The Role of Corporate Ownership on Downsizing Decision Making

Ioannis N. Katsikis
Management Science Laboratory, Department of Management Science and Technology
Athens University of Economics and Business
ioannis@aueb.gr

Abstract
While downsizing has been widely studied, its connection to firm ownership status and the reasons behind it are missing from extant research. This paper aims to close this gap by exploring the differences on downsizing behaviour depending upon the different ownership status of firms: stock versus privately held firms, foreign versus domestic firms, state-owned versus private companies and family owned versus non-family owned firms. By reviewing the literature on recent empirical work, we find that family firms downsize less than non-family firms, irrespective of performance. The findings suggest that the extent of family ownership decreases the likelihood of deep job cuts. We conclude that family owners provide patient capital and have a strong long-term perspective.

Keywords: ownership, downsizing, decision making.

JEL Classifications: L25, G34, G32.

Introduction

During the last decades, downsizing has been utilized widely by firms as a strategic choice (Stavrou et al., 2007; Chadwick et al., 2004; De Meuse et al., 2004) in order to improve operating efficiency (Chadwick et al., 2004; Nixon et al., 2004). Even though, there are many different ways to downsize a firm, in the majority of cases downsizing involves extensive layoffs (Greenberg, 1991; Greenhalgh and McKersie, 1980; McCune et al., 1988). As Stavrou et al., (2007) highlight, in the case of downsizing, the layoff of some people is an essential prelude to “rightsizing” the company so that it can invest in innovations that will make the remaining labour force more competitive (Lazonick, 2003). In any case though it’s a difficult process that has to be designed and executed very carefully and its effect will be very much dependent on the strategy that will be followed.

While various aspects of the downsizing process have been widely studied, their connection to firm ownership status and the reasons behind it are missing from the literature. This paper aims contribute in closing this gap by exploring the differences in downsizing behaviour depending upon the different ownership status of firms: stock versus privately held firms, foreign versus domestic firms, state-owned versus private companies and family owned versus non-family owned firms. The findings suggest that the extent of family ownership decreases the likelihood of deep job cuts while corporate firms downsize less than non-family firms, irrespective of performance. We conclude that family owners provide patient capital and have a strong long-term perspective.

Downsizing: the Role and Use

Downsizing can be empirically defined as deep job cuts (above 5%), Block, (2008, p.18). When sales and profits fall, downsizing and cost-cutting are usually among the first management reactions. As examples, we can consider a wide number of firms, including Xerox, Boeing, Merck & Co, Toshiba and Sony Ericsson which announced job cuts of 5%, 6%, 12%, 20% and 30% of their workforce, respectively, in the wake of the recent financial crisis (Uchitelle, 2008, Vasileiou & Katsikis, 2009). All firms refer to a slowdown in profits and sales as the main reason for the job cuts.

Theoretically, downsizing occurs when the corporation permanently reduces its employment level without necessarily abandoning a product market, process, activity or geographic location (Lazonick, 2003). Cameron (1994), gives a more comprehensive definition of downsizing: it involves reduction in personnel through different personnel-reduction strategies, it is focused on improving the effectiveness of the organization as it represents a set of activities targeted at organizational improvement and finally downsizing affects work processes because when workforce contracts, fewer employees have to deal with the same amount of work and this has an impact on what work gets done and how it gets done.

Types of Downsizing

According to Cameron (1994) downsizing can be implemented in three distinctive types. The first type focus mainly on eliminating headcount or reducing the number of employees in the workforce through early retirements, transfers, golden parachutes, layoffs or firings. These strategies are usually implemented immediately via top-down directive and could have a big negative impact in the performance of the company since critical skills will be lost when employees leave. The main advantages of these actions, in addition to providing an immediate shrinkage, are to capture the attention of members of the organisation to the serious condition that exists, to motivate cost savings in day-to-day work, and to create readiness in the organisation for further change. These strategies will have a short term negative bottom line effect before the full positive effect appears in the long term in the income statement.

According to the same author, (Cameron, 1994) the second type of downsizing is the work redesign strategies whose aim is to reduce work and consequently reduce the number of employees. These strategies cannot be implemented quickly as they require some advanced analysis of the areas to be redesigned. These strategies assure that changes are targeted at work processes and can achieve a greater degree of efficiency because of the simplified structure of the downsized company.

Systematic strategies are, finally, the third type of downsizing. This type focuses on changing the organisation’s culture and redefines downsizing as an ongoing process and as a basis for continuous improvement aiming in are simplifying all the aspects of the organisation (Cameron, 1994). Within this type of downsizing, employees are defined as resources to help generate and implement downsizing ideas instead of being the first target for elimination. Such strategies are considered to have a long term perspective and may not generate the bottom line effect that workforce reduction strategies will.

The shock strategy of workforce reduction may be inevitable in the face of an economic crisis, but the short-term payoffs are usually negated by long-term costs according to Cameron (1994). Furthermore, such a tactic might lead to a loss of loyalty and commitment among the workforce and an alienation from the general goals of the company. On the other hand the systematic strategies have as objective to avoid, over the long term, the need to implement workforce reduction strategies. These three strategies are not mutually exclusive.

The Impact of Downsizing

The impact of downsizing has to be examined from different aspects and it differs a lot according to the perspective of the different agents in the firm. There is a conflict of interest between the different agents, management, employees, stakeholders for example (Lai and Sudarsanam, 1997). Evidence from Cameron (1994) showed that 74 percent of senior managers in downsized companies said that morale and trust suffered after downsizing and also productivity was not increased after downsizing. On the other hand Chen et al., (2001) show that the performance of the company, translated in bottom line figures, has been improved. One is sure that when the downsizing is inevitable. It has to be implemented in such a way that the outcomes are maximized for all the different parts in the company.

Additionally, the actual impact of downsizing on the organisation is dependent on many different factors apart from the strategy that is followed. As one expected the shock strategies of workforce reduction have a lower impact on effectiveness than the carefully designed downsizing strategies. Cameron (1994) provides a comprehensive list of best practices that could turn downsizing into a successful operation. Factors that would influence the outcome of a downsizing strategy include the reward schemes for the employees staying back in the company, the communication of the goals of the management, the trust. According to Mishra (1996) layoff is an organizational crisis since it’s a major threat to a system survival and the positive or negative outcomes that follow the crisis depend on the nature of organizational behaviour during crisis. Organizational performance may increase rather than decrease during crisis if the management inspires trust to the employees, giving trust four dimensions: competence, openness, concern and reliability.

Chen et al., (2001) found that layoffs are followed by significant improvements in stock market and earnings performance. They argue that there is no evidence that layoff announcements are followed by reduced total employment in the subsequent three years; furthermore, they find evidence of improving profit margins and improved labour productivity following layoffs. Finally, they confirm with their findings that layoff firms tend to increase corporate focus and they support the view that a layoff decision is a rational response to ensure corporate survival.

In more detail Chen et al (2001) found evidence that operating performance as measured by earnings before interest and taxes also improves following layoffs. Their evidence points to both employee productivity gains and margin improvements as the source of the performance improvement. These results do not support the belief that firms that layoff employees ultimately hurt themselves. They find no evidence that layoff announcements are followed by reduced total employment at the firm. While employment figures do decline in the year of the layoff, they recover to pre-layoff levels three years later. Firms temporarily cut capital expenditure along with the layoffs; however, both capital expenditure and the ratio of capital expenditure per employee are significantly higher by the third year following layoff decisions than in any previous year. They also find evidence of an increase in corporate focus as measured by the number of business segments the firm reports for accounting purposes. Given recent evidence that corporate focus is value increasing for shareholders, such action is consistent with the view that layoffs form an important component of restructuring by poorly performing firms.

Empirical Research on the Relationship between Ownership and Downsizing

The role of ownership seems to be critical importance in the in the corporate downsizing decision making process as this factor lead to a different behaviour. Although of great importance, only little empirical work has been done on the relationship between the ownership of the firm and its decision for downsizing. As Vicente-Lorente and Suárez-González, (2009, p.1614), argue that ownership has received scarce attention even though it exerts a meaningful influence on the firm strategy as a whole, and consequently on downsizing behaviour employees. In their empirical work, Vicente-Lorente and Suárez-González, (2009), use a sample of large Spanish firms (1990–1998) in order to confirm that stock firms and state-owned firms engaged in a privatization process are more likely to downsize than privately held domestic companies. They found less conclusive results about the downsizing behaviour of foreign firms.

As Vicente-Lorente and Suárez-González (2007) highlight, the extant empirical studies on downsizing determinants differ widely in methods and theory, which complicates any attempt to develop comprehensive models. However, these heterogeneous pieces of research suggest that downsizing is the outcome of a process that involves techno-economic, institutional and socio-cognitive factors (McKinley et al. 2000). These theoretical explanations summarize most of the arguments in the empirical literature that have been forwarded to justify the role of downsizing predictors.

In the following paragraphs, we shall develop our review and discuss the relationship between the following ownership schemes based on a review of empirical studies:

- state-owned versus private firms,
- stock versus privately owned firms,
- foreign versus domestic firms,
- family owned versus non-family owned firms.

Stock versus Privately Owned Firms

Downsizing practices have spread among firms worldwide even though the benefits appear to be unclear. In their empirical study, Vicente-Lorente and Suárez-González (2007) argue that state owned companies that are going to be privatized are more likely to adopt downsizing practices than privately held firms.

State versus Private Owned Firms

In their empirical study, Vicente-Lorente and Suárez-González (2007) found strong support for the organizational decline factors (such as drops in demand, low labour productivity, profitability and liquidity) as robust determinants of downsizing among the largest Spanish firms. Their findings also reveal the existence of an “imitation effect” that can affect the spread of this strategy. In addition, some ownership traits play an important role in the downsizing behaviour of large firms. The same authors (Vicente-Lorente and Suárez-González, 2007) argue that state owned companies that are going to be privatized are more likely to adopt downsizing practices than privately held firms. The evidence supporting that foreign firms depict an enhanced proclivity to downsize appears to be weak and seemingly temporary.

Foreign versus Domestic Owned Firms

The empirical design of relevant studies (eg. Vicente-Lorente and Suárez-González, 2007) has been unable to disentangle the ultimate underlying drivers of downsizing. This becomes clear in the case of foreign-controlled companies, in which legitimacy and short-term thinking are both reasons for these firms to be more active in downsizing decisions. The evidence supporting that foreign firms depict an enhanced proclivity to downsize appears to be weak and seemingly temporary. Nonetheless, their findings can be seen as a source of compelling research questions and future empirical work in this issue.

Family versus non-family Owned Firms

Using agency and stewardship theory, Block (2008, p.18) argued that both family ownership and family management, which are two dimensions of family firms, reduce the likelihood of making deep job cuts. In his paper he extends the literature on the relation between family firms and their employees. Contrary to most other studies, his paper’s findings relate to different types and dimensions of family firms. The main finding is that the impact of family management and the extent of family ownership have different effects. Family ownership is found to reduce the likelihood of downsizing, while family management does not. These results indicate strong differences regarding social responsibility within the population of family firms, differences that should be accounted for in further studies.

Additionally, Stavrou et al. (2007) found that family firms are less likely to downsize than their non-family counterparts and that financial performance is not part of their decision-process. Differently, the layoff ratio of non-family businesses is negatively related to performance. Can we, then, infer that family owned or controlled firms follow Berman et al.’s (1999) intrinsic stakeholder relationship model when managing their employees while their non family counterparts espouse Berman et al.’s (1999) strategic stakeholder relationship model? If that is the case, should we go a step further and postulate that – on the basis of Freeman’s (1984) logic that a company’s relationship with stakeholders is crucial in understanding how it operates and draws value from stakeholders – their reduced willingness to downsize is related to their intrinsic commitment towards their employees as stakeholders, expressed in the form of employee and community-friendly approaches.

In their recent paper, Stavrou et al., (2007) found support for the negative family business/downsizing relationship beyond profitability considerations. In summary, the same authors suggest that if a family firm unwillingness to downsize is indeed ingrained into their value system – as part of their identity – and goes beyond immediate performance considerations, then it would be reasonable to accept that family firms do espouse Berman et al.'s (1999) intrinsic stakeholder orientation model. However, given the idiosyncrasies of a family firm's value system, future work can further explore the relationship between downsizing and family status by directly considering proxies describing the basic parameters of this value system.

Conclusion and Discussion

While downsizing has been widely studied, its connection to firm ownership status and the reasons behind it are missing from relevant literature. This short paper aimed to explore the differences in downsizing behaviour depending upon the different ownership status of firms: stock versus privately held firms, foreign versus domestic firms, state-owned versus private companies and family owned versus non-family owned firms.

In the following table we exhibit the results of our review on the role and the effect of ownership on the corporate downsizing behavior. As it is obvious findings from a variety of recent empirical studies proves that ownership does matter when firms undertake downsizing strategies and whether they may have strong or weak tendency to downsize.

Table 1: The Role of Ownership on Downsizing Behavior

Ownership status	*Downsizing behavior*
State owned	Strong
Private firms	Weak
Stock listed firms	Strong
Non-stock listed	Weak
Foreign owned	-
Domestic owned	-
Family owned	Weak
Non-family owned	Strong

By reviewing recent empirical work, we found that family firms downsize less than non-family firms, irrespective of performance. The findings suggest that the extent of family ownership decreases the likelihood of deep job cuts. Thus, we conclude, family owners provide patient capital and have a strong long-term perspective.

References

Berman S.L., Wicks A.C., Kotha S. and Jones T.M., (1999), Does Stakeholder Orientation Matter? The Relationship between Stakeholder Management Models and Firm Financial Performance, Academy of Management Journal 42(5), pp. 488–501.

Block, J.H., (2008), The Impact of Family Ownership and Family Management on Employment Downsizing: Evidence from S&P 500 Firms, Available online at SSRN: http://ssrn.com/abstract=1096533

Cameron K., (1994), Strategies for Successful Organizational Downsizing, Human Resource Management, Vol. 33 (2), pp. 189-211

Chadwick C., Hunter L.W. and Walston S.L., (2004), Effects of Downsizing Practices on the Performance of Hospitals, Strategic Management Journal 25(5), pp. 405–427.

Chen P., Mehrotra V., Sivakumar R. and Yu W., (2001), Layoffs, Shareholders' Wealth, and Corporate Performance, Journal of Empirical Finance 8, pp. 171–199

De Meuse K.P., Bergmann T.J., Vanderheiden P.A. and Roraff C.E., (2004), New Evidence Regarding Organizational Downsizing and a Firm's Financial Performance: A Long-term Analysis, Journal of Managerial Issues 16(2), pp. 155–161.

Donaldson G., (1994), Corporate Restructuring, Managing the Change Process from Within, Harvard Business School Press, Boston

Greenberg E.R., (1991), Downsizing: AMA Survey Results, Compensation and Benefits Review 23(4), pp.33–37.

Greenhalgh L. and McKersie R.B., (1980), Cost Effectiveness of Alternative Strategies for Cutback Management, Public Administration Review 40, pp.575–584.

International Monetary Fund, (2009), World Economic Outlook, January 2009

Lai J. and Sudarsanam S., (1997), Corporate Restructuring in Response to Performance Decline: Impact of Ownership, Governance and Lenders, European Finance Review, Volume 1, pp. 197-233

Lazonick W., (2003), Corporate Restructuring, The Oxford Handbook of Work and Organization, Oxford University Press

McCune J.T., Beatty R.W. and Montagno R.V., (1988), Downsizing: Practices in Manufacturing Firms, Human Resource Management 27(2), p.145.

McKinley W., Zhao J. and Rust K.G., (2000), A Sociocognitive Interpretation of Organizational Downsizing, Academy of Management Review 25(1), pp. 227–241.

Mishra A., (1996), Organizational Responses to Crisis: The Centrality of Trust, Kramer, Roderick M. and Thomas Tyler (eds.) Trust in Organizations, Newbury Park, CA: Sage, pp. 261-287

Nixon R.D., Hitt M.A., Lee H.U. and Jeong E., (2004), Research Notes and Commentaries: Market Reactions to Announcements of Corporate Downsizing Actions and Implementation Strategies, Strategic Management Journal, 25(11), pp.1121–1129.

Rust K.G., McKinley W., Moon G. and Edwards J.C., (2005), Ideological Foundations of Perceived Contract Breach Associated With Downsizing: An Empirical Investigation, Journal of Leadership and Organizational Studies, Vol.12, pp. 37 - 52.

Singer G. and Halsall C., (2002), Restructuring Marketing Spending to do More with Less, McKinsey & Company Marketing Practice.

Stavrou E.; Kassinis G. and Filotheou, A., (2007), Downsizing and Stakeholder Orientation Among the Fortune 500: Does Family Ownership Matter? Journal of Business Ethics, Vol.72 (2), pp. 149-162

Uchitelle, L. (2008). U.S. Layoffs Increase as Businesses Confront Crisis. International Herald Tribune (online version), October 26th, 2008

Vasileiou N. and Katsikis I., (2009), Restructuring an International Company: The Case of Sony Ericsson, “6th Conference on Management Science, Technology and the New Economic Environment”, 8th May 2009, Athens, Greece.

Vicente-Lorente J.D. and Suárez-González I., (2007), Ownership Traits and Downsizing Behaviour: Evidence for the Largest Spanish Firms, 1990—1998, Organization Studies, Vol.28, pp. 1613 - 1638.