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## Article

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## COUNTERINTUITIVE PERSPECTIVES

# Turnaround strategies for companies in crisis: Watch out the causes of decline before firing people


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**Abstract** When a company goes into crisis, the first and most typical response is the dismissal of people, even before considering the sources of the decline. Although the reduction of costs may seem a quick and reasonable measure in this context, downsizing is not the only possibility, nor the most advisable response when facing decline. In turn, by identifying and understanding the sources of decline in time, a company may want to decide on human resource (HR) alternatives to layoffs. This research shows how the HR responses of declining companies should be in line with the sources of the decline. Adopting a configurational perspective, we propose a model of analysis that links sources of decline, turnaround strategy, and HR strategy (HRS) and practices. This model identifies four basic HRS for organizations in decline, according to its sources: flexibility-oriented, efficiency-oriented, niche-oriented, and maintenance-oriented HRS.

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## Introduction

Generally speaking, economic crises bring about layoffs, hiring freezes, and temporary or permanent closures of business divisions. Institutions such as United States Army, Hewlett Packard, Schlumberger, Microsoft, JP Morgan Chase&Co or Procter and Gamble, among many others, announced massive layoffs in 2015 (Fortune, 2015).

Likewise, out of the 1208 executives interviewed by Bain & Company's 14th Management Tools & Trends survey, 61% resorted to downsizing as a management tool (Bain & Co, 2013). This clearly illustrates that, in difficult situations, the most prevalent strategy for managing human resources is downsizing (Cascio, 2002; Chadwick et al., 2004; Luan et al., 2013; Trevor and Nyberg, 2008; Tsai and Yen, 2008; Zatzick et al., 2009).

However, such decision may sometimes be counterproductive in terms of the enhancement of company performance (Luan et al., 2013; Muñoz-Bullón and Sánchez-Bueno, 2011). Against this background, we question whether, in a situation of decline, there are HR alternatives

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to turnaround other than massive dismissal. In fact, downsizing is not the only possible or recommended course of action when facing decline.

Based on this, we relate the sources of decline (firm-based and industry contraction-based) to the turnaround strategies of retrenchment and recovery (Arogyaswamy et al., 1995), and propose an integrated set or model of HRS and practices to deal with them accordingly from a configurational perspective. This model is central in two main aspects: as a contribution to the turnaround literature (for a review, see Trahms et al., 2013), which has not focused on the importance of HR issues to date; and for managerial practice, given that most firms experience organizational decline at some point in time (Ndofor et al., 2013). In this sense, company decline represents one of the most important and demanding challenges in the career of a manager (Barker and Duhaime, 1997), thereby involving diverse company resources, especially human resources.

In the following sections, we first review the literature on organizational decline and turnaround. Second, we highlight the HRS most frequently adopted by firms in decline. Third, we propose our set of HR responses in the face of organizational decline, according to the sources of decline.

## Decline and turnaround strategies

Organizational decline is the deterioration of a company's performance due to a consistent decrease in its internal resources (see, for instance, Cameron et al., 1987b; D'Aveni, 1989; Francis and Desai, 2005; McKinley et al., 2014; Musteen et al., 2011). Although there is no doubt that when decline is not dealt with, it may result in the company's eventual disappearance (Francis and Desai, 2005), how to measure decline is not so clear, as it will depend on the characteristics of the target firms. Generally speaking, the literature seems to consider the return on assets (ROA) or return on equity (ROE) tendency during the previous two or three years as a reasonable measure tool (Trahms et al., 2013).

Nonetheless, it is not only measuring decline that matters here, but also managing to recognize and address the root of the problem accordingly (Barker, 2005). The difficulty, indeed, stems from the fact that there are multiple sources that are both external and internal. External or industry contraction-based decline conditions will lead to a reduction in terms of the prospects of companies competing in specific industries if they do not adapt to new external dynamics (Whetten, 1987). In contrast, the poor performance of a company operating in a growing industry may be behind internal or firm-based decline (Cameron et al., 1987a). Industry contraction-based decline is related to economic, technological, legal, political or cultural, social and competition changes (Datta et al., 2010; Scherrer, 2003; Trahms et al., 2013). In contrast, firm-based decline is related to financial problems, structural characteristics of an organization (size or operating procedures), governance (board characteristics, ownership structure), HR policies and employees' attributes (Datta et al., 2010; Scherrer, 2003; Trahms et al., 2013).

Turnaround, a concept that is ever-present in organizational decline, is described as the recovery of a company's

performance after serious decline (Balgobin and Pandit, 2001). The literature addresses two main turnaround strategies: retrenchment and recovery (Pearce and Robbins, 1993). Retrenchment strategies, also known as operating actions, are intended to reduce cost and assets (Pearce and Robbins, 1993). Conversely, strategic recovery strategies are based on the adjustment of the areas in which a company competes (Barker and Duhaime, 1997; Ndofor et al., 2013). Authors like Pearce and Robbins (1993) point to the universality of retrenchment in the turnaround process, without considering the varying nature of the underlying problems, and contend that fighting particular causes of decline should be postponed until the recovery phase. In contrast, other scholars have claimed that the turnaround responses should be in accordance with the sources of decline (Arogyaswamy et al., 1995; Hofer, 1980; Ndofor et al., 2013). If decline is due to weak strategic posture or to a firm-based problem, retrenchment will not solve the problem (Ndofor et al., 2013) but will worsen employee performance (Datta et al., 2010) when the company is most vulnerable to failure. In this vein, we share the latter perspective in the sense that turnaround strategies should be linked to their sources of decline. We also contend that, even in the most dramatic situations with both external and internal sources of decline affecting firm performance, the combination of retrenchment and recovery strategies may allow firms to consolidate turnaround performance (Schmitt and Raisch, 2013).

In line with Arogyaswamy et al. (1995), we support the idea that the adequate management of HR could be advantageous in the turnaround strategy, and agree with the authors in terms of the most effective recovery turnaround responses they propose. Based on this, we build a model of HRS and practices in the face of organizational decline.

## SHRM in tough times

Based on the assumption that HRM is a means to achieve competitive success also in times of crisis (Pfeffer, 2005), business strategy and HRS have to be aligned (Boselie, 2009). Management has to acknowledge the importance of HRM when formulating and implementing strategic responses to decline (Arogyaswamy et al., 1995), and therefore considering workforce as a source of strategic advantage, not just as a cost to be minimized or avoided (Pfeffer, 2005).

In relation to this, Schuler (1987) proposed the relationship between turnaround and HRM practices (among other corporate strategies), but did not consider the sources of decline and their turnaround strategy was cutting targeted costs. In contrast, Wright and Snell (1998) proposed a model for exploring fit and flexibility in SHRM under unpredictable and changing demands. However, this model did not focus on the decline and turnaround literature, in particular. Finally, the most recurrent strategy in uncertain times is employment downsizing (Cascio, 2002). Downsizing, a concept with long research tradition that still attracts the attention of numerous researchers (Datta et al., 2010; Luan et al., 2013; Mellahi and Wilkinson, 2010; Muñoz-Bullón and Sánchez-Bueno, 2011), is described as actions taken by companies seeking to adapt to external factors, solve management problems, and improve efficiency to increase productivity and competitiveness (Tsai and Yen, 2008). Downsizing

measures are a set of HR practices to be tailored to all crisis situations. However, the literature also reveals that downsizing may increase organizational demoralization or reduce the company to an inadequate size (Luan et al., 2013), and thus, this measure must be taken with caution.

We consider two main variables to construct our model, firm-based decline and industry contraction-based decline, which yield three main scenarios regarding the source of decline: firm-based decline, industry contraction-based decline, and the two types of decline taken together. For each of the three categories, we analyze the causes of decline in depth, and identify which turnaround strategies, as well as distinctive HRS and practices companies are adopting in each of these three scenarios. The combination of the two dimensions described is aimed to build different configurations or systems of HRM practices.

In relation to this, the universalistic approach focuses on the effectiveness of individual HR practices, irrespective of the context (Delery and Doty, 1996); the contingency approach considers that HR measures need to be in line with the context in which they operate to have beneficial effects (Martin-Alcázar et al., 2005); and the configurational approach focuses on building synergies among HRM practices (Verburg et al., 2007). Given that in our research we aim to develop a coherent HRM system in tough times, we will consider a configurational approach.

### Type 1 decline: firm-based decline

In a situation of firm-based decline, Ndofor et al. (2013) found that recovery strategies had a positive influence on turnaround, while retrenchment actions had a negative influence on firms' performance recovery. Indeed, firms require significant changes in strategy and organizational structure to develop or redevelop resources and capabilities (Arogyaswamy et al., 1995). From the human resource perspective, firms must have flexible resources and the capabilities to accept new challenges (Wright and Snell, 1998), and to cope with the strategic orientation that the company needs.

**Proposition 1.** *A flexibility-oriented HRS will contribute to the recovery strategy needed in a situation of firm-based decline.*

In a situation of firm-based decline, a flexibility-oriented HRS aims to either recombine existing resources and capabilities, or have access to new resources externally that are incorporated to existing resources in order to obtain a strategic response to decline. As HR practices can encourage employee flexibility (Beltran-Martin et al., 2013), management should focus on obtaining sufficient diversity in skills and behaviors to adapt to changes (Bhattacharya et al., 2005).

In this sense, training activities enhance employee's functional flexibility, as they favor the abilities required to perform diverse tasks (Beltran-Martin et al., 2013). Extensive training on customer-oriented positions will enhance market responsiveness as part of a flexible HR system (Chang et al., 2013). Extensive training will target future skill requirements (Guthrie, 2001; Diaz-Fernandez et al., 2016).

In order to have a variety of skills and behaviors, management should increase their attention to skill and competency-based pay in addition to performance-based pay (Bhattacharya et al., 2005) to target internal deficiencies (e.g. increase productivity or punctuality), differentiating core or peripheral employees (Atkinson, 1984). Also, flexible HR practices, such as teamwork structures, variable compensation plans, and adaptable performance appraisal, are beneficial (Bhattacharya et al., 2005).

A firm may obtain functional flexibility through processes such as job-rotation, widely designed jobs, and cross-functional teams (Beltran-Martin et al., 2013; Bhattacharya et al., 2005). Numerical flexibility is also a concern in this situation; employees might be transferred to other departments (Hitt et al., 1994) where they are required. Employees who do not develop and update their skills on a regular basis will have fewer opportunities to survive.

With regards to staffing choices, permanent selection in priority areas based on cognitive skills and learning abilities is associated with flexible employee skills and behaviors (Bhattacharya et al., 2005). Conversely, the company's peripheral workforce is employed under part-time or limited-term employment arrangement to face concrete peaks (Atkinson, 1984).

### Type 2 decline: industry-contraction based decline

Industry contraction-based decline takes place when a company's industry is reduced in size (Arogyaswamy et al., 1995). It is when performance deteriorates and there is even the risk of disappearance, as is the case in cigar manufacturing, or shipbuilding (Arogyaswamy et al., 1995; Whetten, 1987). The turnaround strategies of firms suffering from industry contraction-based decline—, but not firm-based decline,—are most successful when there is concentration on expanding the firm's market power (Harrigan, 1980). In a contracting industry, the companies that are most efficient in using limited resources have more chances to survive (Zammuto and Cameron, 1985). Expanding companies in industry contraction-based decline will benefit from the exploitation of their current resources and capabilities (Benner and Tushman, 2003). In this sense, HR practices may influence the firm efficiency (Hsieh and Chen, 2011).

**Proposition 2.** *An efficiency-oriented HRS will contribute to the recovery strategy needed in a situation of industry contraction-based decline.*

An efficiency-oriented HRS aims to obtain efficient responses in order to expand the industry position in situations of industry contraction-based decline where the company is performing well but the firm is under extreme pressure from the environment. In order to exploit existing resources and capabilities, some studies propose intensive training to improve current job-related skills (Guthrie, 2001), specially for production units (Diaz-Fernandez et al., 2016).

With regards to compensating practices, incentive systems that target on individuals' performance in current jobs are recommended to exploit existing resources and capabilities (Kang and Snell, 2009). Concrete reward practices that

foster cost control and responsibility are related to greater perceived performance (Allen and Helms, 2002).

Narrow job designs and selection focuses on specialists (over generalists) to contribute to the exploitation of existing resources and capabilities (Kang and Snell, 2009; Diaz-Fernandez et al., 2016). According to Kang and Snell (2009), tight job definitions and hierarchical job movement with scarce job rotations encourage employees to exploit their knowledge.

### Type 3 decline: industry contraction-based and firm-based decline

Arogyaswamy et al. (1995) suggested two recovery strategies for firms with industry contraction-based and firm-based decline, depending on whether the decline is long-term or cyclical: scaling back to customer segments, and holding industry position, respectively. We now explain each of these turnaround responses.

#### Scaling back to customer segments

Although this is often difficult, a reasonable strategy consists of finding a niche in the industry that offers good opportunities, that is free or taken by weaker competitors, whose existing resources and capabilities are advantageous (Arogyaswamy et al., 1995) and employees further develop their skills to better match customers' needs (Batt, 2000).

**Proposition 3.1.** *A niche-oriented HRS will contribute to the recovery strategy needed to scale back to viable customer segments in a situation of both firm-based and long-term industry contraction-based decline.*

We consider that the most appropriate HRS to succeed in a certain niche is the niche-oriented HRS, as the aim of this strategy is to compete in a narrow segment within an industry. Hsieh and Chen (2011) referred to a focus strategy supported on a commitment-oriented HRS to compete in a segment, and they stated that HRS should retain experienced employees with a great insight in the niche, as their knowledge and experience are crucial to understanding the context of a specific segment.

In what follows, we analyze HR choices within this HRS niche. Extensive training will contribute to retain senior employees, as well as to enhance commitment, employee creativity and cohesiveness to exploit knowledge (Hsieh and Chen, 2011; Zhou et al., 2013) within the segment.

In relation to compensation choices, intrinsic and extrinsic rewards, such as employee title, seniority, status, responsibility, job autonomy, stock ownership plans, benefits, regular recognition by managers, or employment security will contribute to retain valuable senior employees (Hsieh and Chen, 2011). Job rotations or job enrichment will expand the choices and motivation for employees to develop different assignments (Kang and Snell, 2009), and will improve the existing opportunities for experienced employees' discretion, given that the focus is to foster experienced employees' commitment rather than hiring new ones. In case of the need of new employees, selection processes should target selective hiring (Zhou et al., 2013) based upon quality (Batt, 2002).

#### Holding industry position

If the company cannot find a niche or expand its position, a transitory option is to hold the industry position (Arogyaswamy et al., 1995) while maintaining HR costs until the recovery phase. This is a situation with a cyclical industry-contraction based decline and weak position.

**Proposition 3.2.** *A maintenance-oriented HR strategy will contribute to the recovery strategy needed to hold on to its industry position in a situation of both firm-based and cyclical industry contraction-based decline.*

A maintenance-oriented HRS involves HR practices aiming to hold on to the firm's industry position temporarily. Common measures include reducing working hours (Cameron, 1994), mandatory short weeks, the restriction of overtime work (Chu and Siu, 2001), sabbatical leaves (Cascio, 2002), or change to part time (Cameron, 1994). In noncore areas, firms can rely on natural attrition (Cameron, 1994; Zatzick et al., 2009), impose hiring freezes (Cascio, 2002; Zatzick et al., 2009), salary reductions (Chu and Siu, 2001), or unpaid vacations (Cascio, 2002). These downsizing measures can be applied for a certain period of time, but they cannot be continued in the long term without affecting employee morale (Mellahi and Wilkinson, 2010).

#### Responsible HR practices

When the selected response is to reduce the scope of firm activities or it is simply that human resources are not valuable, many employees in non-core areas who cannot be maintained will lose their jobs. This workforce reduction will depend on the intensification of both firm-based and industry contraction-based decline, due to the timing of the decline awareness (Pajunen, 2006). Cascio's (2002, p. 80) valuable contribution to the downsizing literature on a responsible restructuring strategy focuses on "people as assets to be developed", arguing that even if a company has to reduce headcounts, it should be done responsibly. Responsible downsizing (Cascio, 2002) in non-core businesses means offering employees early retirement packages, providing outplacement services and sufficient notice of layoffs, communicating clearly and inclusively about the layoff criteria (Zatzick et al., 2009) and offering a selective voluntary resignation program in non-core areas with a reasonable severance package (Cascio, 2002). However, these adopted retrenchment measures have to be in line with the recovery strategy adopted (Schmitt and Raisch, 2013).

### Some concluding comments and implications for SHRM

This study has called into question layoffs as the first and often unique measure taken by companies experiencing decline, and has proposed a set of SHRM interventions as an alternative in this context. The fact that this is considered a set (i.e., that these should be considered altogether) is crucial here, as employees are exposed to multiple practices simultaneously (Bello-Pintado, 2015). In this vein, our main goal was not to propose an exhaustive list of HRM practices, nor to suggest HR practices according to the size of the organization or any other specificities in each

department. Instead, we aimed to explain alternative HR practices that go beyond the usual downsizing responses in the case of declining organizations.

We paid special attention to the cases in which the declining companies still have some strategic leeway after the introduction of the most effective recovery strategies proposed by Arogyaswamy et al. (1995). Overall, management will have to consider both the root of the problem and timing in terms of awareness of the decline. The earlier management realizes declining situation, the earlier the company will be able to tackle the problem. According to the sources of decline and the most effective recovery strategies examined, we propose four HR strategies for organizations in decline: flexibility-oriented HRS, efficiency-oriented HRS, niche-oriented HRS and maintenance-oriented HRS. We briefly mention the situation in which, due to the long-time awareness of the decline, both sources of decline have been intensified and firms have to combine recovery and retrenchment measures through responsible HRS.

This paper provides an initial framework for future research. The current literature on SHRM in declining companies is still in need of further research on, for example, the HRM practices that companies adopt in situations of internal or external decline in various geographical areas, with different employee regulations to understand institutional pressures in the turnaround process, or the use of an individual HRM practice, such as training, in situations of either firm-based or industry contraction-based decline across different countries. Moreover, the current framework could be extended to analyze SHRM in public organizations in tough times. Furthermore, considering alternative options to avoid workforce reduction will benefit society, given that this will imply not contributing to unemployment figures. We believe that the present SHRM model in declining firms provides a challenging basis for future research in SHRM with the hope of contributing to the literature to date.

For HR practitioners, our study stresses the importance of detecting the causes of decline when proposing appropriate HR strategies and practices. SHRM in declining organizations is not only a matter of pay cuts, hiring freezes, layoffs, or reducing the number of work hours. HR professionals may increase their strategic value, and therefore the value of HR practices, by tailoring their response to the source of decline.

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