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When Downsizing Becomes "Dumbsizing"

By Bernard Baumohl

Rightsizing. Restructuring. Downsizing. The terms are cold and unemotional. Yet the euphemisms of the early 1990s all mean the same thing: layoffs. Over the past five years, corporate America has been driven by a single-minded mission to gut itself of "excess workers." It was supposed to be the fastest and easiest way to cut business costs, be more competitive and raise profits -- or at least that's what many top executives thought.

But there is mounting evidence that this slash-and-burn labor policy is backfiring. Studies now show that a number of companies that trimmed their work forces not only failed to see a rebound in earnings but found their ability to compete eroded even further. "What's happened shouldn't be called downsizing. It's dumbsizing," says Gerald Celente, director of the Trends Research Institute in Rhinebeck, New York. "All these firings are going to end up hurting our international competitiveness, not helping it."

Whatever it is called, its effect on the American economy has been painful and profound. More than 6 million permanent pink slips have been handed out since 1987, and layoffs are occurring at an even faster pace this year than in 1992. Despite signs of a brisker economy, at least 87 large firms announced major job cuts in the first two months of 1993 alone.

What is so troubling is that while companies do trim a bloated work force from time to time, many of the recent layoffs may not have been necessary. According to a new study by Wayne Cascio, a business professor at the University of Colorado, companies have too often assumed that if the competition was cutting costs by firing workers, then they had to follow suit. Compaq Computer, for example, announced last October that it was laying off 1,000 workers. Yet two weeks later, the company admitted that profits would double in 1992. Firms like General Electric and Campbell Soup continued to slash personnel even though they both just had highly profitable years. "There is tremendous peer pressure to get rid of

workers," says A. Gary Shilling, an economic consultant. "Everybody's doing it because they think they have to."

But the deeper problem facing some companies was an inability to respond adroitly to changing markets, and decimating their work forces may have made that task even tougher when the recovery finally rolled around. "Just look at what they've done to IBM and Sears," says Celente. "They've cut the heart out of these companies. They are blaming an overstaffed work force for bringing down profits. But that's not the real problem. These companies lost out competitively because they didn't change their products."

One of the most obvious effects of downsizing is that the employees who survive are forced to work longer and harder. In February the manufacturing workweek stretched to 41.5 hours, the longest in 27 years. The resulting increase in stress leads to discontent, lowers creativity and undermines corporate loyalty. A study by the American Management Association last year showed that of more than 500 firms surveyed that had cut jobs since 1987, more than 75% reported that employee morale had collapsed. Indeed, two-thirds of the companies showed no increase in efficiency at all and less than half saw any improvement in profits.

Not only was there often no payoff on the bottom line, but corporate chiefs who expected at least some applause from Wall Street for reducing labor costs also got a nasty shock. "Senior executives may think that a press release announcing layoffs sends a signal like, 'Look, I'm cutting costs, therefore reward me,' " says Carol Coles, president of Mitchell & Co., a management consulting firm in Waltham, Massachusetts. "But investors are a lot savvier than that. They know that firms that had major layoffs often have more significant problems. Streamlining a company does not push stock prices higher."

Coles studied 14 firms that announced major staff cuts during the 1980s and found that the rise in their stock prices lagged the overall market by 70% in the past three years. For example, Bethlehem Steel began laying off workers in 1986. Yet its stock has fallen 50%, in contrast to a rise of 48% by the S&P 500. Monsanto started cutting its work force in 1985, but its stock rose a slim 30%. Clearly these were troubled companies that would probably have suffered sluggish stock prices in any event, but the study indicates that cutting labor costs did not make Wall Street forgive their more deep-seated problems.

"There is a reverential belief that during hard times, you can turn a company around, resuscitate its profitability and raise shareholder value by laying off workers," says Alexander Hiam, author of Closing the Quality Gap. "But that's a huge myth." For both individual companies and the economy as a whole, a true recovery may require dispelling that myth and focusing once again on real ways to increase performance and creativity.

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