# Downsizing: corporate restructuring strategy

Downsizing or layoff is a widespread strategic decision and change practice since 1970’s and during the economic downturn in the year 2007 it became a more common phenomenon. In 2001 alone fortune 500 companies reportedly cut a total of 1040466 jobs and one predicts that by 2015 a further 3. 3 million jobs will be outsourced. Changing patterns in reasons cited for job loss support this impression of the rising importance of restructurings. Differences in factors such as the state of the economy and the signal sent by job loss could make the process of downsizing and the effects of job loss differ between restructurings of healthy organizations and downsizing due to financial distress. Recent companies to pursue downsizing include American Express, Alcoa, Motorola, HP, Dell, Lucent to name a few.

## DOWNSIZING APPROACHES

There are many kind of approaches in downsizing. The reasons for the firm to undertake such approaches also varies. As documented by Palmer et al,. they include restructuring, closing or selling of a business unit, cost reduction, cost savings, increased productivity through greater efficiency and effectiveness and coping with external pressure including recessions and economic downturn, economical change, increased competitive pressures through greater globalization of business and technological change.

Multiple strategies may be associated with downsizing beyond the simple cost cutting approach. For instance, after the terrorist attack on united states on September 11, 2001, Praxair Inc. a supplier of speciality gases and coating the United States, experienced a downturn in productivity. They announced the need to reduce their worldwide workforce by 900 employees as well as the need to restructure their business to cater to products where demand was increasing. To this end they simultaneously downsized and invested in two new product plants.

Sometimes employees are the last resort for cost cutting and thus the company follows downsizing. For example, in the end of the second quarter of 2001 Charles Schwab & company was hit by a major economic downturn in commission based revenue. This company has hired a lot of workforce during the boom period of the business cycle. So they had an overabundance of staff and finally realised the need to restructure and downsizing was their last resort of cost cutting. As a result by the end of 2003, the company has reduced nearly 25% of its workforce and significantly decreased the staff bonuses in a move to save the company from its declining profit.

But downsizing will not necessarily lead to gains in productivity unless and until its complemented with other business strategies. For example , a research in 1990 showed that expected increase in profits did not increase in two out of three cases through cost cutting by downsizing. This research showed that share prices may initially rise with the announcement of cost cutting by downsizing but often fall, trading at or below the market over a two year period.

## TYPES OF DOWNSIZING

There are mainly three types of downsizing. They are as follows:

Retrenchment

Downscaling

Downscoping

The above three strategies are further elaborated below:

(1) RETRENCHMENT: it is a corporate strategy by which the firm centralizes or specializes its operations to maintain and improve the productivity and profit. It can brought about by removal of unnecessary jobs and amenities or reengineering process. This finally helps in gaining competitive advantage and improve the economies of scale.

If a company or government follows the process of retrenchment, it decreases the money which is outgoing and the expenditures or have a new focus so that they can become more solvent financially. Retrenchment is a general strategy of cutting back the cost and a useful approach towards the layoff process.

Companies usually use the strategy of retrenchment through two approaches. One of them being reducing the overall expenditure by decreasing the workforce, closing of offices and branches which are not performing according to expected profit, freezing hiring and cutting salaries. As the firm centralizes the operation it may move its head quarters to a favourable place where the operating cost is lowered or easy availability of raw materials is possible. It can also streamline its process and decreasing the quality of materials used in production.

The other approach of the company is by downsizing in non profitable market, i. e. following the process of downsizing in the market segment which is not performing well currently and in turn building upon its operations in market which has proved to be profitable in long run. This usually happens when the non profitable market becomes saturated or obsolete for the sole reason of new and improved technology and modernization.

There are basically five major activities that take place for retrenchment:

Turnaround: there are two strategies to do it. Firstly the company can consolidate the operation and secondly it can contract its operations by cutting cost of labour and marketing.

Captive company : for a captive company to perform well they can be an exclusive supplier to a giant company. Its future is held by another big company

Divestment : it mainly involves in removal of a portion of the business. It may sell, close or spin-off any strategic business unit, a product line or any operating division. They actually downsize their scope of business functioning.

Liquidation: The process is simple. It is done by Taking the book value of assets, subtracting depreciation and selling the business. There can be potentially viable assets which are lost in the process.

Bankruptcy: this is when the company looses its total profit. It is a legal protective strategy. There can at least be a possibility of turnaround if the company declares itself bankrupt to its loyal customers.

(2). DOWNSCALING: the process of downscaling involves permanent alterations to employment and tangible resource capacity. The decrease in resources decreases the necessity of workforce operating them and thus the process of downsizing is easy and viable for sustaining the company. It improves the competitive advantage of the company and reduces the firm's economies of scale. It can also involve improvement in the competitive market share of the firm. This strategy is actually followed by firms who are facing increased competition in the market place and wants to improve the efficiency by implementing changes in the workforce.

(3). DOWNSCOPING: when the form divests operations and activities or markets in which it operates. This is usually achieved by decreasing the vertical and horizontal integration. If a firm has over diversified its operations it can use the corporate strategy of downsizing to improve its performance. The strategy helps in refocusing the organization's core business. It involves two main processes. Firstly reducing the level of diversification by divesting the business which are not related to its core competency. Secondly selectively removing workforce units and employees who do not contribute to the strategic objective of the organization. The assets of the firm which are unproductive are spun-off or sold. It helps the firm to achieve the optimal level of diversification. The process of refocusing also reduces the information processing requirement of the top management. The emphasis of the firm is more on strategic control rather than financial control. It is reducing the diversity of business in its portfolio. European firms use more of downscoping as compared to the United States's firms. One of the best examples of downscoping can be the Tata group who have restructured its business to retain only 91 of its 250 business. The company has tried to build a more focussed approach without actually abandoning the best traditional manufacturing process.

# CHALLENGES IN DOWNSIZING

There are certain challenges the organization has to face while the process of downsizing is being implemented.

They are explained as follows:

Survivor syndrome : this is mainly observed in employees who are retained in the organization after the downsizing process has been done. They feel guilty that they are still in the organization when their valued work colleagues are and employed. They suffer from low morale and feel that they also can get laid off in future. Particularly when they are not involved in the organization’s restructuring process they feel left out and dissociated. Managing such survivors effectively is a major challenge

Due diligence: there can be questions in the organization regarding the necessity of the downsizing in the organization if the process is unplanned or non selective. This may lead to damage of the employee-employer relationship in the organization.

Employee retention: loss of important and skilled employees can occur due to unplanned downsizing. Sometimes the retained employees become unsure about their future in the firm and reconsider their decision to stay back with the firm. Loosing these employees can greatly affect the productivity of the firm.

Cultural adjustments: downsizing leads to significant cultural change. For example the subcultures of the firm may be broken down by restructuring and downsizing and disruption of informal networks may occur. So the management must pay more attention to reintegrate the culture and formulate new strategic decisions

Communication: the company should make sure that they convey and communicate the future of the present employees and also the market situation they are presently in. they should communicate their future strategy and vision to the shareholders, employees and the customers.

Choice of restructuring technique: downsizing is not always the most viable technique for restructuring. Many companies do not seek initial alternative to it. The decision of using any substitute method should be analysed properly before carrying on the process of downsizing.

## DOWNSIZING IN THE PHARMACEUTICAL INDUSTRY

There has been major downsizing and lay off in the pharmaceutical companies over the last few years. From the year 2007 when the recession started nearly 80, 000 jobs in pharmaceutical industry is lost. The recent consolidation of the industry, e. g., Merck-Schering, Pfizer-Wyeth and Roche-Genentech suggests that many more biotechnology and pharmaceutical jobs may be lost over the next year or so. Companies like of Amgen, Genentech, Gilead are lacking funds to maintain its operations in the down economy. There is a lack of venture and private equity capital which is ultimately leading to cost cutting by reduction in work force.

Xenoport, a San Jose based pharmaceutical firm has announced that it will downsize 222 person from its existing workforce in the next few months. The company executives claim that this downsizing is necessary as the US Food and Drug Administration failed to grant approval to the leas drug candidate.

The move will help the company save nearly $15. 6 million annually and in turn invest them on future drug development.

Another firm named Exelis which is based in San-Francisco will cut down its workforce by 40% to have more focus on development of the late stage drug candidate. This biotechnology firm wants to reduce their cash expenditure by nearly $90 million in the year 2011 and wants to focus on anti cancer drugs like XL184, XL147 and XL765 development. It has been less than a year when the company has announced a $1. 0 billion deal with Sanofi-Aventis in which $140 million was invested by Sanofi in order to license two of its major oncology drug candidates.

Finally, BNET compiled a top biotech layoff list for 2009. The notables that made the list are shown below.

Sepracor (530). The layoffs represented 20 percent of Sepracor’s workforce, and another 410 contract sales reps also got the axe. The restructuring apparently worked and Dainippon Sumitomo Pharma the company later in 2009.

Allergan (460). This represented a five percent reduction in the company’s workforce.

Genmab (300). Arzerra (ofatumumab) the company’s leukemia drug won FDA approval a week before layoffs were announced (go figure). But Genmab wanted to cut manufacturing and late-stage clinical work to refocus on antibody discovery.

Oscient Pharmaceuticals (280). Oscient cut about 100 jobs in February, 2009 to entice acquisition partners. When that didn't work, the firm cut another 180 in June as it dumped the sales force for its two marketed products. Cornerstone Therapeutics later picked up Oscient's antibiotic Factive during bankruptcy.

Amylin Pharmaceuticals (200). After cutting 340 jobs at the end of 2008 amid declining diabetes drug sales and regulatory delays, Amylin eliminated 200 sales reps in mid-2009.

The above represents one of the largest lay offs in 2009. It was earlier considered that life science won't be affected by the downturn of the economy. But contradictory to the popular belief it is one of the hard hit sectors.

Most of the companies are following the downsizing with the mixture of junior and senior employees. But during major lay-offs most of the downsized employees are not experienced. Entry level employees are also downsized for the process of cutting cost. Pharmaceutical companies require nearly 15 years for the drug development process. There may be many critical decisions to be made during the process. For taking such decisions more experienced and expert employees are required and without their suggestions they can not actually render the drug development process to complete. The ability to take proper decision and the corporate knowledge is not observed in the entry level employees. It might take those years to understand the complexity of the process. So mostly the sales level employees are suffering from the downsizing effects. To summarize it, the fact that choosing the employee to be laid of is very crucial in pharmaceutical industry. They should not loose experienced workforce as it might lead to their loss of efficiency of operations and competitive advantage in the market. The current lay-offs of the industry can increase the drug stock prices for short term period but the future of such measures in the long term is still uncertain and cannot be predicted.

## CONCLUSION:

Downsizing can be fairly costly strategic decision. For example it has been calculated that the total cost of the retrenching of a single employee who earns around $ 30, 000 is around $7, 000. the process of downsizing can have major pschycological and emotional effect on the employee. The employee may loose his/her morale and efficiency to work better elsewhere. There can also be social effect on both those who remain in the organization and those who leave. For these reasons the smartest companies make sure that they address the right issues in right ways before they jettison jobs and further explore alternatives for their operations before they restore to downsizing as their corporate strategy.