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The downsizing dilemmas of European employers

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In times of economic crisis, managers often take drastic measures to survive. This column presents new research on the preferences of managers from across Europe when faced with 'downsizing'. It seems that, when recession bites, the instincts or 'animal spirits' of employers that were previously suppressed by prosperity or considered to be outdated resurface. European employers predominantly resort to offering early retirement packages (and to a lesser extent buy-outs) in response to the threat of downsizing, exacerbating, in the long run, the problems associated with Europe's ageing population. The only notable exception to this rule is the response of Danish employers, who prefer to tackle this problem by reducing the working hours of their employees.

Drastic measures are taken when managers formulate strategies to survive economic crises. Among these are downsizing, outsourcing, firing workers and cutting back on wages. But how do firms balance their interests against those of their workers?

Information on how choices are made in times of crisis is scarce, because studies tend to focus on 'normal' economic conditions, when any economic volatility lies within certain bounds. Under such stable conditions, any shocks can be faced by taking relatively minor or piecemeal action. However, during both the so-called Great Recession the shocks are severe and the adaptive policies of firms have to be radical if profitability was to be restored. In such times of uncertainty, the 'animal spirits' to which Keynes alluded may well dominate decisions to downsize and/or lay off workers (see Akerlof and Shiller 2009).

The firing dilemma

The dilemma which employers face today is to address the difficult question of whether to keep workers in anticipation of better times to come, or to lay them off. The traditional assumption in economics is that concepts of fairness are irrelevant in such a dilemma; we nevertheless believe that considerations of equity and efficiency must be paid attention to in understanding such decisions. The reason for expecting these considerations to be important is because the findings of experimental and survey research (Bewley 2005, Camerer and Malmendier 2007, Fehr and Schmidt 1999) show fairness to be a dominant force in most economic matters. While this notion may seem unorthodox to some economists, it is widely accepted by those who combine the insights of the real world with textbook economics.

Downsizing options

In finding an answer to the question how employers react to a shock in demand we turn to a set of European employers and focus on the role of fairness when faced with the prospect of downsizing.

By studying dismissal policy choices in a representative sample of organisations in six European countries in 2009 (Denmark, Germany, Sweden, Poland, the Netherlands and Italy), our dataset contains a variety of different work and welfare state cultures. The OECD (2010a) has well documented that job and worker flows are remarkably different across countries and how these differences in labour reallocation are connected with the strictness of employment protection legislation.

Our data offer a complementary view as we asked also whether employers perceive the strictness of employment protection legislation. These data were collected within the framework of the research project ‘Activating Senior Potential in Ageing Europe’ funded as part of the EU 7th Framework research program (see Henkens and Schippers 2012). Actual decisions to lay off workers are not examined, but we rather focus on the options open to employers, and their preferences among such options, when managing a large reorganisation. Employers in all countries were asked to consider the question: “[s]uppose, under the current economic conditions, your organisation is forced to downsize 20% of your staff. Which of the following policy measures would you favour?”. The six options offered were:

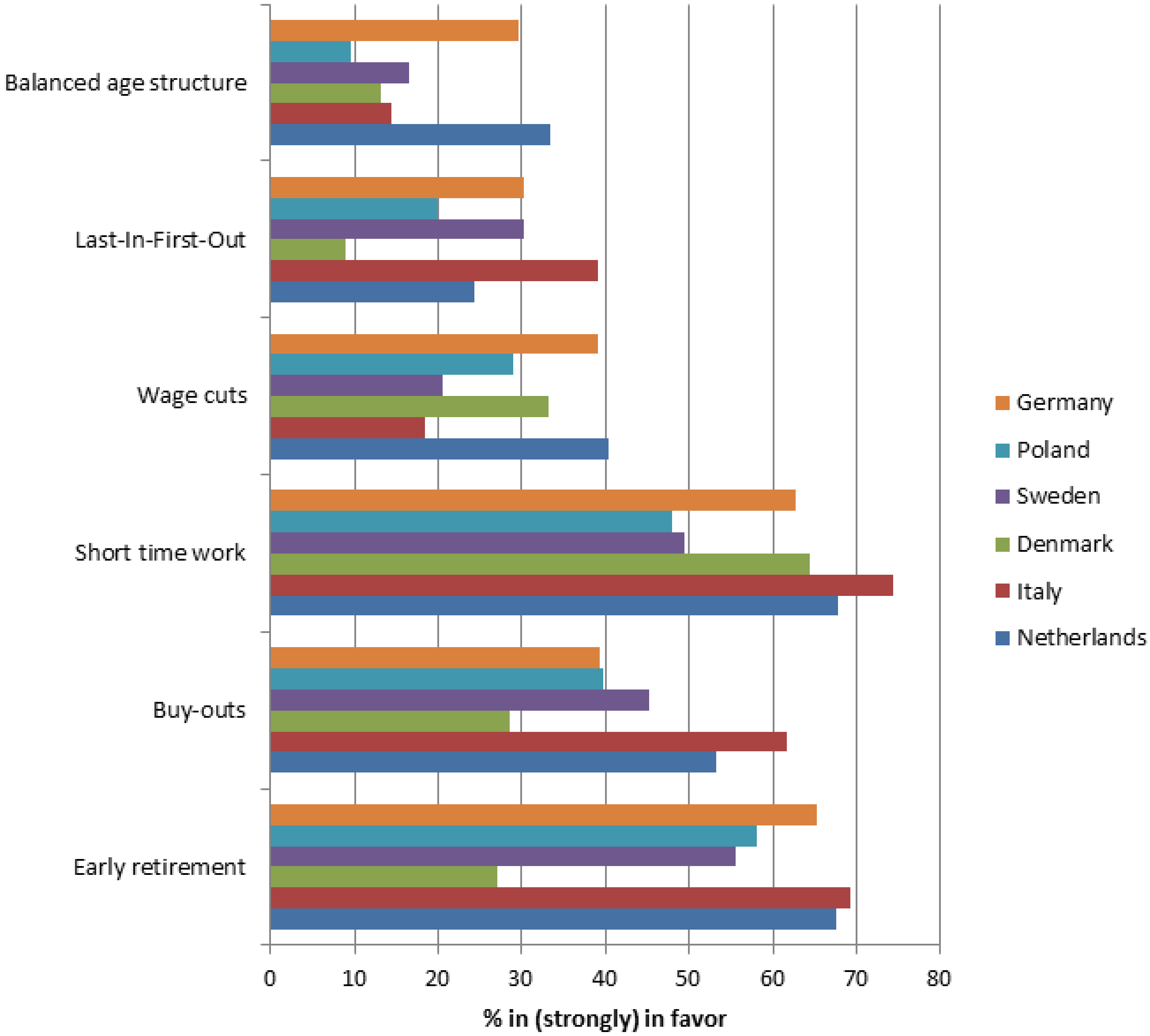
- Dismissals based on the last in first out (‘LIFO’) principle.
- Dismissals based on the representative age structure of the organisation.
- Early retirement of older employees.
- Buy-outs to facilitate voluntary exits.
- Short-time work.
- Reduction of wages for all employees.

The last two measures are not really downsizing measures but options which an employer can choose to prevent or alleviate the prospect of downsizing.

Downsizing preferences

For the sample countries, Figure 1 summarises the preferences of European employers if their organisations faced the threat of downsizing. It is clear that early retirement, buy-outs and short-time work are the dominant preferred options for managing downsizing across all sample countries. By contrast, cutting wages across the board is an unpopular option, although it would still be considered by a number of organisations in the Netherlands and Germany.

Figure 1. Policy options for dealing with mass lay-offs across European employers, 2009



Source: ASPA (2009), weighted figures.

Generational fairness

What explains the preferences displayed in Figure 1? From the large number of relevant factors (see Van Dalen and Henkens 2013) we focus on generational fairness and the perceived strictness of employment protection. Tables 1 and 2 rank generational fairness and the perceived difficulty of employment protection rules by level of employer agreement, respectively. Table 1 shows the diverse opinions of European employers with respect to the treatment of young and old workers in the case of downsizing. Italian employers clearly favour younger workers in times of crisis, while Swedish employers are more evenly divided across the various categories. However, employers in the other sample countries disagree that younger workers should receive preferential treatment. This disagreement may be a forceful explanation of the preference for early retirement, because such programs offer higher replacement rates than unemployment or welfare benefits. An additional insight offered by Table 1 is that the preference for younger workers over older ones is largely related to the state of the local labour market. For instance, youth unemployment in Italy is extremely high (approximately 30%) and outranks the unemployment rate of older workers by a factor of 7 (in the 1990s, this was even a factor of 10). By contrast, Sweden, which also has a high level of youth unemployment compared with the unemployment rate of older workers, displays a relatively high level of generational fairness towards the young.

Table 1. Generational fairness among employers, ranked by level of agreement

	"Younger workers should get preferential treatment in staying on when an organization has to downsize."		
	Agree	No opinion	Disagree
Italy	50	14	36
Sweden	36	30	34
Poland	25	29	46
Netherlands	24	20	56
Germany	23	30	47
Denmark	13	49	38

Source: ASPA (2009), weighted figures.

Strictness in employment protection legislation

With respect to the perceived strictness of employment protection, employers in Italy, the Netherlands, Sweden and Germany perceive these rules to be relatively strict. In each of these sample countries, the majority of employers state that it is (very) difficult to fire workers who have long tenures, whereas Polish and Danish employers are less certain about the complexity of firing tenured staff. These country-level perceptions are largely in line with the OECD's official employment protection indicators (see OECD 2010b). The only exception may be Italy. According to the OECD's indicators for 2008, the protection of permanent workers against (individual) dismissal is registered as quite flexible; however, the Italian employers in our sample perceive individual dismissal as strictly regulated. This anomaly may be explained on the basis that employers interpret this question in a broad sense (i.e., considering collective as well as individual dismissals). Indeed, employment protection for the case of collective dismissals in Italy is one of the most restrictive in the OECD.

Table 2. Perceived strictness of employment protection, ranked by level of difficulty

	Difficulty of dismissing an employee with tenure		
	(Very) easy	Neither easy nor difficult	(Very) difficult
Italy	4	13	83
Netherlands	3	27	70
Sweden	3	35	62
Germany	7	31	62
Poland	14	49	37
Denmark	28	46	26

Source: ASPA (2009), weighted figures.

Close examination by means of multivariate analysis (see Van Dalen and Henkens 2013) shows that the most preferred downsizing options – early retirement and buy-outs – are clearly positively related to the degree of the generational fairness and strictness of the employment legislation perceived by employers. To illustrate the effect size of these factors: even those employers who strongly disagree with the preferential treatment of younger workers have a 52% likelihood of favouring early retirement as a downsizing option compared with 72% of employers who favour younger employees. In other words, a strong switch towards favouring younger workers implies that the likelihood of so doing increases by 20 percentage points. While this strong driving force behind generational fairness is less visible in the use of buy-outs, this is largely understandable; buy-outs can also be used to facilitate the exits of younger workers, whereas early retirement is by definition restricted to older ones.

Further, the perception of the strictness of employment protection is also clearly associated with selected downsizing options: the more employers perceive these rules to be strict, the more they opt for buy-out routes and early retirement programmes. One should however take note that there seems to be a clear and structural driving force for employers to choose these exit options. Almost half of employers (49%) who find it very easy to dismiss a worker would opt for early retirement as a downsizing measure compared with almost three-quarters (74%) of employers who find it very difficult to fire a worker.

Conclusions

When a recession deepens, the instincts or ‘animal spirits’ of employers that were previously suppressed by prosperity or considered to be outdated may resurface. One such instinctive motive related to assisting a business in distress is encouraging older workers to take early retirement. Given the ageing populations and unsustainable pension and social security systems of the developed world, an attitude common among western governments has been to reverse this early retirement trend and shift towards ‘active aging’, by encouraging workers to extend their careers substantially.

Our findings show that the Great Recession seems to have reactivated the instincts of employers.

- European employers predominantly resort to offering early retirement packages (and to a lesser extent buy-outs) in response to the threat of downsizing.
- The only exception to this rule is the response of Danish employers, who prefer to tackle this problem by reducing the working hours of their employees.

The fact that fairness matters in labour market decisions may turn out to be of some importance because issues of generational fairness are becoming more and more prominent in the public debates in countries facing soaring youth unemployment rates.

In the view of the general public interest, the obvious solution would be to send older workers into early retirement (or at least to reduce their working hours) in order to pave the way for younger workers to forge their own careers. This type of generational fairness resonates with an electorate suffering the consequences of high and rising unemployment (see OECD 2006). However, this idea of reshuffling intergenerational labour denies the harsh fact that these types of policies do not work at the macroeconomic level (Munnell and Wu 2012, Kapteyn et al. 2010).

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