

MAKING COMPANIES EFFICIENT

The year downsizing grew up

There are better ways to do it, even where it is still unavoidable

Downsizing, it seems, has got itself downsized. At the start of 1996, mass sacking by American companies was causing a hullabaloo in the United States. Pat Buchanan, railing against "job-destroying" corporations, romped home in the Republicans' New Hampshire primary. Robert Reich, Bill Clinton's labour secretary, said that firms which devastated communities by moving jobs abroad might face punitive taxes. Magazines splashed stories about "killer bosses" who paid themselves millions while laying waste to their workforces. The *New York Times*, in a series of seven hefty articles, declared that "job apprehension has intruded everywhere, diluting self-worth, splintering families, fragmenting communities, altering the chemistry of workplaces...and rubbing salt on the very soul of the country."

In this mood of doom, AT&T's announcement last January that it was sacking 40,000 people came as a special shock. It was not just that the culprit was "cuddly old Ma Bell," rather than some fly-by-night sweat-shop in the South. Much worse, AT&T was prospering; the man who wielded the knife, Bob Allen, was prospering with it, having just seen his pay go up to \$5m a year; and Wall Street greeted the dismal news by boosting the company's shares.

And yet, a few months later, the subject was almost forgotten. Bill Clinton and Bob Dole mentioned downsizing in the presidential fight about as frequently as Dubrovnik. Pat Buchanan's peasants returned to their six-packs and cheese whiz. The *New York Times's*

series, repackaged into a book, drew little interest. "Downsizing" remained a reliable topic for comedians, but as a subject of economic analysis it had suddenly gone flat.

There are two reasons for the waning of interest. The first is that the people who made the loudest noise about the problem at the start of the year have now taken a closer look at the statistics.

The headlines may be full of household companies announcing gigantic lay-offs—50,000 at Sears, 10,000 at Xerox, 18,000 at Delta, 16,800 at Eastman Kodak, 35,000 at IBM, on top of AT&T's huge contribution. But the wider figures tell a different story. The unemployment rate came down from 7.1% of the workforce in January 1993 to 5.1% in mid-1996. The economy continued to create many more jobs than it destroyed, providing 8.5m new places for workers in 1993-96. And the employment growth was concentrated in jobs paying above the median wage rather than in hamburger-flipping. In 1992-96 over half the employment growth was in jobs paying in the top third of wages (and the number of hamburger-flippers actually fell). For all its downsizing, America was far better at generating decent jobs than Europe with its loyalty to jobs for life.

The second reason is that many big firms have had enough of downsizing for the moment. Three enthusiastic downsizers over the past decade have been IBM, General Motors and Hughes Electronics, a division of General Electric. IBM slimmed itself down from 406,000 employees in 1987 to 202,000 in

1995, one of the most dramatic workforce reductions ever. Over the past year it has been recruiting 21,000 people, more than in the successful 1970s. General Motors cut its workforce from 800,000 in 1979 to 450,000 in the early 1990s. In the past year, it set out to recruit 11,000 people. Hughes Electronics has reduced its workforce by a quarter in the past decade—but in 1996 was set to add 8,000. After the downsizing, re-enter upsizing.

From panic to planning

For all that, it would be wrong to think the thing was over. Downsizing has spread from the private to the public sector and from workers to managers. Older white-collar workers were considerably more at risk of losing their jobs in 1991-92 than in the previous recession in the early 1980s. And the victims seldom have an early time of it: two studies by Henry Farber of Princeton University and Ann Huff Stevens of Rutgers suggest that even people who get another full-time job earn on average 10% less than they did in their previous jobs.

The past decade has seen downsizing evolve from an act of desperation into a calculated choice. The first downsizers were failing companies: many of them had no choice but to go in for repeated bloodlettings as their businesses shrank and morale collapsed. But more recently a new sort of company has taken up the practice: successful firms that use job-cutting as a way to pursue a wider purpose.

General Electric led the way, removing 104,000 of its 402,000 workers in 1980-

90 even though it faced no great crisis. Others have started to do the same. Compaq cut its workforce by 10% in 1992, despite healthy returns, because it thought the computer market was bound to stay intensely competitive. Goldman Sachs cut its workforce by 10% not once but twice, to increase productivity. Procter & Gamble sent away 13,000 workers even though it was the best-performing company in its business. AT&T sacrificed 40,000 not because it was desperate but because it wanted to divide itself into three smaller, sharper companies.

The transformation of downsizing is the result of two trends in management thinking. One is the realisation that size in itself is no longer a source of competitive advantage. The past decade has seen the humbling of a series of giants. Du Pont, Salomon Brothers and Westinghouse, as well as General Motors, IBM and Sears. Rather than celebrating their size, big companies have taken to hiding it; they try to imitate the agility of their smaller rivals by shrinking their headquarters, slashing away layers of management and breaking themselves up into smaller units. Some have gone the whole hog and broken themselves up into smaller units. Some have gone the whole hog and broken themselves up into separate companies. In 1995 ITT, America's quintessential conglomerate, showed AT&T the way to do that.

The other new management fashion is to focus on your "core competences": the things that you—and you alone—can do better than anyone else. J.P. Morgan, an investment bank, has constructed an index measuring a company's focus on a scale of 1-100. American companies that decided to "clarify" their business (jargon breeds jargon) by focusing on the one thing they did best outperformed the market by 11% in the next two years; firms that diversified underperformed by about 4%.

Naturally, the fashion for focus has led to an epidemic of "outsourcing". It is now routine for companies to have their catering, cleaning, building maintenance, security, computer systems and even their mail rooms run by outside contractors. Many are going even further. Nike designs and sells sports shoes without stitching a thread itself. Cirrus Logic, a semiconductor firm, has

all its manufacturing done by sub-contractors such as Taiwan's Semiconductor Manufacturing Corporation.

This explains one of the paradoxes at the heart of the downsizing debate: that the total number of jobs in the economy is growing at a time when big companies are laying people off in record numbers. Big companies have not so much been destroying jobs as handing them over to other people, often with a contract attached. The past decade has seen strong growth in two sorts of companies—small consultancies that provide specialist services to larger companies (of which they may previously have been a part) and large companies operating on a wider front, such as Electronic Data Systems, which manages information, and Pitney Bowes, which runs mail rooms. America's biggest employer is now Manpower, a temporary-help agency that hires out 767,000 substitute workers a year.

Another consequence of calculated downsizing is a widespread re-examination of the idea of contracts between companies and employees. Some companies that once prided themselves on rewarding diligence with a job for life have started "pruning", lopping off a few workers every year. But others have begun to reformulate the traditional job contract in terms that may be useful to workers as well as to employers. If the workers promise not to make too much fuss when they are asked to leave, the employers promise to give them the opportunities they need to keep their skills up to date. For life-time employment, read—once hopes—life-time employability.

Economists have tried to throw cold water on this loosening of the relationship between companies and their employees, pointing to official figures which suggest that the average length of job tenure is about the same today as it was in the 1970s. But the official statistics fail to take into account either new companies or privately held ones, the two categories

where labour mobility is particularly pronounced. A better guide than the official labour statistics is surveys of student opinion. Young people now seem to take it for granted that they will have lots of different employers, and perhaps even lots of different careers, during their working lives.

The gleam ahead

So, is the worst over? Are most companies now so efficient that they can start growing again? Or will downsizing gather pace? Concerning America, opinion is divided.

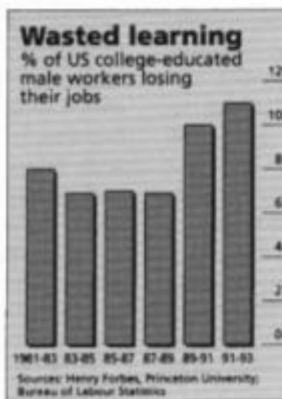
Michael Jensen, of the Harvard Business School, thinks the worst is still to come. He sees the world in the middle of "a modern industrial revolution" it will take decades to adjust to. Lower trade barriers and the collapse of communism has brought more than a billion cheap workers into the global labour market. New technology has made it easier to send jobs abroad or to replace humans with machines at home. New management practices such as "total quality management" have made companies much more efficient. The result is a huge over-capacity in the rich world. Mr Jensen predicts that millions of jobs will disappear, as western companies slim their operations or move into higher-value-added activities. Wages for manual work, he thinks, may fall by a half or more. There could be Luddite-like insurrections of the poor and "displaced".

Others take a less dramatic view. Nitin Nohria, a colleague at the Harvard Business School who has studied downsizing in Fortune-100 companies, argues that many firms shrank themselves in order to concentrate on their core businesses; now they have done this, they can start expanding again. And this time the growth is likely to be more enduring, partly because they are now doing what they are best at and partly because they will be increasingly free to invade the territories of more ramshackle companies in Europe and East Asia.

David Lewin, at the Anderson School of Management at the University of California, Los Angeles (UCLA), presents an even wider-ranging case for optimism. As newly efficient companies outperform their rivals, the demand for their products rises, and they have to hire new workers to keep up. Downsizing, properly done, is thus a self-eliminating process.

And downsizing, Mr Lewin points out, has its downside, as companies are starting to discover. Having fired 12,000 people in recent years, Delta Airlines has found itself short of baggage handlers, maintenance workers and customer-service agents; none of which helps it to attract travellers. Downsizing can have a devastating impact on innovations, as skills and contacts that have been developed over the years are destroyed at a stroke.

Even the cult of contracting out, Mr Lewin argues, can be carried too far. It is harder to draw the line between periph-



eral and essential than people once thought. Handing your computing system over to another company, for example, reduces your control over your information technology. Even if contracting out helps companies to control their costs when times are hard, it can put a break on growth when times are good. You have to take your turn in the queue along with all the contractor's other clients. And tight markets then lead to higher prices. This has been particularly worrisome for airlines, which have not always been able to get essential maintenance done in time to meet their flight schedules.

Companies, Mr Lewin concludes, have begun to discover the virtues of stability. They can maintain their special efficiencies only if they can give their workers a unique set of skills and a feeling that they belong together. Teams work best if the team members get to know and trust each other—and if each team member masters a broad enough range of skills to be able to double up for absent colleagues. Profit-sharing makes sense only if the employees are around at the end of the year to enjoy their rewards. For Mr Lewin, profit-sharing is an anti-downsizing concept. In the past, companies resorted to downsizing because workers refused to take a pay cut. Now, for many firms, pay is on the way to becoming a variable rather than a fixed cost.

America's lessons for the laggards

It sounds like crossed fingers for America. About continental Europe and Japan, on the other hand, the management theorists are unanimous: downsizing is bound to get worse. These parts of the world still have hundreds of huge companies protected by the state against competition. Deregulation, when it inevitably comes, will make them shed jobs as savagely as AT&T and all those American companies already have done. Moreover, many European companies (think of Lagardère in France or Siemens in Germany) are still unfocused in comparison with their American competitors. Growing global competition will force these companies to choose between excelling in one business—cutting large numbers of jobs in the process—and becoming also-rans in dozens of them.

However, continental Europe and Japan have one big advantage: they have America's example to learn from. The Americans have made almost all the mistakes it is possible to make in downsizing. Europeans and Japanese can learn three lessons from America's experience.

The first is that there is a big difference

Workers' shuffle

US displacement rates*	1981-82	1991-92
Total	3.9	3.8
Occupations: white collar	2.6	3.6
blue collar	7.3	5.2
Age: 25-34 years	5.0	3.8
35-44 years	3.8	3.9
45-54 years	3.0	3.8
55 years & over	3.6	4.3

* Number of workers made redundant per 100 employed with three or more years of tenure on their current job
Source: Council of Economic Advisors

between blind and thought-out downsizing. Most of America's early attempts were flops. A 1990 survey of downsizing by the American Management Association found that fewer than half the firms that cut jobs actually improved their performance. A 1991 study of stock-market reactions to downsizing found that, although companies at first increased their stock prices when they announced job cuts, they were performing below the market average three years later. But recent, better-planned downsizings have prospered. AT&T now looks better positioned to defend its market. Procter & Gamble is outperforming Kao in East Asia and Unilever in Europe. Goldman Sachs is arguably the world's most successful investment bank.

The second lesson is that there is an art—maybe a science—in deciding whom to sack. Many of the early downsizers let the victims select themselves, by offering early-retirement packages and generous severance pay. The result was that anybody who was capable of getting another job went off and got it, while the duds stayed behind. The point was taken, and companies started to do the choosing themselves. Unfortunately, the criteria they used were often much too crude: last-in-first-out (which meant that they lost all their bright young people); or the removal of everybody below a certain level in the hierarchy (which meant that top-heavy firms became even top-heavier); or the weeding out of all middle managers (which meant that they lost a wealth of experience and connections).

Karen Stephenson, an anthropologist-turned-management-theorist at UCLA's Anderson School, claims that it is possible to be cleverer than this. The key is to look beneath the corporate hierarchy and to find the informal networks that shape the day-to-day life of a company. Ms Stephenson says she has developed a technique for identifying the key figures in these networks, the people who shape the conversations in the corridors and know where the bodies are hidden.

Companies can make downsizing more acceptable by using these people to spread the bad news—and more efficiently by ensuring they hold on to these key players. The technique has been used by a lot of organisations, including IBM and TRW, an aerospace company.

The third thing the American experience has taught is that there are good ways of getting rid of people and bad ones. Apple, a computer company, regularly announces that a certain number of people will be laid off in a few weeks' time, leaving its workers to wonder whose neck is for the axe. Some companies tell the victims by sending anonymous messages via e-mail or voice-mail. Others deliver the news simply by putting rubbish bags on the desks of those doomed to leave. This is not only brutal, but foolish. Workers waste their time worrying about the future. The survivors of each downsizing may spend less time working and more time in building their family life. Few have the energy or the commitment to engage in creative thinking.

Getting rid of people will never be nice, but some firms are doing it as un nastily as they can. They make it clear from the start that their employees need to keep their skills up to date and their options open: in short, that they cannot count on a permanent job. They use their own kindly people, or bring in professional "outplacement" companies, to give advice to employees who are being told to go. They try to keep work teams intact, so as to minimise disruption and demoralisation. And they try to ease the pain. Navcon, a Californian defence contractor, asks those who survive a downsizing to make a point of helping those who leave. They also seek to tackle "survivors' guilt". Michigan National Bank encourages the survivors to get involved with local charities.

The language of downsizing is a nasty mix of pseudo-science and euphemism. These days you can be "rightsized", "displaced", even "put into the mobility pool". The reality is wrenching, even for those who have the luck to jump to another well-paid job. And some of the consultants who make a living from the business have all the moral dignity of ambulance-chasing lawyers. But European and Japanese managers will have to learn to live with downsizing over the next decade or so. Studying the American experience, however distasteful much of it sounds, makes better sense than flying by the seat of your pants.