



Center for
Applied
Research

1600 John F. Kennedy Blvd.
Suite 600
Philadelphia, PA 19103
215.320.3200 tel
215.320.3204 fax
center@cfar.com

1030 Massachusetts Ave.
Suite 330
Cambridge, MA 02138
617.576.1166 tel
617.576.3015 fax
center@cfar.com

Briefing Notes:
The Timing and Depth of Cuts

The financial crisis challenging today's global economy reverberates in daily headlines about layoffs, deficits, bailouts, relief packages, and foreclosures. The stock market sways on its very foundations. Companies are rushing to restructure their operations as the economic climate gives new meaning to the "tyranny of the urgent."

The asymmetry of planning processes for expansion and downsizing is evident in the frequency with which managers are asked to make significant cuts within extremely short time periods with little planning, yet are rarely given directives to expand over comparably short periods without a plan. The decisions surrounding the timing and depth of cuts are difficult. Is a single, quickly taken, deep cut the best approach, or is a slow, more careful process less destructive to the long-term health of the overall enterprise? How do managers balance what's strategically important for the long term with the urgencies of the present? Is it possible to effect valuable organizational transformation while maintaining stability in white water conditions?

In our research, we have seen success in both quick and slow cuts. The key to success seems to be a strategic conception that drives the cuts and gives them a "face validity"—that is, they appear sensible even to those who are painfully affected.

One firm that implemented a 45% cut in its management ranks developed the plan during negotiations with an outside buyer who insisted on one deep cut. Few were involved in the planning. Immediately after the sale was completed the senior management put the plan into effect, laying off an entire layer of middle management, eliminating many staff functions, and widening spans of control.

A senior manager described the cuts as informed by a "knowledge of anatomy"—those making the cuts knew the firm well and had been restructuring it over a year-long period under considerable constraints from the corporate level. This sale was a retrenchment opportunity, though the buyer specified a cut about 10% deeper than management was comfortable with. The company rebounded quickly, however, because of the work that needed to be done, and because those remaining could see a logic to the decision.

The communication of the rationale gave employees a clear sign regarding how their behavior in the future might be linked to their survival. Without this understanding, retained employees feel at risk of some random process. Furthermore, putting the firm's back to the wall paradoxically reduces the major post-cut anxiety—when will the next round come? The firm will either turn around or everyone will be dismissed.

Human Resource Needs

A successful long-term retrenchment process was employed by a utility facing a two-year period of deregulation. Senior management realized that the company was overstaffed to be profitable in a more competitive environment. A high-level task force intensively studied the human resource needs of the major divisions, and reported its findings to each division manager. The division managers, in turn, submitted head-count reduction plans to senior management with timetables and specific targets.

The original committee then assumed a new role: overseeing the implementation process and trouble-shooting on critical issues, such as readjusting salary scales and designing new career paths. A commitment to downsize without involuntary separation, using attrition, aggressive outplacement, and transfers, was a critical feature of this process.

First Signs of Trouble

In several cases, we have seen the damaging effects of a series of cutbacks. At first signs of trouble, senior managers often are reluctant to confront the limits of the current implicit or explicit strategic plan; they begin with expense controls, job freezes, and elimination of frills, thereby hedging the need for deeper cuts. This has a number of negative consequences.

First, hedging undermines leaders by sending a signal that they will not or cannot take risks. If the trouble signs are apparent throughout the organization—increasing inventory, reduced sales, industry-wide rumors—subordinates begin to wonder if the leaders are really in touch with the problem. The effects of a business crisis on morale, productivity, and performance will be heightened if employees do not feel that senior management has taken charge. What, to the top, may be justified as “keeping options open” is experienced by the middle and bottom as vacillation. The perspectives of senior management and unit managers vary greatly. For example, to the top, thinking through a portfolio of options about plan consolidation—a number of alternative figures—is desirable; to the staff associated with each of these units, it's not a portfolio of options but their jobs that are at stake.

In one case, an organization did not adequately rethink the strategic plan, and yet had to make cuts based on instructions from a higher level. The first response was to control expenses and to implement a small cut. Those laid off were treated fairly. Those remaining felt positively about the cuts—the organization was leaner, had pared down some poor performers, and was now ready to meet business challenges.

Only six months later, the organization was faced with deeper cuts and a plan consolidation, and still lacked a meaningful product strategy. This cut was devastating to morale. Employees could not see legitimate differences between themselves and those laid off. Instead of feeling chosen, retained employees did not understand the criteria for severance and feared future cuts. Engineers who were retained, but whose projects had been eliminated, left voluntarily in high numbers after the cut. The mistrust between middle and top management grew significantly.

The lessons we draw from these cases and others we studied follow.

Use the initial pressure to cut as a trigger to rethink and further develop the strategic plan, rather than take short-term steps to buy time.

Short terms steps often have the counter-productive effect of reducing the pressure to confront the overall plan. If small cuts are being contemplated, imagining a contingency of much deeper cuts can clarify everyone's thinking. Then, at least, the initial response is taken in the context of where the organization might have to go if the economic threats escalate.

Err on the side of over-cutting rather than under-cutting.

Post-cost revitalization is significantly enhanced by understaffed settings. Many unnecessary, bureaucratic tasks fall away, and the challenge of essential work can reduce worry and anxiety.

Avoid across-the-board strategies.

A desire to be fair and to avoid conflict can frequently lead to across-the-board approaches. However, they rest on the highly improbably assumption that all units are operating with equal effectiveness and will weather cuts similarly. Further more, across-the-board approaches do not convey any information about the relative importance of different functions or tasks to the firm's survival.

Challenge of Downsizing

If we look more broadly at the challenges facing the global business community—and especially in the United States, under a new administration—we see that the primary task of business leaders over the next months and years will be to manage highly uncertain transitions in which there will be substantial dislocations—winners and losers. The leaders who will be effective in coping with these long-term challenges may well be those who have viewed the challenge of downsizing as the leading edge of transformation, not simply a business cycle problem.

Adapted from Gilmore and Hirshhorn, “The Timing and Depth of Cuts.” *Directors & Boards*, Spring 1984.

For more information on this or related materials, contact CFAR at center@cfar.com or 215.320.3200, or visit our website at <http://www.cfar.com>.