DOWNSIZING AND THE NEW WORK COVENANT

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Corporate downsizing remains the most pervasive yet unsuccessful organizational improvement strategy in the 1990s business world. Instead of the exception practiced by only a few organizations in trouble, downsizing has become the norm. It is still rare to go a week without reading about one more firm's massive layoff, restructuring, or downsizing effort in the national news. Almost no company, especially those of medium and large size, has avoided downsizing in the last ten years. A 1995 study of six industrialized countries (Canada, France, Germany, Great Britain, Japan, and the United States) found that more than 90 percent of the firms had downsized, and more than two-thirds were planning to do it again.(1) It is estimated that only 20 percent of higher education institutions are financially solvent, and downsizing in colleges now matches or exceeds the incidence in many industries.(2)

The trouble is, little evidence exists that downsizing as a strategy for improvement is successful. For example, two thirds of companies that downsize end up doing it again a year later, and the stock prices of firms that downsized during the 1980s actually lagged industry averages in the 1990s.(3) One survey found that 74 percent of senior managers in downsized companies said that morale, trust, and productivity suffered after downsizing, and half of the 1468 firms in another survey indicated that productivity deteriorated after downsizing.(4) A majority of organizations that downsized in a third survey failed to achieved desired results, with only 9 percent reporting an improvement in quality.(5)

Evidence suggests, in other words, that quality, productivity, and customer service often decline over time, and financial performance--while frequently improving in the short-run after downsizing due to promised savings and lower costs--erodes over the long-run. Whereas most firms enjoy an immediate increase in stock price after a downsizing or restructuring announcement, but no more than one year later those gains have eroded compared to industry averages.(6)

Despite the fact that downsizing is still a common strategy for increasing shareholder value and firm profitability, the desired results don't always follow. One study compared the difference between companies that achieved increased profitability as a result of revenue growth versus those that cut costs to improve financial performance. Firms that achieved higher than average profitability (compared to the industry average) by means of revenue enhancement measures achieved an annual market value growth of 15 percent. Firms that achieved higher than average profitability by means of downsizing (i.e., reducing costs) achieved an average market value growth of 11 percent. The market, in other words, places a higher value on companies that improve their bottom lines through revenue growth as opposed to through downsizing.(7)

In health care organizations, the results are similar. In a study of 281 acute care hospitals, for example, all of which reduced headcount through downsizing, mortality and morbidity rates were 200% to 400% higher in the facilities that downsized by means of a traditional across-the-board reduction methods. That is, patient deaths were significantly higher when downsizing occurred by eliminating jobs as the chief approach

to downsizing, and when reductions occurred by announcing a certain percentage cutback.[8] The cost savings associated with downsizing in these hospitals dissipated in 12 to 18 months, and costs rose again to pre-downsizing levels in a relatively short time.[9]

The Traditional Work Covenant

Empirical research on organizational downsizing suggests that one of the primary reasons these negative effects occur is that downsizing violates a long-standing, implicit work covenant between the organization and its employees.[10] That traditional work covenant includes assumptions that hard work, loyalty to the firm, extra-mile effort, and excellent performance will be rewarded with monetary compensation, long-term employment, and personal recognition. In other words, if I give my all to the organization, if I add value to the enterprise, if I achieve my objectives, I expect that the organization will continue to value me, that I'll remain employed, and that I'll be recognized and rewarded. If I am laid off despite my best efforts, that covenant is violated. In other words, when the organization eliminates employees' jobs, irrespective of their value-added performance, a set of negative, dysfunctional attributes emerge in organizations which are referred to as "the dirty dozen."[11] Employee responses to this covenant violation negatively affect the organization's performance, often in unmeasurable and undetected ways. In previously published work, my colleagues and I reported a series of attributes that we identified in most organizations that engage in downsizing or that face declining marketshare or revenues. We labeled these attributes "the dirty dozen," and they are summarized in Table 1.

Insert Table 1 here

In brief, we discovered that when most organizations engage in downsizing or experience the need to downsize, the "threat-rigidity response" tends to occur. That is, when organizations as well as managers experience threat, they become rigid, they hunker-down, and they become turf-protective. They react first with conservative, across-the-board directives. Communication channels become constricted, and generally only good news is passed upward since stories are well-known of messengers getting shot who bore bad news. The emergence of organized, vocal, special interest groups increases the levels of politicking and conflict among organization members, so employee morale suffers. A "mean mood" overtakes the organization. Slack resources (such as contingency accounts, reserves, or new project funds) are eliminated, but this sacrifices flexibility and the ability to adapt to future changes. Savings are used to meet operating expenses. An escalation of centralized decision making occurs where top managers increase their control over a decreasing resource pool, and mistakes become both more visible and less affordable. Lower level employees become increasingly fearful of making important (or risky) decisions without the approval or sign-off of upper management. This centralization leads to scapegoating of top leaders, however, as the frustrations and anxieties of organization members mount. (The team is losing so we

blame the coach.) The credibility of the top leaders suffer because of their implied failure to avoid the painful circumstances the organization is experiencing, so it becomes more and more difficult to lead the organization. A short-term orientation predominates so that long-term planning, as well as innovation--inherently costly and risky--is abandoned.

The point is, we found that violating the traditional work covenant by downsizing almost always produces these negative effects in organizations. Few firms (or government agencies, educational institutions, or health care organizations, for that matter) avoid them. That's because the traditional work covenant has been replaced by an alternative work covenant. The alternative covenant reads something like this:

The Alternative Work Covenant

> *When you come to work for our organization, you must understand that you are expendable. We don't want to fire you, but we will if we have to. Competition is brutal, so we must redesign the way we work so we can do more with less. We can't guarantee that you will have a job in the future because, after all, escalating competition and stockholder demands create enormous cost pressures on the firm. We're sorry, but that's just the way it is.*
>
> *Oh, by the way, one more thing. People are our most important asset, and we think you're invaluable. Your devotion to our company and to our customers is the key to our success. We are dependent on you to be innovative, risk-taking, committed to company goals, and a real team player. Hard work and extra-mile effort are what we need from all our employees. OK?*

In other words, the alternative work covenant that has been established as a result of downsizing has led to a more one-sided arrangement. It doesn't seem quite fair to employees, on the one hand, to have the company expect high performance and loyalty to the firm with no guarantees of long-term rewards or security. On the other hand, organizations are caught in a equally uncomfortable quandary. Incredible cost pressures, escalating domestic and off-shore competition, and constant technological innovation providing cheaper automated alternatives demand that employment levels not stay the same. It is a well-accepted fact that most medium and large size organizations are full of redundancies, inefficiencies, and excess employees.[12]

What, then, is a solution to this seemingly intractable dilemma? How can organizations remain viable, improve their efficiency, increase their productivity, and, at the same time, not create the problems resulting from the "dirty dozen?" How can employees receive fair treatment when the need to reduce jobs is unremitting?

The New Work Covenant

One answer lies in the formulation of a new work covenant between the organization and its employees. Since a central problem with the modern alternative work covenant is that it is one-sided and patently unfair to employees, the challenge is to identify a way in which both the organization and the employees receive equitable

treatment as well as desired benefits. That is, the organization must receive commitment and high levels of performance from its employees while, at the same time, employees must receive a return on their investment in the organization.

This new work covenant should read something like this:

In this organization, we cannot guaranteed that you will have life-long, and maybe not even long-term, employment. We wish we could, but the realities of the modern competitive environment make it impossible. Moreover, you are at risk if the organization is at risk. The organization must thrive for you to thrive. You are also at risk if you are not improving. We expect you to continually improve on your current competency and performance levels. Further, you must add value to the firm and to those with whom you work. Your value must exceed your cost.

In turn, while you are employed, you will receive (1) clearly articulated expectations--you'll not fail because you are not clear about what is expected of you; (2) dignity and respect--we will ensure an environment with fairness, honor, and an absence of harassment; (3) opportunities for learning--you will be smarter when you leave here than when you started; (4) skill development and training opportunities--you will be more competent and capable when you leave here than when you started; (5) sufficient resources to do your job--you will not fail because you do not have the needed equipment, space, time, or financial resources; (6) fair pay for performance--it may not be the highest in the industry, but it will be equitable and mutually satisfactory to you and the organization; (7) coaching--you will have models and mentors who will assist you to perform at the highest levels of your potential; (8) honest feedback--you will know how you are doing and how you can improve, and you will have opportunities to express concerns and make suggestions; (9) opportunities for advancement and progression--this may not be hierarchical promotion because there may be no levels in the hierarchy to move up to, but the opportunities will help you grow, expand your talents, and provide satisfaction; (10) continued employability--we will guarantee that if you leave here you will find employment someplace else if you desire it, and that you will be more employable than when you started. We promise you, in other words, that you will receive enough information to allow you to make informed choices, to contribute, to grow, and to plan for your own future. And, at the end of the day, we're even.

This new covenant is not only more fair to employees, but it highlights the important responsibilities of employees to achieve more than they were required to achieve before. Both the employee and the organization are better off as a result of this new covenant. That is, employees are required to continually improve, to add value to the organization, and to contribute to the welfare of their fellow employees. These responsibilities were unacknowledged and usually not fulfilled under the traditional work covenant. This is because the expectation under that covenant was merely that employees would show up everyday and put in a full day's work. If they did that, their responsibility was fulfilled. The new work covenant, on the other hand, requires improvement, providing measurable contribution, and assisting colleagues at work.

The organization, in turn, guarantees an investment in human dignity and assistance in the improvement process. Life-long (improved) employability, not necessarily employment, is assured. The organization invests in individuals as human resources to be developed, rather than treating them as human liabilities to be cut back. At the end of the day, not only are the employees and the organization even, but everyone is also better off.

Table 1 **Negative Attributes Associated with Downsizing (The "Dirty Dozen")**

ATTRIBUTE	EXPLANATION
Centralization	Decision making is pulled toward the top of the organization. Less power is shared.
Short-term, crisis mentality	Long-term planning is neglected. The focus is on immediacy.
Loss of innovativeness	Trial and error learning is curtailed. Less tolerance for risk and failure associated with creative activity.
Resistance to change	Conservatism and the threat-rigidity response lead to "hunkering-down" and a protectionist stance.
Decreasing morale	Infighting and a "mean mood" permeates the organization.
Politicized special	Special interest groups organize and become more interest groups vocal. The climate becomes politicized.
Nonprioritized cutbacks	Across-the-board cutbacks are used to ameliorate conflict. Priorities are not obvious.
Loss of trust	Leaders lose the confidence of subordinates, and distrust among organization members increases.
Increasing conflict	Fewer resources result in internal competition and fighting for a smaller pie.
Restricted communication	Only good news is passed upward.

	Information is not widely shared because of fear and distrust.
Lack of teamwork	Individualism and disconnectedness make teamwork difficult. Individuals are not inclined to form teams.
Lack of leadership	Leadership anemia occurs as leaders are scapegoated, priorities are unclear, and a siege mentality prevails.

SOURCE: Cameron, Kim, and Whetten, 1987.

FOOTNOTES

(1) From a survey conducted by Wyatt Associates, reported in the Wall Street Journal, 1996.

(2) Kim S. Cameron and John R. Smart (1998) “Maintaining effectiveness amid downsizing and decline in institutions of higher education**.”** Research in Higher Education, (in press).

(3) Steven Pearlstein (1994) "Corporate cutbacks yet to pay off." The Washington Post, January 4. B6.

(4) Ronald Henkoff (1990) "Cost cutting: How to do it right." Fortune, April 9. 17-19; and A. Bennett (1991) "Downsizing doesn't necessarily bring an upswing in corporate profitability." Wall Street Journal, June 6. B1, B4.

(5) Ibid.

(6) Workplace Trends and USA Today, 28 October 1991, p. 3B.

(7) Dwight Gertz and (1996) Grow to be Great: Breaking the Downsizing Cycle.

(8) Kim S. Cameron, Sarah J. Freeman, and Aneil K. Mishra (1993) "Downsizing and redesigning organizations," In George P. Huber and William H. Glick (eds) Organizational Change and Redesign, 19-63. New York: Oxford University Press.

(9) Emmett C. Murphy, (1994) Strategies for Health Care Excellence. Printed in cooperation with the American Society for Work Redesign, Washington DC, pages 8-10.

(10) See evidence reviewed in Kim S. Cameron (1997) “Techniques for making organizations effective: Some popular approaches.” In Enhancing Organizational Performance: Issues, Evidence, and Techniques. Washington DC: National Research Council.

(11) Kim S. Cameron, Myung U. Kim, and David A. Whetten (1987) “Organizational effects of decline and turbulence.” Administrative Science Quarterly, 32: 222-240; And Kim S. Cameron, David A. Whetten, and Myung U. Kim (1987) Organizational dysfunctions of decline.” Academy of Management Journal, 30: 126-138.

(12) Kim S. Cameron (1995) “Downsizing, quality, and performance.” In Robert E. Cole (ed.) The Death and Life of the American Quality Movement. New York: Oxford University Press; Kim S. Cameron (1994) "Strategies for successful organizational downsizing." Human Resource Management Journal, 33: 189-212;

Kim S. Cameron, Sarah J. Freeman, and Aneil K. Mishra (1993) "Downsizing and redesigning organizations," In George P. Huber and William H. Glick (eds.) Organizational Change and Redesign, 19-63. New York: Oxford University Press; Kim S. Cameron, Sarah J. Freeman, and Aneil K. Mishra (1991) "Effective organizational downsizing: Best practices and apparent contradictions." Academy of Management Executive, 5: 57-73; and Robert Tomasko (1987) Downsizing: Reshaping the Corporation for the Future. New York: AMACOM.

THE TRADITIONAL WORK COVENANT

We expect our employees to work hard, to display loyalty to the firm, to expend extra-mile effort, and to achieve excellent performance. We expect them to give their all to the organization, to add value to the enterprise, to achieve the objectives established jointly with the organization. In turn, the organization will reward them with monetary compensation, with personal recognition, and with continuity in employment.