

## Case A.3

# Downsizing and Business Reorganisation

## An historical case study of IBM

During the 1980s and 1990s many businesses, especially in the USA, undertook large-scale reorganisation. One result was mass redundancies, as major corporations attempted to 'downsize'.

The initial wave of downsizing consisted mainly of companies which were suffering from falling profits. Their objective was to reduce costs and thereby bolster their profits. Later, downsizing began to be practised by companies doing well in their various markets. These included companies such as General Electric (104 000 redundancies between 1980 and 1990), Procter and Gamble (13 000) and AT&T (40 000). Such companies practised downsizing not out of desperation, but as a means of improving their performance. By reducing the size of their headquarters and removing layers of managerial bureaucracy, and even in many cases breaking up the business into smaller units, it was hoped that the business would become more flexible and ultimately more efficient.

In addition, businesses have been increasingly focusing upon 'core competencies'. What this means is that peripheral or non-core activities have been axed. In effect, businesses have sought to become more specialist and produce those goods or services where they can do better than their rivals.

The case of [IBM](#) ([see also](#)) presents one of the most dramatic examples. In 1987, IBM employed 406 000 people. By 1995, its workforce had shrunk to 202 000. This wave of downsizing started in the late 1980s as IBM's profits began to fall, largely as a consequence of failing to predict the rise of the workstation and the decline of the mainframe computer, on which IBM's profits had largely depended. In 1991, desperate measures were undertaken to revive IBM's declining position. The chairman of IBM, John Akers, announced that the company was to be split into thirteen autonomous units, nine of which were manufacturing and development businesses. These were to act as suppliers to the remaining four units, which were concerned with marketing and servicing. Between these units there was to operate an internal market with a series of negotiated transfer prices. It was hoped that such a radical reorganisation would enable IBM to compete more effectively in a world market where the speed of technological change was intensifying, and where the number of small business with new and innovative products was growing rapidly.

In the USA, the initial wave of downsizing and business reorganisation was met with horror, as so many people were put out of work. It has been estimated that between 1980 and 1995 the largest 100 American firms shed 25 per cent of their workforce, the equivalent of 4 million workers. More recently, however, views concerning the impact of downsizing have been revised. What has happened in many cases is that businesses, now that they have got back to their core competencies, are looking to expand as their market positions have strengthened. In addition, many activities conducted by businesses, such as catering, building maintenance and the operation and running of computer systems, are things they cannot do without. As such, companies have been forced into 'outsourcing': that is, funding another

company to provide the service for them. These other companies have then absorbed most of the redundant labour.

It appears that if downsizing is truly successful, then it is a self-eliminating process. As the new lean and efficient company betters its rivals, so the demand for its product rises, and with it the demand for labour.

If unsuccessful, the slimming of business may turn into anorexia, which is not healthy. Some companies that have cut their costs drastically have found that the quality of their operations has suffered, leading to a fall in revenue: a fall that may be greater than the fall in costs. The result is a reduction in profit.

## **The boom of the late 1990s**

Strong economic growth in both the USA and UK up to 2001 revealed a further legacy for business of the downsizing trend of the 1990s: recruiting and holding on to staff. The downsizing era:

... tore up the implicit contract of employment which had, for decades, tied people to their companies. Under that contract, workers gave commitment and loyalty, in return for job security until retirement.<sup>1</sup>

Companies found that, with workers in short supply, especially in key areas such as computer or Internet technicians, they were in a constant battle to recruit and retain their services. Commitment and loyalty were at premium. In the USA:

Besides signing-on bonuses and share options, employers are offering free meals, manicures on company premises and laptop computers. Employees who announce they are leaving are often offered large pay increases to change their minds ... British companies are also competing to offer better pay and perks. Norfrost, the Scottish freezer manufacturer, even allows staff to bring their dogs to work.<sup>2</sup>

Employees once again seemed to be of value, but without the tradition of commitment and loyalty lost during the era of downsizing, employers were having to stretch to ever greater lengths to hold on to this valuable resource.

### **Questions**

1. Why might downsizing fail to improve the economic position of a business?
2. What side-effects, other than on levels of employment, might widespread downsizing have on the national economy?

<sup>1</sup> *Financial Times* (13/6/00).

<sup>2</sup> *Ibid.*