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THE ORGANIZATIONAL STRATEGIES AND EFFECTS OF CORPORATE DOWNSIZING DURING ECONOMY DOWNTURN: A STUDY ON SELECTED MALAYSIAN COMPANIES

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Supervisor,

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To my husband,

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whose relentless support and understanding

sustain my interest to persist - thank you.

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ABSTRACT

This paper is an evaluative assessment of organizational strategies and the effects of corporate downsizing in Malaysia. It reports the results of a study of 30 Malaysian companies that engaged in downsizing during the economic downturn. Three research questions on strategies and the effect of downsizing are probed. The questions are 1) What are general strategies used by organizations to downsize 2) What are the impact of downsizing on organizations and 3) What are the differences between organizations that downsize effectively and those that are not. This research explains three main strategies for downsizing and the impact of downsizing in terms of organizations' improvement and performance. It also discusses the managerial actions to overcome the negative effects of downsizing in addition to employee morale and attitude. Finally, comparisons of best practices' principles among successful downsizing firms are presented.

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

The Asian economy downturn occurred recently is probably deeper and broader than many previous economic downturns. It appears to be another shift in the business cycle, indicative of signs of maturity of at least a part of the economy. Traditional business costs have been under review, causing workers including managers and other white-collar workers, to be laid off. Already, in the 80s, several management gurus, including Robert Hayes and William Abernathy of Harvard Business Review, William Ouchi (advocate of Theory Z) and Tom Peters (author of In Search of Excellence) talked about new management philosophies. They advocated the need to keep organization 'lean and mean', productivity improvement, innovation through work autonomy, being customer-oriented, value based management, etc.

As a result, big international organizations began actively trimming corporate staff, slashing management layers in addition to widespread cutbacks and lowering costs to give value to the customers. More than 85 percent of the Fortune 500 companies have downsized in the last fifteen years and more so are planning in the future (Bennet, 1998; Buch, 1999). Coupled with strong overseas competition due to globalization, this trend persisted in the 90s into other organizational activities. Companies intensify payroll cost-cutting, abandon certain industries and combine advanced technology with lower cost in labor including professional labor. Employee empowerment and self-management to reduce supervision become a key management term.

The above dramatic transformation in the way companies are now managed has changed the assumptions underlying organizational performance and effectiveness in the last decades. Twenty years ago, the following four propositions were almost unassailable in the literature on management and organizations:

a) Bigger organizations are better organizations.

b) Unending growth is a natural and desirable work process.

c) Organizational adaptability and flexibility are associated with slack resources, loose coupling, and redundancy.

d) Consistency and congruence are hallmarks of effective organizations (Cameron, 1994).

Currently, however, each of these assumptions has been called into question. A new competitive and political environment which organization faces in the current decade has led to a different set of replacement assumptions that supplements the earlier assumptions. Organizations have learned the lesson that size is sometimes a liability and decide that smaller, as well as bigger, also means better. Downsizing and decline are treated as natural and desirable phases of an organizational development. This is because the need to reduce waste and inefficiency is necessary for the organization to remain healthy throughout. Adaptability, flexibility and leanness are associated with efficiency that increases speed, improve quality and lower cost. Conflict and inconsistency that were earlier treated as drawbacks are now indicatives of organizational effectiveness (Crainer, 1998).

These changes in the assumptions underlying effective organizations have been a product of and have led to downsizing as a strategy of choice for a majority of organizations in the United States. Similarly, Malaysia also shares common rationale behind such an exercise. However, one of the major reasons for massive downsizing in this country is due to the economic downturn in 1997. Most Malaysian organizations were experiencing an average of 8 percent GDP growth prior to the economic downturn (Investors Digest, 2000). However, in mid 1997, starting with Thailand, the region's economy was spiraling downward with stock markets turning bearish and businesses derailed. During the economic turmoil, Malaysia's projected GDP were considerably reduced. Apart from the measures implemented by the authorities, plenty of business organizations embarked upon cost-cutting drives, which include freezing salary, increments, bonuses, promotions and salary cuts. From banking to manufacturing sector, nearly all types of businesses are affected by the crisis (Asiaweek, 1999).

Nevertheless when the economy starting to pick up, companies are still pursuing the downsizing exercises as part of the cost reduction strategy. In the United States, for many firms downsizing is the continuation of efforts that began in the 1980s. Through this decade, firms reduced their ranks in an attempt to become more competitive. Today, firms all over the world continue the trend, attempting to cut cost quickly in order to meet demands of the global marketplace. As noted by Hamel and Prahalad (1994), downsizing for the sake of cost reduction alone has been castigated intellectually as short-sighted and neglectful of what resources will be needed to increase the revenue stream of future. Almost 80 percent of the companies in the research conducted by the Arthur D. Little Company and reported by Tomasko (1998) indicates that expense reduction as the downsized firms primary goal while the rest engaged in downsizing as part of their companies' organizational change.

With several Malaysian organizations going global and establishing overseas operations, several jobs including management and supervision are also exported or decentralized from corporate headquarters as growth begins to accelerate. Technology has brought countries closer and with the help of automation, corporate bureaucracy is minimized to a desirable level. This resulted in flattened organizational structure and further elimination of jobs (Crainer, 1998). The followings are summary of the chief objectives that are cited by most companies that have succeeding downsizing announcements.

a) Cut costs, especially overheads.

b) Increase adaptibility: Speed up decision-making, foster entrepreneurship, ease adaptation to the business cycle, etc. Efforts to trim management layers are often particularly focused on this goal.

c) Enhance a focus on the company's core competence by eliminating peripheral and superfluous positions and activities.

d) Shift some or all of an activity previously done internally to external parties (that is, by outsourcing) to neutralize any political behavior embedded by an entrenched subunit, spread risk on high-risk projects, and help knowledge and skills from the outside transferred inside the organization.

e) By doing some or all of these things, improve shareholder equity, under the assumption that the market responds positively to initiatives undertaken by firms to get lean, mean and focused (Baron & Krepps, 1999).

Presumably companies have always wanted to achieve these objectives and the following rationales are driving them do to so more ferociously now. Among the more common reasons given are:

a) Competition has intensified and is now a global scale.

b) Product life cycles have decreased, putting premium on faster response and shorter cycle times.

c) Increasingly diverse customer needs mandate more agile organizational response.

d) Escalating benefits costs especially for mature workforce and legal liabilities have made labor more expensive, favoring a less labor-intensive, more capital-intensive strategy.

e) Innovations, improvements and cost reductions in information technology have led firms to automate tasks previously done by administrative functionaries and generally reduce the need for human labor.

f) Increased capital market discipline through mergers and takeovers and other means has focused top management on short-run, bottom line performance, which often can be improved easily by cutting costs, particularly labor costs, than through other means.

g) In the case of downsizing that is tied to outsourcing, the growth of contracting services and various labor market intermediaries such as temporaries agencies and leasing firms has worsen the matter. For Malaysia corporations, these intermediaries have made it easier for the firms to the use imported labor for example, workforce from Indonesia and Bangladesh. Moreover, the rampant competition among such providers enables firms purchasing their services such as using Australian consultants for our local construction projects to impose stringent quality standards. Many labor supply firms provide guarantees that anyone they place are acceptable to the client's firm, whereas such guarantees are neither easy nor inexpensive to obtain if the client firm hires a regular or a local employee for the same activity.

h) Finally, as foreign labor market is abundant, outsourcing has become cheaper and thus more attractive because a larger segment of the labor force desires more flexibility and variety in their lives than the traditional long-term attachment of an individual to an employer affords.

Malaysian organizations that are privatized or corporatized made initial staff reduction to become lean. The organizations are expected to enhance the staff cutbacks in order to survive due to intensifying competition. It is normal for Malaysian companies to exercise downsizing if they have reached plateau in their growth and earnings could only come from cost-reductions (K. Rajkumar, 1999). As a newly appointed Chief Executive Officer of a mature company, an announcement of a cut by headcount reductions is the surest way to assure higher profit during his first year in office.

Downsizing is also a managerial response to inane incentive. For example, a division head is told that his or her performance will be assessed based on per capita sales or earnings. The denominator in the per capita is full-time equivalent regular employees. Thus, the manager is given an

1.2 Problem Statement

Previous research on downsizing in Malaysia has covered some aspects of the organizational strategies and effects of downsizing to Malaysian corporations but not in detail. More importantly, downsizing activities in Malaysia especially retrenchment of employees still prevails even right after economic downturn. The fear of another bad turn in economic cycle matters where our local cases are concerned. Economic reason aside, downsizing is still the favorable choice among corporate policy-makers' cost-reduction strategy.

The reason for this ongoing activity might be due to lack of information and literature written on the costs of Malaysia downsizing in general. Downsizing almost inevitably imposes substantial financial costs to the companies and also psychological costs on the workforce. The overall effects on the companies are seldom as rosy as management expects.

We are also guideline-deficient on what is the right way for Malaysia companies to downsize. There is insufficient research on what type of strategies need to be employed, specifically on the validity of each strategy employed by Malaysian corporations and why certain strategies should not be employed. A focused description of human resources and managerial actions to overcome the negative effects of downsizing is unsatisfactory. Whereas most companies have implemented some form of downsizing in the past decade or so, very few systematic or predictive studies have been conducted on effective strategies of downsizing and its effect.

1.3 Research Objectives

The objective of this study is to investigate the best way to downsize Malaysian organizations. In addition, it also highlights the differences between successful and unsuccessful downsizing. This research is crucial because the success of organizations that have downsized in the past has not been particularly laudable. Furthermore, examples of better practices in the management of layoffs in Malaysia corporations are not investigated. The intent of this research is to address those issues directly by reporting the results of 30 selected Malaysian companies.

1.4 *Significance of the Study*

The significance of this study is the findings from this research. It makes a manager consider when pursuing downsizing activities as part of the company human resources policy program. The findings indicate that downsizing is very costly when executed wrongly. It is likely to work better when it is part of broader initiatives and a well-conceived general strategy of restructuring the firm and its workforce. Downsizing programs that go beyond layoffs and pursue underlying organizational problems or try to exploit real opportunities are more likely to address the real problems or successfully exploit the real opportunities.

1.5 *Assumption and Limitation*

There are several assumptions, limitation and biases in this study. This research assumes that the human resources senior managers interviewed are as likely to be as well informed as any manager about overall company downsizing policies of their companies. The use of a single highly informed key informant to appraise organizational practices of each company rather than several inside observers increases the biases in this study. As a result, there is no opportunity to counter check internal consistency of the findings.

Almost all of the informants are implicated with the planning and management of the companies' policies. Still, the limitation of this study is that these executives are probably less well-informed than local plant or office managers who are involved directly with execution of downsizing activities such as layoffs and firings. Therefore, their assessments are subject to some imprecision, and this should be noted in interpreting the results of this research.

1.6 Definition of Terms

Downsizing

A variety of terms are commonly used as substitutes for downsizing in organizations, and this variety sometimes leads to confusion about what is being implemented or investigated. In this, several questions have been asked in regards to the most popular terms used in organizations. According to Dessler (2000), downsizing is reducing, usually dramatically, the number of people employed by the firm and it is being done by more and more employers. Meanwhile according to Coultar and Robbin (1996), downsizing is defined as a reduction in the size of an organization's workforce.

Both definitions, although are straightforward, does not imply a value, either positive or negative and this encompasses a wide range of possible approaches. The popular jargons employed by the managers surveyed are *'compressing, retrenching, streamlining, reengineering, renewing, redeploying and reshaping'* to describe the organization's activity. It can be said that each of these terms shares at least some common meaning, but each has its own unique connotation. What is important, however, is that to be clear about the features of downsizing that are central to its definition so that when substitute concepts are used, it is understood that they refer to the same circumstance.

Corporate Downsizing

Corporate downsizing in this paper refers to a set of activities, undertaken on the part of management of an organization and designed to improve organizational efficiency, productivity and competitiveness. It is one of the management tools for achieving desired change in an organization. Corporate strategy represents a strategy implemented by managers that affects a) the size of the firm's workforce b) the costs and c) the work processes.

Organizational Strategies

Organizational strategies in this paper refers to a general framework that provides guidance for actions to be employed by the management and, at the same time, is shaped by the actions taken. Organizational strategy emerges over time as intentions collide with and accommodate a changing reality in an organization (Mintzberg, 1994).

Economy Downturn

The economic downturn refers to the Asian economic downturn that was percipitated in July 1997 when Thailand abandoned its fixed exchange rate and floated the baht. The downward slide of foreign exchange rates of the four other Asian countries with fundamental current account deficits soon followed. By January 1998, the Indonesian rupiah had fallen by

77 percent of its value as at 1 July 1997, while the Thai baht had fallen by 53 percent, the South Korean won by 42 percent, the Malaysian ringgit by 40 percent and the Philippine peso by 38 percent (Lim, 1998). The current account surplus economies were also affected, although less severely. The Singapore dollar has fallen by 17 percent, the Taiwanese dollar by 17 percent and the Japanese yen by 9 percent.

During this time, all open economy that was surrounded by economies that were having problems was affected. There are very few economies that were not affected at that moment. Malaysia experienced a downturn of 4.5 percent in its economy. In this respect, Malaysia is not in a unique position. The downturn of the Asian economies and the large outflows of funds from the region had an impact on the Malaysian economy. This outflow of funds brought about by the herd mentality of investors caused the depreciation of Ringgit Malaysia (RM) and the collapse of the stock market. As a result, the stock market and the property market in the country showed serious decline.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This paper builds upon the findings of several studies that attempted to address the same issue. The aim of this study is to identify the best way to downsize Malaysian organizations by learning the differences between successful and unsuccessful downsizing approaches. It also tries to address the impact of each organizational strategy learned in to addition to investigate the better practices in the management of layoffs in Malaysia corporations.

2.2 The Approach to Downsizing

Freeman and Cameron (1997) labeled approaches to downsizing as having either a convergent orientation or a reorientation approach. For convergent orientation, concerns for efficiency (i.e. doing things right) dominates and the organization's mission remains unchanged, while the goal of reorientation approach is to pursue a new mission and