees are not only informed that their release is final, they are provided outplacement services funded by their former employers. Thus, the employers themselves are ensuring that these people will, indeed, not remain available to them. Many of the more senior employees, finding new employment at their current compensation levels difficult if not impossible and having personal savings at their disposal, are choosing to become entrepreneurs, thereby, forever removing them from the available labor pool. We entered 2001 experiencing labor shortages across most industries, which were particularly acute for high skill and technology workers. At the moment this scarcity may have temporarily abated, but its root causes remain and the scenario is certain to revisit us as soon as the economy enters the next upturn.

2.Poor morale & lack of trust among younger employees as terminations increasingly target older employees. Much has been exposted recently in the press about the disturbing loss of employee loyalty. Terminating large numbers of older, more senior and experienced employees who have faithfully served the corporation for many years, has a profound long term effect on younger, newer employees. Place yourself in their shoes for a moment. They have already been indoctrinated by friends, relatives, neighbors and the media that business, especially big business, is not to be trusted. Now they see their co-workers, supervisors, and mentors being fired because "cost cuts need to be made and these individuals represent higher per capita costs to the organization." The message is clear and they understand. The reward for loyalty is to be axed when you are over fifty and unlikely to find

another comparable position. They may not bolt today, due to a tightening job market, but they will remember and when the economy improves they will seek a future where they feel more secure.

3.Loss of knowledge and experience base. This is a frequently overlooked aspect of the cost of losing long term employees. Many companies and even industries are currently developing knowledge bases in order to capture and access organizational knowledge resources. Yet, no matter how effective these databases are, and they can be extremely beneficial, they will never be a substitute for the knowledge, experience and wisdom that rests in the veterans of the organization. Although this is true in terms of deductive knowledge, it is even more important regarding the organization's continuity and history. People need to feel a sense of belonging to more than just the present, the "now" of an organization. They also need a sense of past and future. Without this, there are no ties, no traditions, no continuity and often no shared ethics and values.

4.Loss of corporate culture and available mentors for existing and new employees. This loss of continuity is also reflected in dispossession of the corporate culture. I am a great believer in change vs. the status quo. However, there are some things that should not change. "In this company we do thus and so, because we believe it to be fundamentally right." Every organization needs to have incontrovertible statements that transcend the fluctuating business climate and current trends. These values can and should be committed to pen and paper, but they are not passed on in this manner, at least not primarily. Rather, they are taught and lived and mentored from one person to the next. The fewer seasoned people the company has to pass these on, the less they will be able to maintain the soul of the organization.

5.Loss of established customer service and customer contact points. It happens to all of us. One day you call your favorite supplier or vendor and ask for good ole' Joe who you have done business with for years and are shocked to learn he is no longer there. "Why? Has he died or contracted cancer?" you ask. "No," is the response. We have had a major reduction in staff due to the economy. In silence you ponder: "If after all these years Joe is gone, who's left? Will they even be in business tomorrow? Maybe, I should begin looking around for another supplier." No one is irreplaceable. However, long term customer and supplier/vendor relationships are invaluable; they also say something about the reliability and stability of your organization. Although the

organization's investment in these relationships does not show as a line item on the asset portion of your balance sheet, do not underestimate their value, especially in a day when the global search for new suppliers and vendors is made instantaneous by the internet. Without relationships, price rules and the only price that matters today is the lowest one. Years spent in commodity businesses taught me this principle all too well.

6. Employees may be needed again before termination savings are fully realized. If the economy does begin rebounding by mid 2002, then many of the anticipated savings of reducing the workforce will have not yet been fully realized before companies will need to begin replacing the terminated workers. The expense of replacement includes both the termination costs as well as the costs of training and integrating the new hires. Thus, in cases where terminations include substantial severance and outplacement costs, these plus the training and initial inefficiency costs of the new hires frequently equal one to several years of the terminated workers' cost to the organization.

7. Possible need to bring employees back as independent contractors at higher total cost. The shrinking labor pool together with the fact that a high percentage of the middle-aged and older terminated employees are either beginning their own businesses or opting for early retirement will mean that many of those who remain and are willing to return to former employers will want to do so under their own conditions. A large number of these may choose to do so as independent contractors preferring to gain a greater degree of control over their own lives. Many companies initially prefer this approach believing that they may only require the services of the former employees for a limited period of time. Frequently, however, the weeks and months become years and the independent contractors, knowing the inner workings of the organization and where projects and sponsors may be found, remain costing the company significantly more than if they had stayed on the payroll.

8. Hidden costs that are never fully accounted for such as declining morale, lost customer relationships and lost productivity due to over-stressing the remaining employees. There are very real costs associated with mass layoffs that in my experience are almost never fully assessed. Declining morale, disrupted customer relationships, a frequently steep decline in customer service and the frustration of remaining employees who

cannot possibly absorb all of the responsibilities of their departed coworkers, results in an attitude of surrender to cutting corners wherever possible.

9. Future sales may be lost due to the inability to ramp up delivery quickly as the economy improves. I have already addressed at some length the labor pool shortage that may well be just around the corner. An economy spurred by the tax cut, a weakened dollar propelling export sales and/or a drop in oil and gas prices could individually or in combination cause demand in many industries to grow rapidly. Where will they find sufficient personnel fast enough to meet that demand? Any failure to respond quickly to the increased demand will result in lost sales and possibly long term market share erosion.

10. Diminished market position and status as market leader, innovator and corporate citizen. I am frequently amazed at the lengths that major corporations will go to and the investment they willingly incur during "good times" to build their image in the public's mind. However, as soon as the economy dips, the slashing begins with little thought as to the negative impact it can have within days upon years of careful work and millions of dollars invested to build that image.

When cutting is absolutely necessary, do so with a scalpel rather than meat cleaver. Across-the-board percentage staff reductions are the most damaging variety and should only be used in those instances which demand the immediate and drastic cost reductions compelled by the imminence of business failure. The use of global reductions as a general cost reduction methodology is tantamount to an abdication of responsibility by the leadership and management.

Whenever large scale reductions of any sort are made, they should be matched by reductions of a corresponding magnitude in senior executive compensation. Huge compensation packages for corporate executive leaders have been justified as necessary to attract and motivate the best talent available and as just rewards for their leading mega-corporations to unprecedented high profit levels and market valuations. This standard must also apply in the reverse and thus, significant drops in profit and worth, requiring deep cost cutting throughout the organization, should be equally reflected in deep cuts to the senior executive compensation levels.

As an alternative to layoffs and terminations, corporate leaders and managers should look to rapidly redeploy corporate assets in order to bolster revenues and profits. In the case of people assets, this can often be done through the reassignment of personnel to those areas and functions of the organization offering the greatest potential for rapid internal innovation. Such action frequently results in innovative breakthroughs of enormous and immediate value to the company as people new to a given function approach it with a fresh perspective and a different experience and personal knowledge base from which to draw upon.

Although severe cost cutting can increase the near term profitability of virtually any corporation, ultimately, the broad-based innovations of its committed and motivated employees is essential to restoring profitable long term growth, especially in periods of economic downturn. And it is sustainable growth, not temporary savings, that should be the primary goal of every corporate business leader.



John Di Frances is an internationally recognized expert on Strategic Business Issues. His professional career spans thirty years of global corporate, nonprofit, academic and government agency experience in senior executive and industry leadership positions. John advises senior executives globally and is a prominent professional speaker. Since 1983 he has served as the Managing Partner of DI FRANCES & ASSOCIATES, LLC.