The Effects of Downsizing Stifles on Organizational Innovation Propensity

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Abstract

Workforce downsizing has become a popular human resource practice in organizations over the last few years. During the economic or financial crisis, most companies take an appropriate measure to implement downsizing strategies in order to optimize cost efficiencies as well as to achieve operational effectiveness. However, more surprisingly, its long term impact on a number of organizational outcomes remains ambiguous. Research on the impact of downsizing is still questionable. Organizations recognize that a stable and effective organization structure and culture must be in place to have a favorable working environment for innovation. To perform daily work, develop innovation and obtain efficiencies, workers' knowledge must frequently be shared across organizational boundaries. Organizational downsizing is a popular approach amongst managers these days. This paper therefore, aims to review various pitfalls introduced into the organization as a result of the downsizing exercise. This paper attempts to identify both direct and indirect consequences of downsizing to the organization's ability with the purpose of innovation in the long run.

Keywords Downsizing Stifles, Propensity, Organizational Innovation.

Paper type: Conceptual Paper

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1. Introduction

Downsizing has been a managerial practice to increase organizational efficiency during the last two decades (e.g., Cameron et al., 1991). Downsizing has also been implemented to achieve bottom-line objectives. More specifically, it has been widely employed to: a) achieve a reduction of overhead and operational cost, b) speed up decision-making and communication through a reduction of management levels, and c) reduce a duplication of efforts due to mergers (Nienstedt, 1989). Although the announcement of downsizing results in short-term positive reactions, the downsizing ability to enhance productivity and improve bottom-line performance has been controversial (McKinley et al., 1995).

It is the fact that there are few examples of companies achieving their primary goal, which leads to new activities of downsizing a few years later. Negative impact on variables including employees' loyalty, motivation and morale (Devine et al., 2003; Mishra & Mishra, 1994; Mishra & Spreitzer, 1998), Return on Assets (ROA), Return on Equity (ROE), Return on Investments (ROI) and Stock Price (Cascio, 1993; De Meuse et al., 1994) have been investigated. The main aim of this paper is, therefore to review various negative effects of downsizing on organizational innovation.

As known, organizational downsizing strategies have been widely used at the age of globalization, and its potentially negative impact on knowledge sharing has formed a vital part of the knowledge of management discourse. Its negative effects on innovation include: a) the loss of organization's stock of knowledge, b) hindrances towards the individuals' creativity level and c) obstruction to the knowledge creation and sharing process. These three factors in fact, play a vital role in organizational innovations. To achieve this objective, the concepts of organizational downsizing, knowledge management and organizational innovation are also critically reviewed in this paper.

2. Literature Review

2.1 Organizational Downsizing

The concept of downsizing is defined as an organization's conscious use of permanent personnel reduction in order to enhance its efficiency (Budros, 1999, p.70). It is difficult to equate downsizing with layoffs. It is the fact that layoffs mention the individuals' analysis level, whereas downsizing is a wilder concept applicable to other levels of analysis. Downsizing is considered as strategic decisions taken by organizations to outsource their services as well. It also refers to strategic alliances or mergers. Nevertheless, in the current paper, the term "downsizing" is viewed as a reduction of workforce.

During the last two decades, downsizing has been implemented in a number of companies; however, very few managers use this term. On the other hand, the concepts, namely building-down, reorganizing, re-engineering, consolidating, rightsizing have been employed etc. It is the fact that these concepts are overlapping and regarded as synonymous concepts. Downsizing is, in actual fact, considered as a general concept encompassing all of the above-mentioned concepts. The main reason is that the underlying logic is common for all these concepts. They are strategic implementations affecting at least one of the following factors: a) the size of the company's work force, b) the cost, or c) the work process (Cameron, 1994b). Downsizing is also regarded as a multifaceted phenomenon influenced by driving forces. Drew (1994) compartmentalized the causing factors into three categories including macroeconomic, industry-specific and firm-specific elements. Luthans and Sommer (1999) claimed that global competition, technological innovation, increased customer influence, macroeconomic factor, and pressure from rival firms, which constitutes the main driving forces.

2.2 Organizational Innovation

To provide remarkable returns for shareholders, and to alter the direction of the industry, continuous and game-changing innovation is considered as an effective method for corporations to deliver extraordinary value to customers in a faster, better way compared to their competitors, (Carlson & Wilmot, 2006). It is confirmed that innovation management is a key source of competitive advantage to organizations. The importance of innovation for a competitive advantage mentioned in research on innovation management is found to be a main issue. Brown and Eisenhardt (1995) argued that research on innovation was conducted at either an economic-oriented tradition across countries and industrial sectors, or at an organizational-oriented tradition, concerned with the micro level of product development within companies. This paper therefore, puts much emphasis on factors influencing innovation. In this regard, innovation is defined as a general concept used to avoid controversial arguments about innovation types such as being radical or incremental. Furthermore Organizations are mainly knowledge based organizations and their achievement and success depend on innovation as well as innovation can lead to the success of organizations also businesses are shifting towards information based on business (Kiumarsi et al., 2015).

To have innovation taken place in organizations, four antecedent activities including the alignment of value, diversification of thought, acceptance of appropriate failure, and initiation of appropriate metrics should be first taken into account (Bennis & Biederman, 1997). Innovation which results from innovative ideas is more likely to be achieved by a diverse workforce. To encourage innovation determining corporate viability, companies need to have employees with an unusual personality or usual disagreement with company policies or methodologies (Sutton, 2002). Successful and innovative companies encourage those, who have such personal idiosyncrasies and make an attempt to harness the power of divergent viewpoints despite the creative friction among employees (Gandolfi & Oster, 2009).

2.3 Organizational Knowledge Management Sharing

Knowledge management (KM) comprises a wide range of strategies and practices used in an organization to identify, create, represent, distribute, and enable adoption of insights and experiences. Such insights and experiences consist of knowledge, either embodied in individuals or embedded in organizations as processes or practices. Knowledge management efforts typically focus on organizational objectives such as improved performance, competitive advantage, innovation, lesson sharing, integration and continuous improvement of the organization. KM efforts overlap with organizational learning, and may be distinguished from that by a greater emphasis on knowledge management as a strategic asset and a focus of the encouragement of knowledge sharing. That is an activity through which knowledge (i.e. information, skills, or expertise) is shared among people, friends, or members of a family, a community or an organization.

Organizations have recognized that knowledge constitutes a valuable intangible asset for creating and sustaining competitive advantages. Knowledge has dual and complementary forms (i.e., tacit and explicit). Tacit knowledge was first introduced into philosophy by Michael Polanyi (1958). It was defined as work related practical knowledge. It is widely neither expressed nor declared; however, it is rather implied or simply understood and often associated with intuition. This kind of knowledge seems to be challenging to transfer to another person by writing it down or verbalizing it. On the other hand, explicit knowledge has been or can be articulated, codified, and stored in certain media. It can be readily transmitted to others. Knowledge sharing, the subject of this paper, is a complex process involving the contribution of knowledge by an organization or its people, and the collection, assimilation and application of knowledge by an organization or its people (Huysman & De Wit, 2002). In other words, organizational downsizing is one of the factors that influence organizational knowledge sharing.

2.4 Organizational Downsizing and Innovation

Downsizing has an immediate and strong effect on innovative capability of the organization. A primary characteristic of post-downsized organizations is a narrow-minded, prejudiced and intolerant quest for a certainty through efficiency. The rush to get the organization to achieve financial objectives and the efficiency of operations could prove to decimate innovation, thus encouraging and promoting intellectual freeze. The need for conformity, control, and internal harmony will, therefore, take precedence over “different” employees and their ideas. The passion and “unusual” thinking, extremely important to an innovative environment are considered to be arrogant and disruptive in a company bent on efficiency (Horibe, 2001).

During downsizing, significant changes in line and staff personnel are often initiated. With an effort to increase the control, and ensure harmony and unity of purpose, new employees across the organizations that most resemble an ideal model are selected and highly appreciated. During the exercise, there is a main focus on management to get the organization structure function. The remaining employees are forced to work with different bosses, take up additional workload and be cross-trained into different skills, which results in a decrease in specialization. There is, therefore, an increase in tress levels but a decrease in a sense of job security. This leads to a resistance to change, deterioration of communication, which results in a limited knowledge sharing. In addition, the overall stock of knowledge in the organization also seems to be reduced as there are fewer employees left to work.

Several researchers have also examined downsizing and determined its direct impact on the innovative capabilities of firms and their employees. The table below presents a strong underlying message including empirical evidence. It reveals that the innovative capability of an organization is likely to be harmed by an adoption of downsizing. As a result, a growing plea for deeper insight and a more profound understanding of the relationship between downsizing and its impact on innovation has emerged. Table 1 shows a non-exhaustive overview of the published studies and their respective findings.

Table 1: A non-exhaustive overview of published studies and their respective findings

Researchers	Findings
Cameron, Whetten, and Kim (1987)	Downsizing in universities was associated with reduced innovation.
Walsh and Ellwood (1991)	Downsizing conflicts with innovation
Dougherty and Bowman(1995)	Downsizing breaks entrepreneurial networking in organizations and disrupt a firm's ability to create innovation
Bagshaw (1998)	Examined the effects of downsizing and found reduced risk taking and flexibility as well as decreased levels of innovation among downsizing survivors as direct organizational effects of downsizing
Gettler (1998)	Increased employee turnover, decreased overall skill base, decreased levels of risk taking, and a drop in innovation were found in organizations that had engaged in downsizing
Lecky (1998)	Decreased levels of risk taking and innovation in post downsized firms
Amabile and Conti (1999)	Determinants that an organization's work climate is negatively affected by downsizing, and that creativity is markedly diminished during the entire downsizing process. It was further established that creativity in the downsizing firm remained depressed beyond the actual downsizing implementation
Bommer and Jalajas (1999)	Observed four organizational consequences upon the conduct of downsizing educed levels of risk taking, a decreased willingness to make suggestions, a drop in motivation, and increased levels of fear among employees

Researchers	Findings
Fisher and White (2000)	Downsizing influences innovation through its effects on organizational knowledge. Downsizing may seriously damage the learning capacity of organizations
Richtner and Ahlstrom (2006)	Downsizing had an overall negative effect on innovation.

2.5 Effects of Downsizing on Innovation

It is clearly understood that downsizing affects social networks, which causes the loss of knowledge and disrupts learning capacity. Downsizing is viewed as a practice that is harmful to organizational innovation capability as it produces a work environment inhibiting innovation. The negative effects of organizational downsizing on innovation include: a) the loss of organization's stock of knowledge, b) hindrances towards the individual's creativity level and c) obstruction to the knowledge creation and sharing process.

2.6 Downsizing and the organization's stock of knowledge

One of the direct effects of downsizing on innovation is the effect of the organization's stock of knowledge. It is difficult to observe the knowledge status and flow in the organization. As a result, knowledge residing in an organization is unique to that specific organization, which in turn makes it difficult to know whether there are full effects of downsizing implementation on innovation or not.

It is, however, fairly straightforward to assume that implementing downsizing reduces the organization's stock of knowledge, especially tacit knowledge. As employees who leave their organization, critical skills may be lost. That can negatively affect the product know-how, the relationships or operations of customers. Most employees who are let-go are those, who are well-experienced, and who may fall on the higher side of the salary scale. This group of individuals in fact, have a great knowledge of the product, business and market environment. If there are too many inexperienced project members, or the wrong mix of members in a project group, the process of product development is in postponement. Similarly, it has also been found that downsizing breaks the network of informal relationships, which are of crucial importance for innovators who draws upon experiences in various parts of the organization, building commitment and sponsorship from senior management, and as a consequence of downsizing the remaining members in the organization have fewer avenues to get support and resources.

On the other hand, the remaining employees of the exercise also tend to hold on to their tacit knowledge and limit the sharing of this knowledge. The current idea is to seek job security. Organizations usually conduct a few rounds of downsizing activities, and these employees hope that if they get the tacit knowledge, the organization that tends to select them for the next lay-off is minimal. As a result, cross-functional teams and management reviews lose their efficiency. A level of communication within the organization also reduces at a sharp rate.

After the loss of jobs from the restructure, teams were, in the words of observers, "massively under-resourced", some more severely than others. The resource shortage influences the existing structures and knowledge sharing. For example, workers lack time to move around and develop new social networks and informal communication patterns with people in other teams, or attend meetings where knowledge is traditionally shared. Furthermore, innovation is reduced after downsizing due to a constant need for remaining employees to attend to basics and emergencies. Thus, there is a decrease in the learning capacity of the organization.

2.7 Downsizing and individuals' creativity

Individuals' creativity is the main focus of innovation that leads to the development of new ideas (Amabile & Conti, 1986). Negative effects on individuals' creativity will, thus, have a negative impact on innovation. Research on innovative companies often views trust as a critical ingredient. It is true that if employees trust each other; especially, if there is trust between the employees and their manager, and there is trust in their brand, those employees are willing to risk being creative and building up their ideas that can turn into innovation. In fact, such employees hardly fear that their ideas are ignored. That is, these employees are not worried about their manager's stealing for their ideas, and not afraid of being laughed at their outrageous suggestions.

In contrast, lay-offs have been found to be an unpleasant tendency to destroy trust. In this respect, employees are not sure about their future in their company. They begin to worry that the time that they devoted to the development of creative ideas might be perceived as a wasteful time. They in fact, wonder whether they will be in the next batch of dismissed colleagues due to the lack of their ability to demonstrate the productivity of the organization. They are also afraid that more desperate colleagues might steal their ideas. There is, therefore, no trust between the employees and their manager. In other words, if people lack trust, they will spend less time trying to be more innovative. That means, they prefer to keep their ideas; and especially, they avoid rocking the boat, which is not good for innovation.

In other words, downsizing has been found to negatively affect individuals' creativity and is associated with (1) less risk taking among the employees, (2) a reduced willingness to make suggestions, (3) a decreased motivation of doing a good job, and finally (4) increased amount of fear. After the downsizing exercise, resources are limited, and employees are less prone to take risks for fear of losing their jobs in the event of a future cost-cutting program. With the imminent change in the organization structure, employees have limited access to the communication network and have to spend most of their time to adjust to their newly appointed positions or additional tasks assigned to them. Due to this, they are less likely to contribute suggestions at this point of time. All these effects have a bad impact on innovation.

Similarly, Amabile and Conte (1999) found that creativity within the organization suffers considerably during downsizing, and there is the effect in several months after the downsizing. Consequently, it is argued that the future capabilities of innovation for downsizing companies may be in a grave danger. On the other hand, the management's focus on encouraging innovation tends to be distracted. The focus has shifted to attaining all previously established goals for carrying out the downsizing exercise. Managers are also affected with additional workload and standardizing the process. They are driven by the need to ensure operations that are not affected, and they establish additional controls and procedures in carrying out the day to day activities. They also have to adjust their respective departments to work around those, who have left the organization and ensure that the new ones adapt and fit well into their new functions. Besides that, they need to address issues on employees' behaviour and obtain their commitment to achieve new goals.

2.8 Downsizing, the knowledge creation and sharing process

As known, business innovation, especially a new product innovation, is almost never the result of one creative genius who sits in a laboratory for the invention of things. By contrast, innovation is developed from the first germ of an idea through a developed concept and eventual product, service or process via collaboration. Colleagues in an organization share ideas of how to solve problems. As good ideas are identified, they are built upon in conversations, team meetings, e-mail exchanges and by using collaborative tools. Creative people seek feedback on ideas from their more analytical colleagues. Marketing people might be required to review produced ideas. Research people build and test prototypes and so on. Downsizing exercise tends to limit this positive flow of communication within the organization. A new product innovation depends on collaborative work which is defined as "linking the product to the firm's resources, structure, and strategy". Innovators must compete with other innovations and with established products for money, people, and access to major resources.

The other effect of downsizing on innovation is due to its effect on the knowledge creation processes that are necessary for successful innovations (Crossan *et al,* (1999). The ability of a company to create knowledge allows the company to develop better products and services, thus, the ownership of knowledge assets, and the ability to combine them with other assets, create values which in turn lead to a competitive advantage. Organizational knowledge is set up in a continuous and dynamic interplay between tacit and explicit knowledge when there is a shift between the various modes of knowledge conversion.

There are different things that affect the changes from one form to another. Socialization occurs through the creation of teams in which the employees in the organization interact. The team makes it easier for the employees to share their experiences and perspectives. Downsizing results in fewer employees which may hamper the process of socialization. Externalization is about the establishment of designing concepts and prototypes in order to capture the spoken and unspoken needs of customers, which requires the use of metaphors, analogies, and models. The externalization process is created by the use of dialogues. Downsizing results in a loss of experienced employees (tacit knowledge), which results in the loss of organizational competence. Combination may occur when there is co-operation around the development of a new product or a service. Downsizing may result in employees working on projects to reduce the number of meetings and not be willing to make a great deal of documentation, making it difficult to share explicit knowledge, i.e. hampering the combination process.

A culture of mistrust, knowledge hoarding, and rushing is bound to develop after the downsizing. Indicative of mistrust through the period of downsizing, employees constantly wondered who would stay and who would leave, and some resented taking directives from the new – and younger - employees. Survivors will be less inclined to share information and knowledge to help others do their job as they were concerned that by doing so, they might lose their own jobs. Knowledge creation is focused on the generation and application of knowledge that leads to new capabilities for the firm. Innovation, on the other hand, is also concerned with how these new capabilities may be turned into products and services that have economic values in markets; thus, an organization's capacity to innovate and therefore to prosper in an increasingly competitive environment depends on knowledge creation and sharing.

3. Conclusions

Unmatched levels of work force reduction in many industrialized countries have been witnessed for the last few decades. Few organizations have not undergone some forms of downsizing. The rationale was the prevalence of downsizing as a managerial practice implemented to increase the efficiency and effectiveness. Very few studies on downsizing have been conducted. Therefore, a number of key questions about downsizing still remain (e.g., Are such organizations leaner and fitter or understaffed? Has downsizing resulted in increased competitive advantage for those companies who have undergone it or has it hampered their innovative capability?). That is why, this paper has pointed out several negative impacts of organizational downsizing to organization innovation. In this regard, downsizing could negatively affect the level of knowledge and skills brought into the firm, which subsequently affects, for example, the firm's ability to absorb and modify new technologies. As a result, downsizing could "hollow out" the firm's skills capacity and subsequently its ability to innovate. In addition, employees may be negatively affected by stress and uncertainty caused by downsizing and may react with reduced organizational commitment, less job involvement, and reduced work efforts as a result of downsizing.

Consequently, the negative impacts can be categorized into 3 areas: a) the loss of organization's stock of knowledge, b) hindrances towards the individual's creativity level, and c) obstruction to the knowledge creation and sharing process. Though the reasons are clear for organizations to perform downsizing, carefully planned strategies have to be carried out in parallel to avoid the loss of organizational innovative capability, which may result in defeating the purpose of such an exercise in the first place.

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